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Referral marketing: Harnessing the power of your customers

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Abstract The differences between traditional and referral marketing programs are so great that the two share little overlap in terms of appropriate target markets, marketing objectives, marketing organization, and overall planning and implementation strategies. Traditional marketing programs seek advocates among current employees to spread word of mouth, aim marketing efforts at high lifetime-value customers, focus on customer satisfaction, and use promotional programs that heavily rely on social media. In contrast, referral marketing relies on motivating satisfied/delighted customers as a referral base, seeking current customers that can provide referrals with a high lifetime value, using referral-based marketing programs to augment traditional promotions, and developing a compensation system for referrals based on either direct payment or increased visibility. Major advantages of referral marketing programs as compared with traditional marketing programs include greater credibility of friend/family member recommendations over paid advertisements, access to new customers that traditional marketing programs may not reach, and better matching of referred customers' needs to a good or service. This article presents an eight-step process to develop, implement, and evaluate the success of a referral program. In addition, it discusses academic research findings and presents examples of successful referral program strategies from—among others—Dropbox, Roku, PayPal, Digitalis, and Omaha Steaks.

1. Getting to know customer referral programs

Customer referral programs are marketer-directed, word-of-mouth initiatives that entice existing customers to attract friends, family members, and business contacts to become new customers (Kumar, Petersen, & Leone, 2010). Unlike pure word-of-mouth programs, which are customer initiated, referral programs are marketer directed. Marketers often prefer using customer referral programs as opposed to pure word of mouth due to the ability to use incentives to stimulate referrals and to have greater control over message content.

A classic referral marketing success story involves Dropbox, a file sharing synchronization and storage

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provider that expanded its customer base from 100,000 to 4 million users in a 15-month period. Dropbox used a simple referral reward system, giving 500MB increases in storage to both the referrer and the referred party when the latter signed up for any level of service. Dropbox's CEO, Drew Houston, calculated the cost of acquiring this large customer base at $10 billion had traditional marketing programs instead been used. Other media were also not appropriate for Dropbox due to high costs. For example, Dropbox estimated the cost of acquiring customers using Google's AdWords at between $233 and $388 per individual; this was too expensive for a service that charges clients as little as $9.99 per month (Veerasamy, 2014).

There are two types of referral programs: one in which existing customers are paid an incentive, and another in which current customers work without pay on presentations, case histories, and user forums. The second program benefits the referrer by increasing visibility, heightening his or her recognition as a specialist, and/or gaining special treatment from a supplier/vendor (Lee, 2012b). Both program types share common characteristics. They are initiated, managed, and at least partially controlled by the marketer. They use the social connections of existing customers with their friends, family, and business associates. They focus a firm's marketing efforts on existing customers as opposed to new customers. And, finally, the referring customer receives an incentive in each program type, either via direct or indirect payments. Direct payments can come in several forms, such as cash, points in a loyalty program, miles, free goods and services, or donations to a nonprofit organization in the name of the recommending party. In the indirect payment type, the referrer may receive recognition as an expert or may be given the opportunity to serve on a company advisory board (Schmitt, Skiera, & Van den Bulte, 2011).

Referral marketing programs are used by a large number and a wide variety of firms. A recent search on Bing for 'recommend-a-friend program' yielded over 19 million hits. A Google search using the keywords 'member-get-member-campaign' yielded almost 357 million results. Direct payment referral programs have been used by American Express, Marriott, DirecTV, Time Warner, Netflix, AT&T Wireless, AAA, Virgin Mobile, Verizon Wireless, Omaha Steaks, Vonage, Scottrade, and 24 Hour Fitness. Similarly, formal indirect payment referral programs exist in a wide variety of companies and industries, including SAS Institute (Canada), 3M, and Microsoft.

Many referral programs involve services, since personal referrals work especially well for experience goods like telecommunications services or gym club memberships (Barrot, Becker, & Meyners, 2013). Referral programs are also particularly suitable for firms that sell high-risk goods and services (e.g., those that cannot be used on a trial basis or that have high safety or performance risk), for small firms with limited marketing budgets, and for niche markets where traditional promotions cannot effectively reach the target audience. The use of referral marketing programs should increase significantly due to the heightened popularity of social media, the greater use of customer databases by firms, and the growing number of firms available to outsource referral programs.

Despite the widespread use of referral marketing, few studies have examined the value of word of mouth on referral behavior or how referral-based information can be used to more effectively secure new customers (Kumar et al., 2010). There has also been little academic research on when referral rewards should be used or the optimal design of referral programs (Xiao, Tang, & Wirtz, 2011). Misner (1999) describes word-of-mouth marketing as the world's most effective, yet least understood marketing strategy.

This article highlights for marketers the differences between traditional and referral marketing programs and the advantages and disadvantages of referral marketing versus traditional marketing programs. In addition, it develops an action-based plan for planning, implementing, and evaluating referral programs by incorporating both research findings and best marketing practices.

1.1. Differences between traditional and referral marketing programs

The differences between traditional and referral marketing programs are so great that there is little overlap between the programs in terms of appropriate target markets, marketing objectives, marketing organization, and overall planning and implementation strategies. Traditional marketing programs seek advocates among current employees to spread word of mouth, aim marketing efforts at high lifetime-value customers, and use customer loyalty programs to instill buying among current customers through rewards. In contrast, referral marketing relies on motivating current customers as a referral base, views customers as influencers and advocates, seeks out current customers that can provide referrals with high lifetime value, and uses referral-based marketing programs to augment traditional promotions. According to Bill Lee (2013), a referral marketing consultant: "The organizations that achieve rapid growth are those that don't just think of customers as 'buyers of stuff' but as advocates, influencers, and

Table 1. Differences between traditional marketing and referral programs

	Traditional Marketing Model	Referral Model
Customer Focus	New customers who are loyal and heavy users	Existing customers who can recommend valuable customers
Customer Perspective	Customer as a buyer	Customer as an influencer and advocate
Search for Advocates	Among employees	Among current customers
Lifetime Value Focus	High purchases and profits among current and new customers	High purchases and profits among referrals
Customer Satisfaction Goals	Meeting and exceeding expectations of customers	Customer delight turns current customers into advocates
Common Promotion Media	Paid media, sales promotion, sales force, and social media	Traditional word of mouth and social media
Marketing Programs	Customer loyalty programs	Referral programs

contributors." Table 1 summarizes the differences between traditional marketing and referral programs.

1.2. Advantages and disadvantages of referral marketing programs as compared with traditional marketing programs

The major advantages of referral marketing programs as compared with traditional marketing programs include greater credibility of friend/family member recommendations over paid advertisements, access to customers that traditional marketing programs may not effectively reach, and better matching of referred customers' needs to a good or service recommendation.

Referral-based customers may be better matched than those acquired through traditional marketing programs due to reciprocity, triadic balance, and homophily. Reciprocity refers to the obligation of the referrer to provide new customers based on his/her receiving payment. Triadic balance relates to a referring customer bringing in new customers that match well with a firm's offerings. And finally, homophily assumes that referred customers are likely to interact with people similar to themselves (Schmitt et al., 2011).

A study by Garnefeld, Eggert, Helm, and Tax (2013) showed that participation in a referral program increased the referrer's attitudinal and behavioral loyalty to the provider regardless of the reward size. This study supported the notion that participation in a referral program acts as a public commitment toward the advocated goods and services. Thus, customer referral programs assist a company's relationship marketing efforts with both its existing and new customers (Kuester & Benkenstein, 2014).

Potential disadvantages associated with referral programs largely relate to the referring party being compensated as a result of the recommended party becoming a customer. Because a referrer is paid for recruiting any customer, referrers may make unsuitable recommendations (Kuester & Benkenstein, 2014). In addition, referral programs may not be as effective as traditional word-of-mouth programs since prospects may be suspicious of referrals, knowing that the parties providing referrals are being compensated (Schmitt et al., 2011). Table 2 summarizes the advantages and disadvantages of referral programs.

2. Demonstrating the value of referral programs

Based on two studies—Schmitt, Skiera, and Van den Bulte (2011) and Trusov, Bucklin, and Pauwels (2009)—this section evaluates the effectiveness of referral programs in terms of criteria such as customer acquisition costs, new customer longevity, and sales and profit impact. The first study examined the impact of a referral program at a major German bank that acquired 5,181 customers between January 2006 and September 2008. As part of this bank's referral program, every existing customer received a €25 reward for bringing in a new customer. The referred customer did not have to meet any minimum requirements (e.g., assets, minimum stay).

Schmitt et al. (2011) compared the value of customers acquired by the bank's referral program to the value of customers acquired through other marketing programs and found that referred customers had lower acquisition costs, stayed longer,

Table 2. Advantages and disadvantages of referral programs

Advantages of Referral Programs:

- A recommendation from a friend or family member may be more highly valued and respected than a paid advertisement directed at a prospect. The recommending party's reputation is at risk if he/she recommends a poorly performing product or service.
- A referral can provide access to niche customers that a firm's traditional marketing program might otherwise not reach.
- The recommendation is based on a friend's or family member's actual experiences (which may be long term).
- A 'superior match' phenomenon may exist due to reciprocity, triadic balance, and homophily. Since a firm's existing customers know both the marketer and the prospect, the referrer can better assess if there is a good fit between the two. If the good or service is desired by the party making the referral, the friend would be likely to enjoy the product as well. Well-matched customers generate more revenue at lower costs to the firm.
- Customers acquired through word of mouth can generate more revenue for the firm than those customers acquired through traditional marketing efforts (Villanueva, Yoo, & Hassens, 2008).
- Referral programs are a good way to determine customer satisfaction. If relatively few customers are willing to serve as referrals, a firm's customer satisfaction may be poor.

Disadvantages of Referral Programs:

- The recommending party may not be truly impartial if he/she is compensated not only for the recommendation, but also for the recommended party actually becoming a customer.
- Word-of-mouth referrals can be abused by opportunistic referrers. These referrers may recommend inappropriate customers or may recommend unsuitable products or firms due to their referral fees. In other instances, a friend, family member, or business associate may recommend a poorer service provider with a high referral payment.

and generated higher profits than comparable non-referred customers. Among others:

- A referred customer is about 25% more valuable than a comparable non-referred customer. Taking into account differences in acquisition costs, the difference in customer value is almost 35%.
- The probability of being an active customer after 33 months is 82.0% for referred customers versus 79.2% for non-referred customers. The bank's contribution margin, retention, and customer value were also significantly and sizably higher for referred customers.
- Referred customers generated 16% more in profits. Thus, the bank earned a return of about 60% on its €25 referral reward. After controlling for such factors as age and gender, the researchers found that on average, referred customers are about 18% more likely than others to stay with the bank.

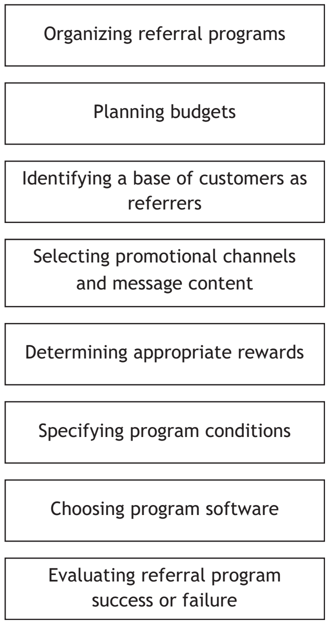
The second study looked at traditional word-of-mouth programs as opposed to word-of-mouth referral programs. It contrasted the number of sign-ups and referrals on a major social networking site over a 36-week period with marketing events and media activity obtained from third-party sources. Trusov et al. (2009) found that word-of-mouth referrals have an immediate (1-day) elasticity[1] that is 8.5 times that of traditional marketing actions. The long-term elasticity of word-of-mouth referrals was 20 times greater than that of marketing events and 30 times higher than media appearances. In addition, the researchers found that word-of-mouth referrals have substantially longer carryover effects than traditional promotional media. The authors concluded that word of mouth may be among the most effective marketing communication strategies. Significantly, they noted that if the paid nature of word of mouth is known to prospective members, fertilized word of mouth may be substantially less effective than organic word-of-mouth activity.

3. Planning, implementing, and evaluating the success of referral programs

This section details an eight-step process that plans, implements, and evaluates the success of a referral program: (1) organizing referral programs,

[1] The percentage change in quantity demanded divided by the percentage change in marketing expenditures

Figure 1. Planning, implementing, and evaluating referral programs



(2) planning budgets, (3) identifying a base of customers as referrers, (4) selecting promotional media and message content, (5) determining appropriate rewards, (6) specifying program conditions, (7) choosing program software, and (8) evaluating program success or failure (see Figure 1). This section is useful to firms that are initially planning a referral program, as well as to companies that seek to revise an existing program.

3.1. Organizing referral programs

A firm's referral program should not be conducted solely within the realm of its sales department or public relations department, as an effective program crosses numerous traditional marketing areas, including sales, advertising, sales promotion, public relations, social media, and relationship marketing. Another common error for a firm entails the creation of several referral programs—such as a customer reference program, a community-building group, and a customer advisory council—that need to be properly integrated (Aquino, 2012). A third pitfall occurs when a firm uses a team-based organization function that does not assign a single person to champion, oversee, and be responsible for this important activity.

To help, small firms or firms that lack expertise in planning, implementing, and controlling referral programs can outsource referral activities to firms such as Extole (which has developed referral marketing programs for close to 300 brands), Ambassador, NextBee, and Shopify.

3.2. Planning budgets

The budget for a referral marketing program needs to include the costs of recruiting appropriate references; referral incentives for both references and referred parties; and program administration costs, including computer software to track purchases by referred customers. A significant distinction of budget planning for referral programs is that, like sales force commissions, the referral incentive is a variable expense. The amount of the incentive can be varied to reflect the profitability of a new customer. In addition to the amount of the incentive, marketers can further control referral program expenses by developing specific circumstances for when referral fees will be paid. These parameters are covered in the specifying program conditions section of this article.

Outsourcing may simplify budget planning, replacing the costs of program administration and recruiting references; furthermore, software costs are clearly more certain than with company-run referral programs. Some outsourcers, like Ambassador (2015), offer a variety of plan options at fixed monthly costs. Outsourcers may also be better able to predict the number of references, the ability of references to attract new clients, and the impact of incentives on new client attraction and retention.

3.3. Identifying a base of customers as referrers

All referral programs need to identify a base of current consumers who are willing to provide testimonials and contact potential customers. A logical group of referrers would include current customers that are passionate about a firm's service and product quality, long-term customers, and marquee customers with excellent reputations. Unfortunately, little academic research has occurred on the effectiveness of these groups.

Several analyses discovered significant gaps between customers' stated willingness to refer individuals and their actual referral behavior. One study examined referral behavior among 9,900 customers at Sprint, a telecommunications firm, and among 6,700 customers at Scottrade, a financial services firm. Referrers overstated the number of people they would recommend at both companies (Kumar, Petersen, & Leone, 2007):

- Sprint: 81% intention to recommend, 30% actual recommendation.
- Scottrade: 68% intention to recommend, 33% actual recommendation.

Another study of 14,160 customers of a major financial services firm also found a big gap between customers' stated willingness to refer and their actual referring behavior. While 70% of customers stated that they intended to make referrals, only 44% actually made a referral (Kumar et al., 2010).

Three major studies identified consumer groups that would serve as excellent referrers. First, a study by Walsh and Elsner (2012) used the term 'market mavens' to represent excellent referrers. Market mavens provide many types of market information to others on an informal basis. The researchers found that market mavens offer more referrals than non-mavens and are able to achieve a considerably higher conversion rate. Furthermore, the average order value and cash contributions of new customers acquired through referrals of market mavens is higher than those of customers acquired through non-mavens.

Second, a study by Kumar, Petersen, and Leone (2010) found that high lifetime-value customers are not necessarily good recruiters of referred customers. This research classified consumers into four groups based on their lifetime value (low versus high) and their customer referral value (low versus high). After 1 year, Champions had high customer lifetime value (CLV) and high customer referral value (CRV). Affluents had high CLV and low CRV. Advocates had low CLV and high CRV. And Misers had low CLV and low CRV. The referral value was $670 for the Advocate group versus $590 for Champions. In contrast, the referral value for Affluents was $49 versus $64 for Misers (Kumar et al., 2007). Based on this research, a marketer has two goals: (1) getting Affluents to become Champions through referring more customers while continuing their current purchasing behavior and (2) moving Misers into any other group. However, it may be difficult to get Affluents to refer many customers since they may not need the money and may value social relationships more highly than economic incentives.

The third study—conducted by Garnefeld, Eggert, Helm, and Tax (2013)—identified referrer characteristics associated with both attracting and retaining new customers. These researchers found that long-tenured customers were better able to attract new customers based on the credibility associated with their experience. However, shorter-tenured customers were found to be better at retaining referred customers.

3.4. Selecting promotional media and message content

The success of Dropbox's referral marketing program is due to its simplicity and ease of use. Unlike other programs, Dropbox's home page is formatted in a simple layout with few user options. The signup process requires limited steps. To share a gallery with friends and family, a user need only copy a link. And, as an incentive to encourage referrers to post information on Twitter or Facebook, Dropbox gives each poster a 125MB increase in storage capacity (Bulygo, n.d.).

The Internet is a popular channel for referral-based word-of-mouth marketing. It provides numerous outlets for consumers to share their views, experiences, and product preferences, including on the firm's own website and through social networks such as Facebook, Twitter, LinkedIn, and Google+. Extole, a referral marketing consulting company, recommends providing between two and four channels from which customers may choose. Firms should consider connecting programs with online activities and other media so that they will reach beyond existing customers' networks of strong ties and face-to-face interactions (Schmitt et al., 2011).

Extole (2015) has found that e-mail is the most popular channel for sharing. E-mail shares also have the highest conversion rates of all sharing channels. Folica, a hair care products marketer, teamed up with Extole to develop a social referral program. The program offered Folica advocates a $10 credit toward a future purchase, and friends/family members a $10 credit toward their first purchase. This referral program was promoted by Folica via e-mail to its 850,000 subscribers. The program was also promoted on Facebook and via a 'send-to-a-friend' link situated at the top of every product page on www.folica.com. In the first 30 days, the referral program experienced a 93% open rate on e-mails shared with friends and a 16% conversion rate (Boris, 2012).

Referral messages can be marketer-directed or referred party-directed. Referring parties can be given pre-scripted messages to relay to their friends and family members. Advocates can also be provided with personalized links containing information to be shared. One form of marketer-directed messages is PURLs: personalized links that brands can provide to advocates. These links supply content such as blogs, e-mails, and instant messages for advocates to share. Sites can be provided with a link using a unique referral code, and referred parties will receive credit every time a friend or family member makes a purchase via the link.

3.5. Determining appropriate rewards

Referral rewards can be in the form of vouchers, redeemable points, free goods, loyalty points, gift cards, charitable donations, gifts, free minutes, miles, and membership upgrades. In-kind rewards such as free products, miles, and membership upgrades are obviously less costly to the referring firm than cash, charitable donations, and gift cards. Referral awards must be viewed as valuable, relevant (i.e., related to the product category), and attainable; faster, sure rewards are better than slow, uncertain rewards (Tereshkin, 2012).

Companies need to test different reward options and amounts to determine which combination of rewards works best. Streaming video player firm Roku experimented with various rewards, including cash, gift cards, and charitable contributions. It ended up choosing a free month of Netflix as an incentive when its research found that 80% of Roku customers were also enthusiastic Netflix subscribers. As a result of this strategy, Roku referrals doubled from their previous levels and product sales increased by five times (MarketingProfs, 2011).

Firms could also use dynamic incentives wherein rewards vary based on the program's success. Incentives could be higher to develop early enthusiasm for the program or to increase referrals in periods of slow sales; incentives could then be lowered when sales targets are met. For example, PayPal dropped its Refer-A-Friend bonus for consumer referrers after reaching a critical mass of early adopters, but kept it for merchants. Subsequently, it dropped the merchant bonus after achieving sales targets (Veerasamy, 2013).

Finally, a referral program can incorporate referral chains with different tiers of referrers. In such a scenario, referrers receive payments based on subsequent referrals of their friends and family members. This is similar to a traditional multi-level marketing program.

Research findings on the impact of correlating incentives to referring results are conflicting. One study found that the likelihood of generating word of mouth, the value of the word of mouth generated, and the likelihood of making a purchase recommendation all increased with increasing incentives (Wirtz & Chew, 2002). Other researchers found that only larger rewards have a positive impact on recommenders' attitudes (Garnefeld et al., 2013).

In contrast, a study by Ryu and Feick (2007) found that while offering a reward increases the likelihood of a referral, there was no difference in effect between smaller and larger rewards. This study also found that the impact of reward programs was much greater for a weaker brand versus a stronger brand. As a result of this finding, Ryu and Feick suggested rewarding the recommender for weak brands and rewarding both the recommender and referred customer for strong brands.

3.6. Specifying program conditions

Program conditions clearly detail those circumstances in which referred parties are entitled to receive rewards. For example, conditions can be based on customers signing up for service (trial), continuing to use a service for a given time period (loyalty), or for making minimum purchases. Conditions also need to determine whether referral fees are transferable, how soon the referred customer must sign up after the referral, whether the referrer needs to be a current customer at the time the referred customer signs on, if the referrer needs to be up-to-date on all bills, and whether the referrer can recommend the same customer multiple times. In some referral programs, the referral reward is given regardless of how long a new referred customer stays with the firm. This creates potential abuse situations in which the referring and referred parties can conspire to split a gift.

Digitalis (2015), maker of planetarium systems that demonstrate advanced astronomy concepts, mails checks monthly based on completed sales. Completed sales are sales for which payment has been collected, the product has been shipped, and the customer has not returned the products. This process can take a few months to complete.

Omaha Steaks (2012) gives customers a $10 Referral E-Reward Card for every referred friend who makes a purchase. While these conditions provide immediate payment and simple recordkeeping, they are based on a trial by a friend or family member, not total purchases over a specific time.

3.7. Choosing program software

Referral programs require highly specialized software to generate referrals via automated e-mails to a select group of current customers, collect testimonials, manage social media marketing platforms, track referrals by current customers, compute purchases by referred parties, run sweepstakes and contests among referrers, thank individuals that refer new clients, calculate payments to referrers, compute the results of all referral programs, and track total referral program costs. Some examples of referral software packages are listed in Table 3.

3.8. Evaluating program success or failure

Referral programs can be evaluated by such metrics as the number of advocates participating in the program; the customer conversion rate; the cost of acquiring a new customer via referral versus via other programs; and the value of each referred customer based on the referred customer's average

Table 3. Some examples of referral software packages

Vendor	Website
Ambassador	www.getambassador.com
Affiliate Software	www.referralsoftware.com
Cup Cake	www.getcake.com
DirectTrack	www.directtrack.com
eWORDofMOUTH	www.ewordofmouth.com
Extole	www.extole.com
Link Trust Systems	www.linktrust.com
Referral Candy	www.referralcandy.com
Referral Key	www.referralkey.com

purchase, retention rate, and profit margin. Firms need to understand that a referral program does not result in immediate sales. An appropriate time horizon to be used in evaluating a program's success or failure could be as much as 1 year for a complex transaction (e.g., an organization good that is purchased on a team basis) or as little as 3 months for a more straightforward exchange (e.g., a mail-order food purchase).

A common pitfall in measuring the value of a referral program entails evaluating the program solely by looking at the number of referrals provided as opposed to determining the monetary value of the referred customers. According to Bill Lee (2012a), a business consultant with significant experience in developing referral programs: "It's a red

Table 4. Referral marketing program checklist

Answer "Yes" or "No" to each question.

Does your firm:

Organizing-Based Issues
- Use a multi-functional perspective in organizing referral marketing?
- Integrate its several referral programs?
- Assign a single person to champion, oversee, and be responsible for referral marketing?
- Evaluate outsourcing its referral marketing programs?

Budget Planning-Based Issues
- Carefully estimate all costs associated with planning, implementing, and controlling referral marketing programs?
- Evaluate the costs and benefits associated with outsourcing?

Referrer Selection-Based Issues
- Understand the gap between a customer's willingness to refer customers and their actual referral behavior?
- Evaluate the effectiveness of market mavens, champions, and advocates, and short- and long-term customers on obtaining and retaining new customers?

Promotional Media-Based Issues
- Integrate social media with its traditional marketing programs?
- Evaluate the use of pre-scripted messages?
- Use personalized links (PURLs) as part of its promotional effort?

Referrer Reward-Based Issues
- Evaluate rewards based on their being valuable, relevant, and attainable?
- Test different reward options and amounts?

Program Conditions-Based Issues
- Deter possible misuse of rewards by referrers?
- Evaluate a number of conditions (such as transferability of rewards, multiple rewards for the same customer referral)?

Software Program Selection-Based Issues
- Evaluate multiple software options in terms of costs, features, scalability, etc.?

Program Evaluation-Based Issues
- Evaluate a referral program based on multiple criteria (number of advocates, customer conversion rate, cost of acquiring a new customer, and the value of each new customer)?

flag when reference managers tout the number of new references they recruited—without regard to their actual value in generating business. They're measuring inputs that have little bearing on business results, not outputs." As evidence of this problem, few of the referrals from the aforementioned Sprint and Scottrade referral programs actually became customers: 12% and 14%, respectively. Of the prospects that did become customers, only 8% of the telecom customers and 11% of the financial services firm customers proved profitable (Kumar et al., 2007). Likewise, in the second financial services firm study cited earlier, 42% of these referral attempts for the financial services firm resulted in a prospect making a purchase and 77% of these referrals were profitable (Kumar et al., 2010).

4. Summary and conclusion

Firms seeking to develop referral programs need to understand the significant differences between referral and traditional marketing programs. Unlike traditional marketing programs, which focus on consumers, referral programs target both referrers and referred consumers. Referral programs also rely heavily on databases—to identify referrers and to record purchases by referred consumers—and on social media.

Referral marketing programs are not equally effective for all firms. Referral programs are especially suitable for firms selling high-risk goods, for small firms with limited marketing budgets, and for firms that cannot effectively reach potential niche clients with traditional promotions. In these situations, a referral from a trusted friend, relative, or business associate is important, especially if the referrer has long-term positive experiences with the firm.

While the author recognizes that referral programs are not equally effective for all firms, too few firms use this important strategy. For example, only 30% of North American banks and credit unions currently run referral programs, despite their profitability (Wilker, 2014). Three common fallacies may account for this limited usage: (1) firms do not consider referral programs an effective marketing strategy; (2) they are overconcerned about the difficulties associated with establishing and running a referral program; and (3) they fear misuse of the program, such as inappropriate recommendations due to compensation.

Table 4 details a referral marketing program checklist that can be used by firms developing a new program, by firms with existing referral programs. This questionnaire should be used to assess how ready a firm is to adopt a referral program and to determine how existing programs can be improved. Since the referral marketing program spans social media, relationship, information technology, and marketing research functions, input is needed from executives in each of these areas to complete this checklist; the firm's chief executive officer should contribute, too.

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