Executive Summary

Customer referral programs are gaining popularity with firms in industries as diverse as financial services, hotels, automobiles, newspapers, and contact lenses. These programs are a form of word-of-mouth marketing, handing out financial incentives to existing customers for bringing in new customers to the firm. However, the profitability of such programs is unknown. Worse, many practitioners are concerned about potential abuse, fearing that customers bring in low-value prospects just to earn the referral fee. It is also unclear whether referral programs, even if effective, are actually more profitable than traditional customer acquisition programs.

This study tackles these questions by investigating whether customers acquired through a referral program generate higher margins, show higher loyalty, and ultimately have higher customer lifetime value than customers acquired through traditional means. It does so by tracking approximately 10,000 customers of a leading German bank for almost three years. The data show that referred customers tend to have a higher contribution margin, though this difference erodes over the customers' lifetime. Referred customers also tend to be more loyal than other customers, and this difference persists over time. As a result, referred customers are more valuable in both the short and the long run. For the bank in question, the average value of a referred customer was at least 40 euros higher than that of a nonreferred customer with similar demographics and time of acquisition. Taking into account that the referral program also had a lower cost than the bank's regular customer acquisition programs, the difference in customer lifetime value was nearly 25%. Considering the initial fee of 25 euros paid to the referrer as an investment, the bank earned a return on investment of approximately 60% on it.

These findings are encouraging news for firms that are considering deploying customer referral programs. That such programs can pay off financially indicates that abuse by opportunistic customers and other harmful side effects of referral programs can be much less important than their benefits. However, the results also show that the bank's referral program was less beneficial with older customers. Thus, firms should think carefully about what prospects to target with such programs.

Biography

Philipp Schmitt is a doctoral student in the Marketing Department in the Faculty of Business and Economics at Goethe University Frankfurt, Germany and was a visiting doctoral student in the Stern School of Business and the Wharton School. His research focuses on customer management and its value implications, marketing metrics, and managerial decision making. He has several years of managerial experience in the financial service industry and has been a Fulbright scholar.

Bernd Skiera is a Chaired Professor of Electronic Commerce in the Department of Marketing in the Faculty of Business and Economics at Johann Wolfgang Goethe-University Frankfurt, Germany, and he is a member of the board of the E-Finance Lab and the Retail Banking Competence Center at the House of Finance at University of Frankfurt. His research areas are customer management, pricing, online marketing (in particular, search engine marketing), and prediction markets, with a particular focus on the financial service industry. He was a finalist for *Journal of Marketing*'s 2008 MSI/H. Paul Root Award with the paper "Customer Equity: An Integral Part of Financial Reporting." His work has been published in, among others, *Management Science*, *Marketing Science*, *Journal of Marketing Research*, *Journal of Service Research*, and *European Journal of Operational Research*.

Christophe Van den Bulte is Associate Professor of Marketing in the Wharton School at the University of Pennsylvania, which he joined before completing his PhD at Pennsylvania State University. His research focuses on social networks, new product diffusion, and business-to-business marketing. Several of his recent projects have examined networks among physicians and the acceptance of new pharmaceuticals or diagnostic tools. He is an associate editor of *Marketing Science*, *Journal of Marketing Research*, and

International Journal of Research in Marketing, and he serves on the editorial boards of *Journal of Marketing* and *Journal of Business-to-Business Marketing*. A monograph on *Social Networks and Marketing*, coauthored with Stefan Wuyts, was published in the Marketing Science Institute's "Relevant Knowledge Series" (2007).