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Maximizing the Benefits of Customer Referrals
Christophe Van den Bulte, PhD, Emanuel Bayer, PhD, Bernd Skiera, PhD, and Philipp Schmitt, PhD

You may already intuitively know that customers referred by other customers are the best kind. They are, in fact, more loyal and profitable than customers that come from other sources. While past research has shown as much, what had not been investigated before were the reasons behind these benefits. Two explanations are better matching and social enrichment.

Better matching refers to the notion that referred customers match with a firm and its offerings better than non-referred customers do. Social enrichment refers to the idea that the relationship between the referred customer and a firm is better because of the presence of the referrer—a person who is familiar with both sides.

In our study, we analyzed data from a German bank on almost 1,800 referred customers and their referrers. Referrers who brought in a new customer received a €25 voucher. We first checked that referred customers generated higher margins and were more loyal than non-referred customers, resulting in a customer lifetime value that was 16 to 25% higher. Then, we tested for behaviors and patterns that should occur if referred customers’ superior profitability and loyalty stem from better matching and social enrichment.

Our findings indicate that better matching is indeed at work when it comes to the referred customers’ higher margins and that social enrichment plays a role in their superior loyalty. These tests and conclusions shed light on why referred customers are more valuable, and can help firms and real estate agents maximize the benefits of customer referrals. Below, we explain better matching, social enrichment, and our findings more in detail.

Better Matching: Active and Passive

The idea that referred customers match with a firm’s product or service better than non-referred customers do—better matching—can be the result of active or passive matching. Active matching involves a deliberate effort to screen and select referrals for a firm. Because referrers already know a firm’s offerings as well as the people they refer, they can act as matchmakers between the two.
Passive matching, on the other hand, stems from the tendency of people to connect with people like themselves. This idea implies that a referrer and the new customer the referrer brings in share several characteristics. Since an established customer is already likely to be a good match with the firm, it follows that his or her referred customer will be, too.

**Shared Characteristics Are Relevant to Profitability**

These shared characteristics between a referrer and their referred customer must be traits that firms cannot easily identify on their own (otherwise, the firm would not need a referrer to acquire a better match). For better matching to occur, these characteristics must also be related to the potential value an individual can bring to the firm. Trust, budget flexibility, and openness to advice from real estate professionals may be examples of such characteristics that apply to the real estate industry.

The result of our first test supports the idea that these shared, hard-to-observe characteristics are associated with the contribution margins of both the referrer and the customers they bring in. In short, because referred customers are similar to their referrers in ways that are significant for the firm, they are more profitable than non-referred customers.

**More Experienced Customers Bring in The Money (At Least For A While)**

The relationship between the firm and a referrer is important because it influences how well the referral will match with the firm. The better the relationship, the better the match. If a customer has been with a firm a long time, then it is likely that this relationship is positive, and that the customer is a particularly good match with the firm. As stated earlier, it follows that their referred customer will be, too.

Additionally, customers who have a longer history with the firm typically understand its offerings well and are fond of the firm. This translates into successful efforts to pick good referrals, instead of just trying to pocket the reward. The results of our second tests suggest as much: referrers who have been customers of the bank for a longer period brought in referred customers with better margins than more recently acquired referrers did.

However, these superior margins are only temporary. Since referred customers are good matches with the firm, they easily find offerings they like, are willing to pay for them, and require less help to understand and use them—all which lead to initial high margins. But, as non-referred customers learn more about a firm’s products or services and as a firm learns more about what these non-referred customers want, the difference in margin between referred and non-referred customers decreases, until it eventually disappears.
Social Enrichment Makes Your Customers Stay Longer

Referred customers are more loyal than non-referred customers because they have a relationship with a fellow customer—their referrer. Referred customers can get guidance about the firm’s offerings and procedures, or receive help from their referrers in other ways. Having this relationship strengthens their trust, attachment, and satisfaction with the firm.

At the same time, this relationship means that if the referrer leaves the firm, his or her referred customer will no longer experience these benefits and, as a result, become just as likely to leave the firm as other customers. The findings from our last two tests corroborate these ideas.

Application and Real Estate Perspective

It is no secret that customer referrals are vital in the real estate industry. As a real estate professional, you may already have a system in place where you provide incentives for customers to refer their friends, family members, and acquaintances. To obtain more attractive referrals from your program, our research suggests, you should focus your attention on generating referrals from your more loyal and profitable customers. The resulting referred customers are likely to be more profitable, as they will be similar in key ways to their referrers. They will also be more loyal due to social enrichment, as long as the referrer is still a customer. Fine-tuning your referral program to take these findings into account may help you improve the value of your referrals.

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