REFERRAL EQUITY AND REFERRAL MANAGEMENT: THE SUPPLIER FIRM'S PERSPECTIVE

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ABSTRACT

From the supplier firm's perspective, a referral is a recommendation from A (the referrer) to B (the potential customer) that B should, or should not, purchase from C (the supplier firm). Thus, as referrals are for *a specific supplier firm, they should be viewed as part of the supplier firm's marketing and sales activities. We recognize three types of referrals – customer-to-potential customer referrals, horizontal referrals, and supplier-initiated referrals – that have critical roles in a potential customer's purchase decision. We develop the concept of* referral equity *to capture the net effect of all referrals for a supplier firm in the market. We argue that supplier firms should view referral equity as a resource that has financial value to the firm as it affects the firm's cash flows and profits. We offer strategies firms can use to manage referrals and build their referral equity and suggest a research agenda.*

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1. INTRODUCTION

> If you're looking at your advertising or marketing as a means of 'pulling in' response to you, let's face it: the most believable form of contact will always be referrals. No question.
>
> (Logullo, 2007, referral marketing consultant)

> Business owners tell me every day that the way they generate the most new business is through referral marketing.
>
> (Jantsch, 2007, marketing consultant)

Referrals generate business – this conventional wisdom seems incontrovertible, and raises an important question: How should a supplier firm manage its referrals? Consulting firms, such as Referral Marketing Solutions, uRefer, and Point of Reference, offer services to increase the supplier firm's customer base through referrals. Books on referral marketing, such as *Endless Referrals* (Burg, 2005), *Get More Referrals Now!* (Cates, 2004), and *The Referral of a Lifetime* (Templeton, 2005), outline how marketing managers and business owners should manage referrals to grow their business. For example, Burg (2005, p. 49) suggests asking for referrals from existing customers: "Joe, as far as you know, would any of them [in Joe's golf foursome] happen to need …?"

Yet these practical efforts, and more than half a century of academic research on word of mouth and interpersonal influence (e.g., Anderson, 1998; Arndt, 1967), offer little actual insight into what referrals really are or how supplier firms can manage them to achieve their marketing objectives. Our goal is to focus attention on the supplier firm's perspective of referrals. Conceptualizing referrals from the supplier firm's perspective has two implications. First, this perspective recognizes that supplier firms are not just spectators of the referral process but can manage it to improve their business results. Second, this perspective allows us to identify areas for research that would suggest related marketing strategies for managers.

We conceptualize referrals from the supplier firm's perspective in three steps. First, we define a referral as a recommendation from A (the referrer) to B (the potential customer), such that B should, or should not, purchase from C (the supplier firm). This definition specifies that a referral is *for* a specific supplier firm and can be positive or negative. For example, if Joe (the potential customer) is considering purchasing a cellular service, and Adam's (the referrer) recommendation influences him to purchase from AT&T, then Adam has given Joe a positive referral *for* AT&T (the supplier firm).

Second, we introduce three types of referrals: (1) customer-to-potential customer referrals, where the referrer is a customer of the supplier firm, for example, an iPhone user recommends to his friend to purchase an iPhone (Arndt, 1967); (2) horizontal referrals, where the referrer is not a customer of the supplier firm, for example, a contract lawyer refers her client to a lawyer who specializes in personal injury (Spurr, 1988); and (3) supplier-initiated referrals, where the supplier firm matches the referrer and a potential customer, as when SAS requests the U.S. Treasury Department to refer SAS to other government departments (Lee, 2008).

Third, we argue that because referrals affect the supplier firm's cash flows and profits, the supplier firm should view positive referrals as assets and negative referrals as liabilities. We thus conceptualize *referral equity* as the present value of the difference between the supplier firm's expected cash flow due to its referral assets and referral liabilities. Referral equity captures the net effect of all referrals on the supplier firm's customer acquisition, customer retention, and marketing costs.

We proceed as follows: In the next section (Section 2), we define a referral, and identify the three actors involved in a referral exchange. In Section 3, we review literature pertaining to the three types of referrals, and in Section 4, we conceptualize the role of referrals in potential customers' purchase decisions. In Sections 5 and 6, we define the referral equity of the supplier firm and suggest referral management strategies for supplier firms to build referral equity, and conclude in Section 7.

2. REFERRALS: A CONCEPTUALIZATION

Consider Joe who wants to purchase a cellular service. Joe asks his friend Adam for advice, and Adam recommends that Joe purchase AT&T's cellular service. Spurr (1988, p. 87) calls this exchange a referral for AT&T, defining a referral as "a recommendation from A to B, such that B should purchase services from C." However, Adam might recommend to Joe *not* to purchase from AT&T. And a referral could also be for a product, not only a service. Therefore, we modify Spurr's (1988) original definition of a referral as *a recommendation from A to B, such that B should, or should not, purchase from C* (see Fig. 1).

Our definition highlights three aspects of a referral. First, it includes three actors: the source of the referral – the referrer (A); the receiver of the referral, who is involved in the purchase decision – the potential customer (B); and the recipient of the referral, who provides the product or service to

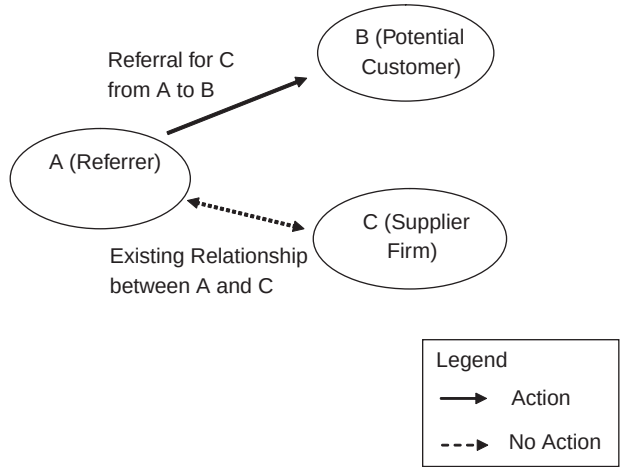

Fig. 1. Referral From Source A to Potential Customer B for Supplier Firm C.

the market – the supplier firm (C) (Gilly, Graham, Wolfinbarger, & Yale, 1998a; Spurr, 1988) (Fig. 1). Second, the definition highlights the role of referrals in marketing: to influence potential customers to purchase, or not, from the supplier firm.[1] Third, we recognize two attributes of a referral: the valence (negative or positive) and the intensity (strength of recommendation). A positive referral would influence the potential customer to purchase from the supplier firm, whereas a negative referral would do the opposite. Furthermore, a referrer can make a recommendation of varying strength to the potential customer – from "superb product/service" to "was ok," for example. In summary, a referral is a one-to-one exchange between a referrer and a potential customer about purchasing from a specific supplier firm; it can be positive or negative, and can vary in its intensity.

As a referral is an exchange, the three actors each give something to receive something (Table 1). Referrers might be customers (existing or prior) of the supplier firm or product experts, and they provide potential customers with information about the supplier firm in their referral (Senecal & Nantel, 2004). One of the reasons customers act as referrers is to reduce post-decision dissonance, that is, doubts about whether they took the right decision (e.g., Engel, Kegerreis, & Blackwell, 1969; Richins & Bloch, 1986). Other reasons customers (or noncustomers) might act as referrers include the desire to gain attention or social status from potential customers (Gatignon & Robertson, 1985). Therefore, in a referral exchange, the

Table 1. Exchanges Between Actors in a Referral.

Actor	Gives (To)	Receives (From)
Referrer	Information about supplier firm (potential customer)	Social status and attention (potential customer)
Potential customer	Social status and attention (referrer)	Information related to supplier firm (referrer)
Supplier firm	Service/product (referrer)	Referral (referrer)

Note: Row 1 indicates that the referrer gives information about supplier firm to the potential customer, and gets social status and attention from the potential customer.

referrer provides information to the potential customer about the supplier firm and receives attention and enhanced social status from the potential customer (see row 1, Table 1).

From the supplier firm's perspective, potential customers are involved in the purchase of a product or service and want information about the supplier firm. They receive information from the referrer and provide attention to the referrer, which enhances the referrer's social status (see row 2, Table 1). Supplier firms receive the referral from the referrer in exchange for providing something to the market. Supplier firms could be firms that provide a product or service (e.g., Apple Inc.), professionals (e.g., lawyer), or a person (e.g., job seeker) (see row 3, Table 1).

Referrals represent one of the many sources of information potential customers may use to make better decisions[2] (Andreasen, 1968). As customers' judgments of the usefulness of advertising continue to decline (Keller & Berry, 2003), supplier firms should manage referrals as part of their communication process (Chen & Xie, 2005), and should recognize the different sources referrals can come from.

3. TYPES OF REFERRALS

Referrals for the supplier firm can come from both customers and non-customers; the supplier firm also might initiate referrals for itself. For example, a supplier firm could receive a referral from another supplier firm (horizontal referral), or the supplier firm could ask one of its existing customers to provide a referral to a potential customer (supplier-initiated referral). We define and review literature on all three types of referrals: customer-to-potential customer referrals (Section 3.1), horizontal referrals (Section 3.2), and supplier-initiated referrals (Section 3.3), summarized in Table 2.

Table 2. Types of Referrals.

Referral Type	Referrer	Potential Customer Known to Supplier Firm?	Referral Valence	Referral Initiated By	Examples of Positive Referrals
Customer-to-potential customer referrals	Customer	No	Positive or negative	Referrer or potential customer	Jane recommends to Elizabeth that Elizabeth purchase an iPhone from Apple
Horizontal referrals	Noncustomer	No	Positive or negative	Referrer or potential customer	A lawyer recommends a client to use services of another lawyer
Supplier-initiated referrals	Customer selected by supplier firm	Yes	Positive only	Supplier firm	Centra Software asks existing customer, Link Inc., to recommend potential customer, Aztec Inc., to purchase from Centra

Note: Row 1 indicates that in customer-to-potential customer referrals, the referrer is a customer of the supplier firm, the potential customer is not known to the supplier firm, the valence of the referral can be negative or positive, and the referral can be initiated by the referrer or the potential customer. In the example, Jane (the referrer) gives a positive referral to Elizabeth (the potential customer) for Apple's (the supplier firm) iPhone.

3.1. Customer-to-Potential Customer Referrals

Consider our initial example again – Joe asks his friend, Adam, for a recommendation for a cellular service and Adam gives Joe a positive referral for AT&T. Adam is either an existing or prior customer of AT&T, and Joe is a potential customer for AT&T. Such a referral exchange represents a customer-to-potential customer referral, in which the referrer and the potential customer are typically in each other's networks of family, friends, or acquaintances. Although AT&T should know that Adam is a current or prior customer, it likely cannot know about Joe and is unaware of the referral Adam provides to Joe. Furthermore, the valence of the referral can be negative or positive and either the referrer or the potential customer can initiate the referral exchange; Joe might seek information from Adam, whom he knows is an existing customer of AT&T, or Adam might offer information about AT&T to Joe (row 1, Table 2).

Marketing researchers have typically studied customer-to-potential customer referrals as "word of mouth." Arndt (1967) defined word of mouth as one-to-one exchange of information about a product or service from a user to a nonuser of the product. However, today, word of mouth is used to denote any information exchange concerning a product or service between consumers (Harrison-Walker, 2001). Thus, word of mouth encompasses both the roles of communication between customers – information flow, and interpersonal influence in a purchase situation. Customer-to-potential customer referrals focus only on interpersonal influence of the communication between customers and potential customers related to purchasing the product. Although word of mouth is now defined as any communication between customers, most of the research on word of mouth has measured word of mouth as the likelihood of a customer giving a recommendation (i.e., likelihood of a referral), and the influence of receiving a referral on potential customers' purchase (cf., Chevalier & Mayzlin, 2006; Godes & Mayzlin, 2004). Below, we review the literature on word of mouth pertinent to customer-to-potential customer referrals.

3.1.1. Antecedents of Customer-to-Potential Customer Referrals

Researchers have studied situations in which customers are likely to act as referrers, such as when they are satisfied with the supplier firm's product (e.g., Anderson, 1998) or have a propensity to communicate their experiences to others (e.g., Singh, 1990). The antecedents of customer-to-potential customer referrals thus consist of satisfaction (or dissatisfaction)

with the supplier firm's product/service, personal characteristics of the referrers, and product characteristics (see Table 3).

Researchers have consistently found that the higher the customers' satisfaction with a product or service, the greater the likelihood that customers will provide positive referrals for the supplier firm (e.g., Anderson, 1998; Bettencourt, 1997). This result has been replicated across multiple product categories, such as coffee (Holmes & Lett, 1977) and car dealerships (Swan & Oliver, 1989). Similarly, the higher the customers' dissatisfaction, the higher the likelihood that they will provide negative referrals for the supplier firm (Richins, 1983). However, Anderson (1998) finds that the effect of satisfaction and dissatisfaction on positive and negative referrals, respectively, is asymmetric, that is, customers exhibit a higher likelihood of providing negative referrals when they are dissatisfied than providing positive referrals when they are satisfied. Researchers have studied numerous antecedents of customer-to-potential customer referrals other than (dis)satisfaction with the supplier firm, including the cultural background of the referrer (Gilly, Money, & Graham, 1998b), the referrer's involvement with the brand (Carroll & Ahuvia, 2006), and others (Table 3).

3.1.2. Consequences of Customer-to-Potential Customer Referrals

Most researchers have taken the potential customer's perspective when studying the consequences of customer-to-potential customer referrals. Zeithaml, Berry, and Parasuraman (1993) find that customer-to-potential customer referrals shape potential customers' expectations. Sheth (1971) and Day (1971) find that referrals have a greater influence on potential customers than does advertising in the purchase of low-risk innovations. This result on relative influence has received empirical support in multiple contexts, including new movies (Still, Barnes, & Kooyman, 1984), consumer services (Murray, 1991), and high-risk innovations, such as mental health services (Speer, Williams, West, & Dupree, 1991). Furthermore, negative referrals have a stronger influence on potential customers' purchase decisions than do positive referrals. This asymmetric effect occurs because people pay more attention to negative information than to positive information, so potential customers grant more importance to negative referrals than to positive ones (Fiske & Taylor, 1991).

Research on customer-to-potential customer referrals in business-to-business (B-to-B) markets is inconclusive. Webster (1970) finds that customer-to-potential customer referrals between firms are infrequent and have the most influence in the initial stages of the purchase process, whereas Martilla (1971) finds that they predominantly influence potential customers

Table 3. Summary of Literature on Antecedents of Customer-to-Potential Customer Referrals.

	Antecedents Studied	Mediators/Moderators Studied	Representative Papers
Satisfaction or dissatisfaction	Satisfaction and dissatisfaction with a product/service; (dis)satisfaction with a company's recovery efforts	Cross-cultural differences; perceived quality; commitment; anger; effect; strength of tie; attitude toward complaining	Richins (1983), Anderson (1998), Bettencourt (1997), Bitner (1990), Grace (2007)
Personal characteristics	Deal-proneness; cultural background; expertise; consumer's propensity; similarity between people; sophistication; perceived justice; embarrassment felt; self-confidence	Motivation; size of incentive; consumer knowledge; situational factors; value of firm's offerings	Singh (1990), Lau and Ng (2001), Walsh, Gwinner, and Swanson (2004), Gruen, Osmonbekov, and Czaplewski (2007)
Product-related	Product involvement; industry characteristics; brand loyalty; company size; service quality	Hedonic or utilitarian products; satisfaction; individual characteristics	Singh (1990), File, Cermak, and Prince (1994), Brady and Robertson (2001), Carroll and Ahuvia (2006)

in the later stages of the purchase process. Most subsequent research has focused on internal information sources and the use of marketing consultants (e.g., Bunn & Clopton, 1993; Moriarty & Spekman, 1984), without considering customer-to-potential customer referrals.

3.2. Horizontal Referrals

Consider Beth who goes to her physician Dr. Smith for an annual health check. Dr. Smith notices that Beth's heartbeat is irregular and recommends that she see a heart specialist, specifically, Dr. Howard. In this case, Dr. Smith has given Beth a positive referral for Dr. Howard; however, Dr. Smith is not a customer of Dr. Howard, and both represent suppliers in the medical industry. Such a referral, in which the referrer is another supplier firm (product or service provider), is a *horizontal referral* (Arbatskaya & Konishi, 2006).

In horizontal referrals, potential customers are usually the referrer's potential or existing customers (row 2, Table 2); in our example, Beth is Dr. Smith's existing customer. The valence of horizontal referrals again can be positive or negative; Dr. Smith (the referrer) might recommend that Beth should *not* see Dr. Howard (the supplier firm). The referral can initiate with either side of the referrer – potential customer dyad; Beth might ask Dr. Smith to recommend a specialist, or Dr. Smith might offer the information himself. Further, Dr. Howard is unlikely to know about Beth, her problem, or the referral exchange, at least until Beth makes an appointment (row 2, Table 2).

Horizontal referrals are most prevalent in industries in which potential customers must undergo a costly search to learn about available products, their characteristics, and their quality (Spurr, 1987). For example, potential customers know less about the quality of a particular lawyer than do other lawyers, and lawyers often gain business through positive referrals from other lawyers (Garicano & Santos, 2004). In consumer markets, a salesperson at Best Buy might recommend that you buy a camera lens unavailable at the store from Amazon.com. Reingen and Kernan (1986) find that a piano tuner (the supplier firm) in their study receives positive referrals from music stores. Horizontal referrals also prevail in industries in which potential customers do not choose goods and services directly but use another supplier firm as a proxy decision maker (Pauly, 1979). For example, patients depend on a generalist doctor (the referrer) to decide which

specialist medical services they need, and which specialist doctor to go to (the supplier firm).

Regardless of the industry, the referrer determines whether the supplier firm offers the solution that the potential customer needs and provides a referral. Thus, horizontal referrals reduce potential customers' search costs and should lead potential customers to an appropriate supplier who can address their problem. For example, Spurr (1988) finds that through horizontal referrals in legal trials, lawyers of higher quality receive trials with claims of greater intrinsic value.

Our overview suggests that researchers have primarily studied positive rather than negative horizontal referrals. Further, our understanding of the influence of horizontal referrals on potential customers' purchase decision and referrers' motivation to give horizontal referrals for supplier firms is limited.

3.3. Supplier-Initiated Referrals

Consider a firm, Axxess Inc., that is planning to purchase a software solution and is evaluating a supplier firm, Centra Software. Centra (the supplier firm) can ask an existing customer, Link Inc. (the referrer), to give a referral for Centra to Axxess (the potential customer). In this example, the supplier firm has initiated the referral for itself, and we call this type of referral a "supplier-initiated referral." In this referral, the supplier firm knows both the existing and the potential customers, as well as the likelihood of a referral exchange. Because it is unlikely that the supplier firm solicits a customer that might give a negative referral, the valence of a supplier-initiated referral should be positive (row 3, Table 2).

The practice of supplier-initiated referrals is prevalent in business markets in which supplier firms sell complex products to meet specific customer needs (Godes et al., 2005; Salminen & Möller, 2006). Kumar, Petersen, and Leone (2009) study the influence of these referrals on potential customers' purchase decisions in B-to-B markets and find that the referral's influence depends on (1) the referrer's characteristics (e.g., size, industry), (2) the referrer's transaction characteristics (e.g., how much and how often they purchase), and (3) referral characteristics (e.g., form of reference, similarity of referrer and potential customer).

The limited research on supplier-initiated referrals, as well as the difference in each actor's perspective in supplier-initiated referrals versus customer-to-potential customer referrals or horizontal referrals, provides

significant opportunities for research. For example, what are the motivations of an existing customer to agree to be a referrer? Will the potential customer discount the referral because the supplier firm chose the referrer? From the supplier firm's perspective, how can supplier firms maximize the benefits of a supplier-initiated referral?

Each of the three referral types – customer-to-potential customer referrals, horizontal referrals, and supplier-initiated referrals – can help supplier firms achieve their marketing objectives. To understand how supplier firms should manage referrals, we must first address how referrals influence potential customers' purchase decision.

4. ROLE OF REFERRALS IN POTENTIAL CUSTOMERS' PURCHASE DECISION

> Whenever there is uncertainty, there is usually the possibility of reducing it by the acquisition of information.
>
> (Arrow, 1973, p. 3)

Consider a purchase situation in which the potential customer has observed price and quality that can be observed prior to experiencing or owning the product. However, the potential customer remains uncertain about the product's quality or the supplier firm's ability to deliver the product according to his or her expectations. This purchase uncertainty increases when there is a degree of irreversibility concerning the product or a time lag in ascertaining the product's quality. For example, imagine Jim, who owns a tool shop and needs to purchase a complex machine. If the machine proves unsatisfactory, such that Jim must sell the (used) machine, he suffers an economic loss, because second-hand machine prices are lower than new machine prices. He also loses the time and money required to buy and test the machine (Arrow, 1973). To reduce purchase uncertainty, potential customers are likely to search for external information through multiple methods, such as, supplier firm–controlled information (e.g., advertising, product brochures), ratings from third-party independent organizations (e.g., JD Power, Consumer Reports), direct inspections or trials, and referrals.

Researchers generally view the role of referrals as reducing potential customers' perceived purchase uncertainty (e.g., Arrow, 1973; Roberts & Urban, 1988). However, this view ignores the potential effect of conflicting referrals on purchase uncertainty. Paese and Sniezek (1991) find that conflicting information reduces confidence in decisions, such that if potential customers receive either conflicting information from multiple

referrals or a mix of positive and negative referrals, referrals likely increase, not decrease, their purchase uncertainty. Nevertheless, potential customers' *purpose* in seeking information through referrals is to reduce their purchase uncertainty, so we take this purpose into account in our discussion.

We conceptualize the role of referrals in potential customers' information search in three dimensions. The first dimension refers to the *nature of the information search through referrals*. Bettman (1979) posits that potential customers first filter available alternatives using relatively simple criteria and then undertake detailed analyses of the resulting reduced set. This conceptualization aligns with Rees's (1966, p. 560) description of extensive and intensive search: "a buyer can search at the extensive margin by getting a quotation from one more seller. He can search at the intensive margin by getting additional information concerning an offer already received." The second dimension refers to the *referral type* (customer-to-potential customer referrals, horizontal referrals, and supplier-initiated referrals) through which potential customers access information. And, the third dimension refers to the *influence of a referral* on potential customers' purchase decision.

We argue that potential customers' external information search through referrals depends on their (1) decision stages (Section 4.1) and (2) purchase situation (Section 4.2). Here we provide the conceptual development, and in the appendix we present illustrative propositions for the role of referrals in potential customers' purchase decision.

4.1. Decision Stages

Most potential customers proceed through (at least) four stages in their decision process: problem recognition, creation of awareness set, creation of consideration set, and choice[3] (Fig. 2). In the first stage, they recognize a problem that requires a purchase to solve. In the second stage, potential customers access their memory to create the awareness set, which consists of all alternatives in the market of which the potential customer is aware (Shocker, Ben-Akiva, Boccara, & Nedungadi, 1991). By the second stage, potential customers have not conducted an external information search, so referrals do not play a role.

In the third stage, potential customers purposefully create a consideration set of product alternatives that are likely to solve their problem (Shocker et al., 1991). To do so, potential customers must search for additional supplier firms, and evaluate all considered alternatives. Therefore, potential customers likely conduct extensive external information search through

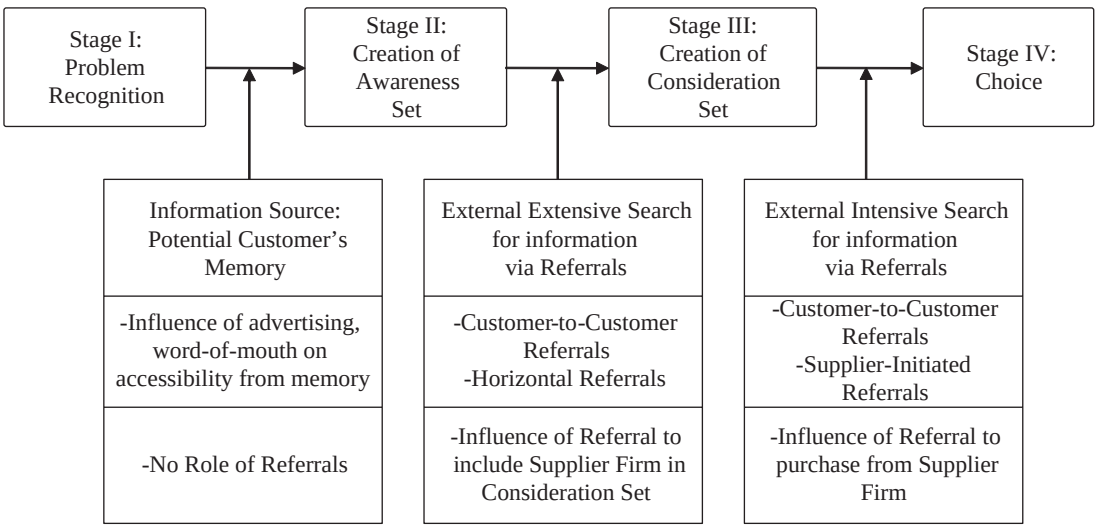

Fig. 2. Role of Referrals in Potential Customer's Decision Process. *Note:* There are multiple ways in which potential customers receive and search for information about the supplier firm (e.g., advertising, trial). This figure highlights the role of referrals only in providing information about the supplier firm to the potential customer.

referrals (Fig. 2). In the fourth stage, choice, potential customers choose a supplier firm from the consideration set, which prompts them to seek additional information about each supplier firm by conducting an intensive information search through referrals (Rees, 1966).

4.2. Purchase Situation

Potential customers' external information search through referrals depends not only on the decision stage of the purchase process, but also on factors that differentiate one purchase decision from another, that is, product characteristics, purchase situation, supplier firm characteristics, referral attributes, and referrer characteristics (Fig. 3).

4.2.1. Product Characteristics

Product characteristics might affect potential customers' external information search in two generic situations. In the first, potential customers have difficulty understanding what a product does or how it works. This situation typically arises when innovations (e.g., digital video recorders) are early in their life cycle (i.e., launch and growth stages). Potential customers' purchase uncertainty should be higher in the earlier stages than in the later stages of the product life cycle (i.e., maturity and decline stages), when potential customers have become familiar with the product (Tellis & Fornell, 1988). Thus, the product's life cycle stage should influence the likelihood of potential customers' information search through referrals.

In the second situation, potential customers may not be able to evaluate product quality before, or even after, purchase, as is the case for experience products (e.g., cruises, restaurants), and credence products (e.g., automobile services, financial investments), respectively. In contrast, potential customers can evaluate the quality of search products prior to purchase (e.g., books, furniture) (Darby & Karni, 1973; Nelson, 1970). Because potential consumers cannot ascertain the quality before purchase, they likely perceive higher purchase uncertainty for experience and credence products than for search products. Therefore, the likelihood of potential customers' information search through referrals depends on the product type: experience, credence, or search.

4.2.2. Potential Customer's Perceived Purchase Situation

The characteristics of the potential customers' purchase situation (prior knowledge, involvement, and complexity) likely influence their external information search (Dowling & Staelin, 1994).

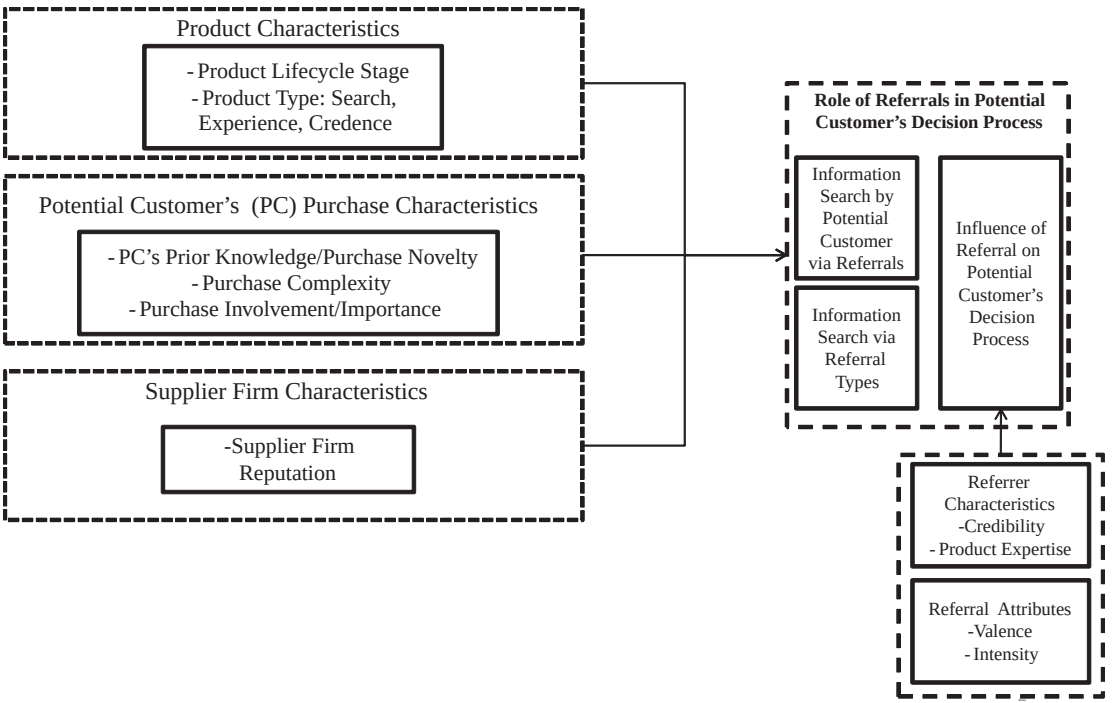

Fig. 3. Role of Referrals in Marketing: Potential Customer's Purchase Decision.

The amount of knowledge potential customers have prior to the start of the purchase process affects the amount and nature of information search they undertake (Brucks, 1985). Because potential customers' prior knowledge (or purchase novelty in B-to-B markets) affects purchase uncertainty (McQuiston, 1989), the likelihood of their information search through referrals depends on their prior knowledge.

Purchase complexity leads potential customers to perceive external information search as difficult and expensive (Schmidt & Spreng, 1996). Herr, Kardes, and Kim (1991) show that potential customers are more likely to understand and remember information they gained from referrals than from sources such as independent reports. Thus, referrals reduce the perceived effort and the cost of acquiring external information. Therefore, the likelihood of potential customers' information search through referrals should depend on their perception of purchase complexity.

Potential customers' involvement in the purchase decision (or purchase importance) positively influences their perceptions of risk associated with the purchase (Webster & Wind, 1972). Therefore, potential consumers highly involved in the purchase decision are likely to search for external information about the purchase (e.g., Celsi & Olson, 1988; Hunter, Bunn, & Perreault, 2006). Thus, the likelihood of information search through referrals should depend on potential customers' purchase involvement.

4.2.3. Supplier Firm Characteristics

Information asymmetry between potential customers and the supplier firm causes potential customers to believe the supplier firm is attempting to sell products or services it does not possess (Stigler, 1961). Consider automobile services: Many potential customers do not understand the service offered, and the service shop (i.e., supplier firm) has an incentive to misrepresent the service required. In this scenario, potential consumers often prefer automotive service shops for which they have received positive referrals (Arrow, 1973). In the absence of previous experience with the supplier firm, potential customers also must rely on the supplier firm's reputation as a signal (Shapiro, 1983), and a stronger reputation provides a signal that reduces potential customers' purchase uncertainty. Therefore, the likelihood of potential customers' information search through referrals should depend on the supplier firm's reputation.

4.2.4. Referral Attributes

We expect that the two attributes of a referral – valence and intensity – also affect the role of referrals in potential customers' purchase decision.

As potential customers pay more attention to negative information than positive information (Fiske & Taylor, 1991), the referral's valence (negative or positive) should affect the referral's influence on the potential customer. Further, the referral's intensity (how strongly the referrer gives the recommendation) should also affect how much influence the referral has on potential customers' purchase decision (Fig. 3).

4.2.5. Referrer Characteristics

Other than the purchase and supplier firm characteristics, the referrer's characteristics also affect the role of referrals in potential customers' purchase decision, specifically the referral's influence on the potential customer. Gilly and colleagues (1998a) find that the referrer's credibility and product expertise affect the referral's influence on potential customers' purchase decision (Fig. 3).

Thus, referrals influence a potential customer's decision to purchase from the supplier firm. With a positive referral, the supplier firm might gain the sale and the associated expected cash flow. With a negative referral, the supplier firm might lose the sale and the associated expected cash flow. We argue that researchers and managers should study and assess the aggregate effect of all referrals for the supplier firm.

5. REFERRAL EQUITY: CONCEPTUALIZATION

> Ebay is one e-commerce leader that is reaping the benefits of referrals from loyal customers. More than half its customers are referrals. "If you just do the math off our quarterly financial filings," CEO Meg Whitman recently told the Wall Street Journal, "you can see that we're spending less than $10 to acquire each new customer. The reason is that we are being driven by word of mouth [referrals]."
>
> (Reichheld & Schefter, 2000, p. 107)

> Almost half of those surveyed, 48%, reported they have avoided a store in the past because of someone else's negative experience.
>
> (Knowledge @ Wharton, 2005)

Ebay's case highlights two effects that positive referrals have on a supplier firm – new customer acquisitions and reduced costs for customer acquisitions. Chevalier and Mayzlin (2006) also find that an increase in a book's positive online reviews increases the books' sales at Amazon.com and Barnesandnoble.com. Knowledge @ Wharton's (2006) summary of a retail dissatisfaction study shows that negative referrals are likely to have the opposite effect – reduced customer acquisitions. We argue that supplier

firms should focus on the effect of all referrals for the supplier firm in the market, and manage them as assets and liabilities that affect its cash flow. We model the net effect of all referrals for the supplier firm as the supplier firm's *referral equity* (Section 5.1), which we define as the present value of the difference between the supplier firm's expected cash flow due to its referral assets (Section 5.2) and referral liabilities (Section 5.3).

5.1. Referral Equity

The equity of a firm is the difference between its assets and liabilities. An asset is an "item with value owned by the firm which can be used to generate additional value or provide liquidity," such as property, plants, and equipment (Banks, 2005, p. 18). Liabilities are "legal obligations to make a payment," such operating expenses and debt (Banks, 2005, p. 207). Assets and liabilities need to be "accounted so that the entity's (i.e., firm's) timing and amount of cash flow can be determined" (Libby, Libby, & Short, 2005, p. 53). Srivastava, Shervani, and Fahey (1998) outlined how marketing-based assets, such as brand equity and channel relationships, can enhance the amount and timing of a firm's cash flow. We build on this stream of research to outline how referrals can be considered as intangible assets, and take it further by considering how referrals can be considered as intangible liabilities.

Intangible assets, such as trademarks, brand names, and firm's goodwill, "are factors of production or specialized resources that allow the supplier firm to earn cash (or profits) beyond the returns on its tangible assets" (Konar & Cohen, 2001, p. 282). Positive referrals should influence potential customers to purchase from the supplier firm, and thus, increase the supplier firm's expected sales, and reduce its customer acquisition costs. Because positive referrals increase the expected cash flow to the supplier firm from its tangible assets (e.g., products), we consider positive referrals an intangible asset of the supplier firm.

Intangible liabilities detract from the profits that a supplier firm can earn from its tangible assets. For example, a lawsuit against a supplier firm could increase potential customers' mistrust of the company and reduce sales; thus, the lawsuit is an intangible liability for the supplier firm (Konar & Cohen, 2001). Negative referrals influence potential customers not to purchase from the supplier firm, and thus, reduce the supplier firm's expected sales, and increase the supplier firm's customer acquisition costs. Therefore, we consider negative referrals an intangible liability of the supplier firm.

We define referral equity as the present value of the difference between the supplier firm's expected cash flow due to its referral assets and referral liabilities. Referral assets can generate positive cash flow by (1) increasing the supplier firm's expected sales and (2) reducing customer acquisition and customer retention costs. Referral liabilities can reduce cash flow by (1) reducing supplier firm's expected sales, (2) increasing customer acquisition and customer retention costs, and (3) increasing other marketing costs such as costs associated with referral programs.

We express referral equity of supplier firm j as:

$$\text{Referral equity}_j = (\text{Referral assets})_j - (\text{Referral liabilities})_j \quad (1)$$

5.2. Referral Assets

We define referral assets as the present value of the supplier firm's positive cash flow due to referrals for the supplier firm:

$$\text{Referral assets}_j = \text{PV}_t(\Delta_{+\text{REF}}[E(\text{Sale}_j)], \Delta_{+\text{REF}}[\text{Marketing costs}_j]) \quad (2)$$

where PV_t is the present value of cash flow at time t, $E(\text{Sale}_j)$ the monetary value of supplier firm j's expected sales, Marketing costs the supplier firm j's marketing expenditure, and $\Delta_{+\text{REF}}[\cdot]$ an operator indicating the change due to positive referrals for the supplier firm, where the subscript '+REF' indicates the effect of only positive referrals.

As we are elaborating on referral assets, we account for the *increase* in supplier firm's cash flow due to referrals. Therefore, $\Delta_{+\text{REF}}[E(\text{Sale}_j)]$ accounts for the *increase* in supplier firm j's expected sales due to positive referrals for supplier firm j, and $\Delta_{+\text{REF}}[\text{Marketing costs}_j]$ accounts for the *reduction in marketing expenditures* due to positive referrals. In Fig. 4, we provide a graphical representation of referral assets.

5.2.1. Effect of Positive Referrals on Expected Sales

We express the supplier firm j's expected sale to customer i (existing or potential) as:

$$E(\text{Sale}_{ij}) = L(\text{Purchase by customer}_{ij}) \times \text{Sale value}_{ij} \quad (3)$$

where $L(\text{Purchase by customer}_{ij})$ is the likelihood that customer i will purchase from supplier firm j and Sale value_{ij} the monetary value of the sale (e.g., in US$) the supplier firm j expects to earn from customer i.

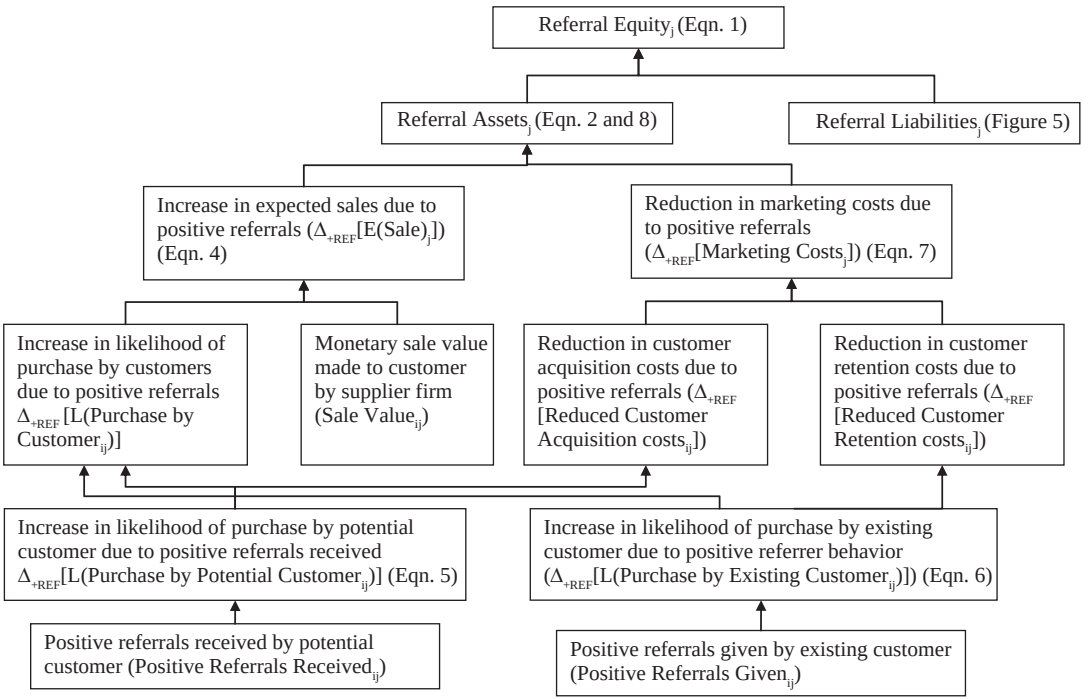

Fig. 4. Referral Assets of the Supplier Firm: Graphical Representation.

Customer i's likelihood of purchase from supplier firm j (L(Purchase by customer$_{ij}$)) depends on price and the information received from sources such as media, independent organizations, and referrals. We isolate the effect of positive referrals on supplier firm j's expected sale to customer i:

$$\Delta_{+\mathrm{REF}}[E(\mathrm{Sale}_{ij})] = \Delta_{+\mathrm{REF}}[L(\text{Purchase by customer}_{ij})] \times \text{Sale value}_{ij} \quad (4)$$

where $\Delta_{+\mathrm{REF}}[L(\text{Purchase by customer}_{ij})]$ is the increase in customer i's likelihood of purchase from supplier firm j due to positive referrals.

The supplier firm's expected sales come from both new (i.e., potential) and existing customers. Positive referrals increase the potential customer i's likelihood of purchase from supplier firm j (Murray, 1991; Nelson, 1970). We consider potential customer i's likelihood of purchase without receiving a referral for supplier firm j as the base and express the effect of positive referrals on the likelihood of purchase as:

$$\Delta_{+\mathrm{REF}}[L(\text{Purchase by potential customer}_{ij})] = f_1(\text{Positive referrals received}_{ij}) \quad (5)$$

where $\Delta_{+\mathrm{REF}}[L(\text{Purchase by potential customer}_{ij})]$ is the increase in potential customer i's likelihood of purchase from supplier firm j due to positive referrals and Positive referrals received$_{ij}$ indicates the positive referrals received by potential customer i for the supplier firm j.

A referral exchange also affects existing customers' likelihood of purchase. When customers give positive referrals to potential customers, they attribute their satisfaction to the supplier firm and thus are likely to repurchase. If we use the likelihood of purchase if the existing customer gave a referral for supplier firm j as the base, the positive referral should increase the existing customer i's likelihood of purchase. Therefore:

$$\Delta_{+\mathrm{REF}}[L(\text{Purchase by existing customer}_{ij})] = f_2(\text{Positive referral behavior}_{ij}) \quad (6)$$

where $\Delta_{+\mathrm{REF}}[L(\text{Purchase by existing customer}_{ij})]$ is the increase in existing customer i's likelihood of purchase from supplier firm j due to positive referrals and Positive referral behavior$_{ij}$ indicates that customer i gives positive referral(s) for supplier firm j.

5.2.2. Effect of Positive Referrals on Marketing Costs

Reichheld and Schefter (2000) argue that positive referrals can increase a supplier firm's cash flow not only by increasing likelihood of sales, but also

by reducing the cost of acquiring potential customers. Say Ethel gives a positive referral for the supplier firm to her friend John, and John decides to purchase from the supplier firm. Ethel has saved customer acquisition costs for the supplier firm, which did not expend any direct marketing effort to acquire John as a customer (Kumar, Petersen, & Leone, 2007). Because positive referrals also influence existing customers to repurchase from the supplier firm, they similarly reduce the supplier firm's customer retention costs. Therefore, we can express reduced marketing costs due to positive referrals that contribute to the supplier firm's referral assets (Eq. (2)) as:

$$\begin{aligned}&\Delta_{+\mathrm{REF}}[\text{Marketing costs}_j]\\&\quad=\sum_i(\Delta_{+\mathrm{REF}}[\text{Reduction in customer acquisition costs}_{ij}]\\&\qquad+\Delta_{+\mathrm{REF}}[\text{Reduction in customer retention costs}_{ij}])\end{aligned}\tag{7}$$

where Σ_i indicates the summation over all customers i from $1, \ldots, n$, $\Delta_{+\mathrm{REF}}[\text{Reduction in customer acquisition costs}_{ij}]$ the reduction in costs for acquiring potential customer i due to positive referrals received for supplier firm j, and $\Delta_{+\mathrm{REF}}[\text{Reduction in customer retention costs}_{ij}]$ the reduction in costs for retaining existing customer i due to positive referrals given for supplier firm j.

Substituting Eqs. (4) and (7) into Eq. (2), we have:

$$\begin{aligned}\text{Referral assets}_j=\mathrm{PV}_t\Bigg(&\sum_i(\Delta_{+\mathrm{REF}}[L(\text{Purchase by customer}_{ij})]\times\text{Sale value}_{ij}),\\&\sum_i(\Delta_{+\mathrm{REF}}[\text{Reduction in customer acquisition costs}]\\&+\Delta_{+\mathrm{REF}}[\text{Reduction in customer retention costs}_{ij}])\Bigg)\end{aligned}\tag{8}$$

5.3. Referral Liabilities

We define referral liabilities as the present value of the supplier firm's negative cash flow due to referrals for the supplier firm:

$$\text{Referral liabilities}_j=\mathrm{PV}_t(\Delta_{-\mathrm{REF}}[E(\text{Sale}_j)],\Delta_{\mathrm{REF}}[\text{Marketing costs}_j])\tag{9}$$

where $\Delta_{-\mathrm{REF}}[\cdot]$ is an operator that indicates the change due to negative referrals for the supplier firm, where the subscript "$-$REF" indicates the

effect of only negative referrals, and $\Delta_{\mathrm{REF}}[\cdot]$ an operator that indicates the change due to positive and negative referrals for the supplier firm, where the subscript "REF" indicates the effect of either positive or negative referrals, or both.

As we are elaborating on referral liabilities, we account for the *reduction* in supplier firm's cash flow due to referrals. Therefore, $\Delta_{-\mathrm{REF}}[E(\mathrm{Sale}_j)]$ accounts for the *reduction* in supplier firm *j*'s expected sales due to *negative* referrals, and $\Delta_{\mathrm{REF}}[\mathrm{Marketing\ costs}_j]$ accounts for the *increase* in supplier firm *j*'s marketing expenditures due to *positive or negative referrals*. In Fig. 5, we provide a graphical representation of referral liabilities.

5.3.1. Effect of Negative Referrals on Expected Sales

From Eq. (3), we can isolate the effect of negative referrals on customer *i*'s likelihood of purchase and the subsequent effect on supplier firm *j*'s expected sale:

$$\Delta_{-\mathrm{REF}}[E(\mathrm{Sale}_{ij})] = \Delta_{-\mathrm{REF}}[L(\mathrm{Purchase\ by\ customer}_{ij})] \times \mathrm{Sale\ value}_{ij} \quad (10)$$

where $\Delta_{-\mathrm{REF}}[L(\mathrm{Purchase\ by\ customer}_{ij})]$ is the reduction in customer *i*'s likelihood of purchasing from supplier firm *j* due to negative referrals.

Negative referrals affect the supplier firm's expected sales from both potential and existing customers; they reduce potential customer *i*'s likelihood of purchase from the supplier firm *j* (Richins, 1983). We consider potential customer *i*'s likelihood of purchase without receiving a referral for supplier firm *j* as the base level, and express the effect of negative referrals on the likelihood of potential customer *i*'s purchase from supplier firm *j* as:

$$\Delta_{-\mathrm{REF}}[L(\mathrm{Purchase\ by\ potential\ customer}_{ij})] = f_1(\mathrm{Negative\ referrals\ received}_{ij}) \quad (11)$$

where $\Delta_{-\mathrm{REF}}[L(\mathrm{Purchase\ by\ potential\ customer}_{ij})]$ is the reduction in potential customer *i*'s likelihood of purchase from supplier firm *j* due to negative referrals and Negative referrals received$_{ij}$ indicates the negative referrals received by potential customer *i* for supplier firm *j*.

A negative referral exchange also affects the existing customer's (the referrer's) likelihood of purchase: when customers give negative referrals, they attribute their dissatisfaction to the supplier firm. Laczniak, DeCarlo, and Ramaswami (2001) find that when customers attribute dissatisfaction to the supplier firm, their subsequent evaluation of the supplier firm decreases. Thus, existing customers who give negative referrals are less likely to repurchase from the supplier firm than those who do not give negative

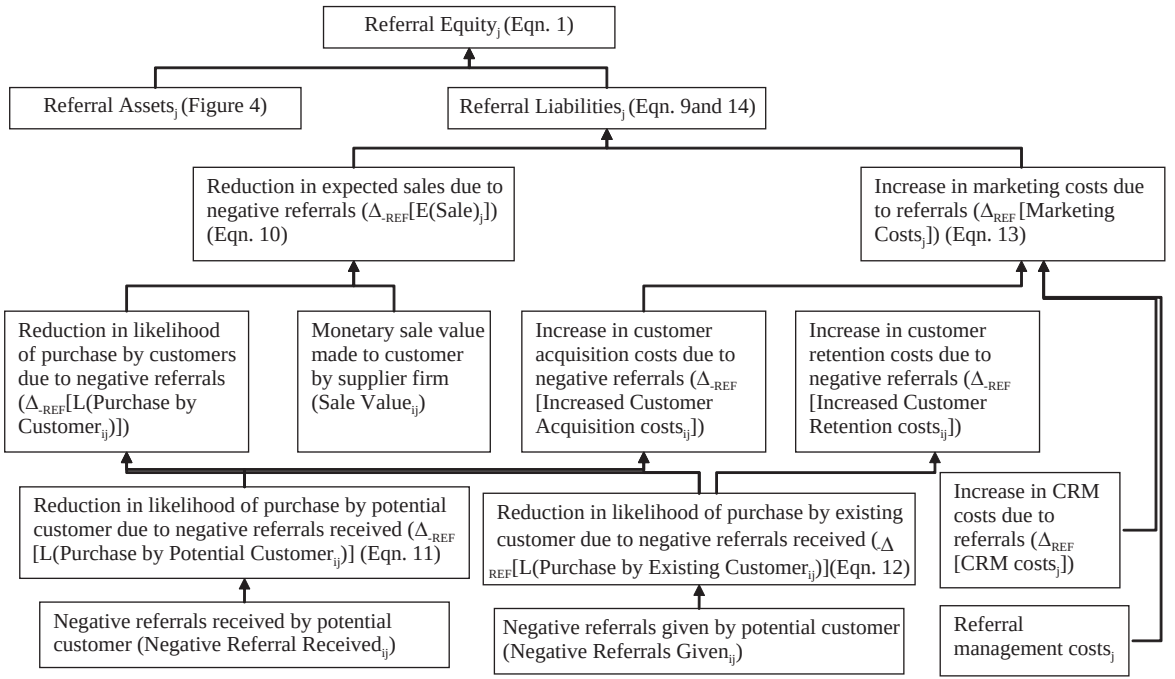

Fig. 5. Referral Liabilities of the Supplier Firm: Graphical Representation.

referrals. As the base level, we use the likelihood of purchase if the existing customer had not acted as a referrer for the supplier firm j, and express the effect of giving a negative referral on the existing customer i's likelihood of purchase as:

$$\Delta_{-\mathrm{REF}}[L(\text{Purchase by existing customer}_{ij})] = f_4(\text{Negative referral behavior}_{ij}) \tag{12}$$

where $\Delta_{-\mathrm{REF}}[L(\text{Purchase by existing customer}_{ij})]$ is the reduction in existing customer i's likelihood of purchase from supplier firm j due to negative referrals and Negative referral behavior$_{ij}$ indicates customer i giving negative referrals for supplier firm j.

5.3.2. Effect of Positive and Negative Referrals on Supplier Firms' Marketing Costs

Both positive and negative referrals can increase the supplier firm's marketing costs. If potential customers receive a negative referral for the supplier firm, their likelihood of purchase declines (Fiske & Taylor, 1991). To increase the likelihood of purchase, the supplier firm must expend additional money on other information sources (e.g., sales representatives) that can communicate positive information about it to the potential customer. The supplier firm must also address the effect of negative referrals on existing customers' likelihood of purchase and make efforts to retain these customers. Therefore, negative referrals increase the supplier firm's customer acquisition and retention costs.

Other costs associated with negative or positive referrals also increase the supplier firm's marketing costs. First, supplier firms must increase expenditure on their customer relationship management (CRM) processes to increase positive referrals. Zeithaml (2000) emphasizes that service firms should improve their service quality to existing customers to ensure positive referrals to potential customers. Supplier firms also bear costs to reduce negative referrals; as Bowman and Narayandas (2001) show, the supplier firm's effective complaint resolution efforts reduce the likelihood that customers will give negative referrals. Therefore, supplier firms increase their expenditure on CRM processes to manage positive or negative referrals.

Second, the supplier firm's marketing expenditure also increases due to referral programs that encourage existing customers or noncustomers to give positive referrals for them. For example, AT&T's "Rewards for Referrals" program gives existing customers rewards up to $75 (cost for

AT&T) if the customer's positive referral converts a potential customer into an AT&T customer (AT&T, 2009). Customer Reference Forum (2008) shows that 28% of the supplier firms in its survey spend more than $500,000 annually to manage their supplier-initiated referrals. We express the increased marketing costs due to referrals, which contribute to the supplier firm's referral liabilities (Eq. (3)), as:

$$\begin{aligned}\Delta_{\mathrm{REF}}[\text{Marketing costs}_j] = \sum_i (&\Delta_{-\mathrm{REF}}[\text{Increase in customer acquisition costs}_{ij}] \\ &+ \Delta_{-\mathrm{REF}}[\text{Increase in customer retention costs}_{ij}]) \\ &+ \Delta_{\mathrm{REF}}[\text{Increase in CRM costs}_j] \\ &+ (\text{Referral program costs}_j) \end{aligned} \tag{13}$$

where $\Delta_{-\mathrm{REF}}[\text{Increase in customer acquisition costs}_{ij}]$ is the increase in costs for acquiring potential customer i due to negative referrals received for supplier firm j, $\Delta_{-\mathrm{REF}}[\text{Increase in customer retention costs}_{ij}]$ the increase in costs for retaining existing customer i due to negative referrals given for supplier firm j, $\Delta_{\mathrm{REF}}[\text{Increase in CRM costs}_j]$ the supplier firm j's increase in expenditure on CRM due to positive or negative referrals or both, and $\text{Referral program costs}_j$ the supplier firm j's expenditures on referral programs.

Substituting Eqs. (10) and (13) into Eq. (9), we have:

$$\begin{aligned}&\text{Referral liabilities}_j \\ &= \mathrm{PV}_t \Bigg(\sum_i (\Delta_{+\mathrm{REF}}[L(\text{Purchase by customer}_{ij})] \times \text{Sale value}_{ij}), \\ &\quad \sum_i (\Delta_{-\mathrm{REF}}[\text{Increase in customer acquisition costs}] \\ &\quad + \Delta_{-\mathrm{REF}}[\text{Increase in customer retention costs}_{ij}]) \Bigg) \\ &\quad + \mathrm{PV}_t(\Delta_{\mathrm{REF}}[\text{Increase in customer relationship} \\ &\qquad \text{management costs}_j], \text{Referral program costs}_j) \end{aligned} \tag{14}$$

Through the concept of referral equity, we show how referrals affect the supplier firm's cash flow; next we discuss how supplier firms can build referral equity.

6. BUILDING REFERRAL EQUITY BY MANAGING REFERRALS

> An account manager from one of my larger vendors – I met with this AM quarterly – told me that one of the new metrics for their quota was going to be references, and asked if I'd be willing to help them out.
>
> (Morrison, 2009, former CIO at Motorola)

Morrison's (2009) experience with one of Motorola's supplier firms highlights how salespeople must build supplier-initiated referrals as part of their performance appraisal. Supplier firms recognize the benefits of building referral equity, though most programs (1) focus on increasing referral assets (i.e., positive referrals), not reducing referral liabilities, and (2) view customers as referrers, not noncustomers as referrers.

In our framework for building referral equity, we acknowledge positive referrals as intangible assets and negative referrals as intangible liabilities, such that referrals can either increase or decrease the returns on the supplier firm's marketing activities. Therefore, building referral equity implies increasing the supplier firm's marketing effectiveness. We recommend that the objectives of a supplier firm to build its referral equity should involve both increasing the number and influence of positive referrals and reducing the number and influence of negative referrals (Fig. 6). We propose

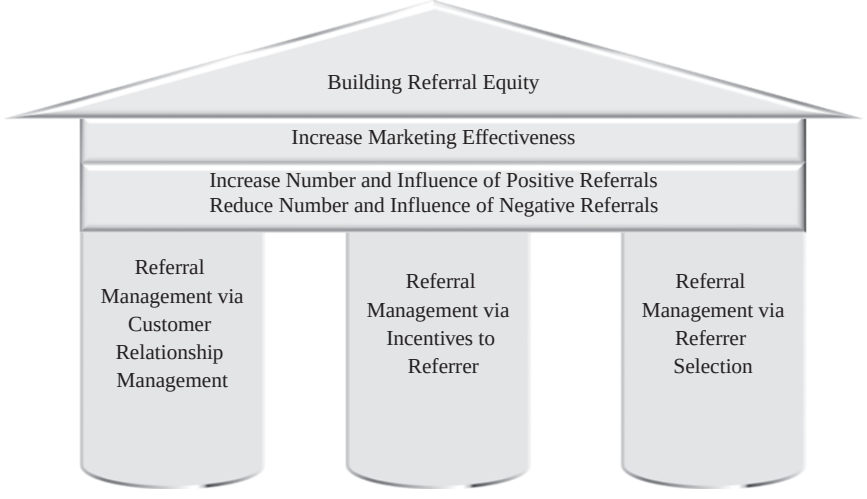

Fig. 6. How to Build Referral Equity: Pillars of Referral Management.

three pillars of referral management as the means to achieve these objectives (Fig. 6):

1. referral management through CRM processes;
2. referral management through incentives to the referrer;
3. referral management through referrer selection.

6.1. Referral Management through CRM Processes

CRM processes aim to achieve and maintain an ongoing relationship with customers (Payne & Frow, 2005) to improve customer satisfaction and thus build the supplier firm's referral equity. Multiple CRM processes, including product management and channel integration, can affect customers' satisfaction and relationship with their supplier firm. We focus on CRM processes that (a) manage the customer's experience and deepen the supplier firm's relationship with the customer and (b) managers consider successful in terms of impact on customer retention and satisfaction. Two CRM processes that satisfy these criteria are customer service and after-sales support, and loyalty and retention programs (Bohling et al., 2006) (Fig. 7).

6.1.1. Customer Service and After-Sales Support

Customers can contact a supplier firm for multiple reasons, such as inquiries about a product's use and availability details, or to change a service contract. For supplier firms, these contacts offer an opportunity to build customer loyalty and influence customers' referral behavior (Bowman & Narayandas, 2001). Goodman, Fichman, Lerch, and Snyder (1995) find that supplier firms' responsiveness to customer inquiries influences not only the customers' overall satisfaction, but also their evaluations of the supplier firms' product and thus their referral behavior.

Dissatisfied customers are more likely to give negative referrals than are satisfied customers, and these negative referrals have a greater influence on potential customers' purchase decisions than do positive referrals (Chevalier & Mayzlin, 2006). Dissatisfied customers often contact the supplier firm to resolve their problems or lodge a complaint. Folkes (1984) finds that customers are likely to give negative referrals after a service failure when they believe the failure is attributable to the supplier firm, is likely to happen again, and could have been avoided. Bowman and Narayandas (2001) also find that if the support offered by the supplier firm does not solve the customer's problems, loyal customers likely give negative referrals.

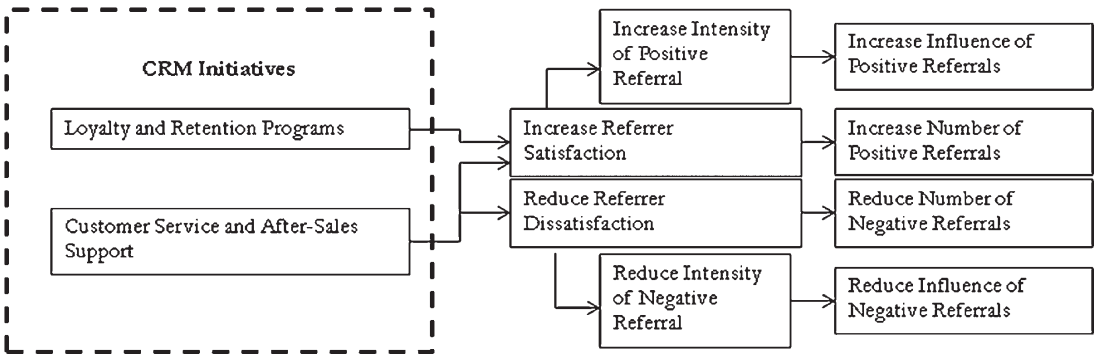

Fig. 7. Referral Management Through Customer Relationship Management: Left Pillar (Fig. 6).
Note: These Strategies are Applicable to Customer-to-Potential Customer Referrals and Supplier-Initiated Referrals.

In contrast, Swanson and Kelley (2001) indicate that if the supplier firm initiates the service failure recovery process and customers believe the failure will not happen again, customers are likely to give positive referrals for the supplier firm.

Customer service and after-sales support processes also alter the influence of positive and negative referrals on potential customers' purchase likelihood. According to Chevalier and Mayzlin (2006), as online reviewers' average star ratings for books on Amazon.com increase (indicating an increase in referral intensity), sales of these books also increase. As customers' (dis)satisfaction with the supplier firm's customer service and after-sales support increases, their referral intensity likely increases, increasing the influence of referrals on potential customers (Fig. 7). Therefore, customer service and after-sales support management can build the supplier firm's referral equity by (1) increasing the number of positive referrals and the influence of positive referrals on potential customers and (2) reducing the number of negative referrals and the influence of negative referrals on potential customers.

6.1.2. Loyalty and Retention Programs

> Owners of Harley–Davidson motorcycles who are members of the H.O.G. (Harley Owners Group) clubs around the world are very visible advocates for the brand. … Harley–Davidson does almost no advertising, depending, instead, upon its community of advocates to purchase both motorcycles and logo gear – and spread the word to others. (Lowenstein, 2006)

As Lowenstein (2006) notes, Harley–Davidson's loyalty program, H.O.G., encourages customers to give positive referrals for Harley–Davidson. Bolton, Kannan, and Bramlett (2000) find that loyalty and retention programs strengthen customers' satisfaction and affect their word-of-mouth behavior. Therefore, we expect that these CRM processes will build referral equity by increasing the number of positive referrals for the supplier firm, and increasing the influence of positive referrals on potential customers.

In B-to-B markets, CRM processes, such as key account management programs, focus on building relationships with customers (Homburg, Workman, & Jensen, 2002). Because the supplier firms have strong relationships with their key customers, they can request these customers to act as referrers, and they should know whether the customer will give a positive referral. Therefore, key account management programs can build referral equity by increasing the number of positive supplier-initiated referrals.

6.2. Referral Management through Incentives

SurePayroll launched a referral rewards program in August 2009 that rewards the referrer with a $50 gift card or $50 donation to select charities, if the potential customer becomes a client of SurePayroll (SurePayroll, 2009). Such rewards create incentives for customers to give referrals for the supplier firm. However, providing referral rewards is only one way to build referral equity; we note the potential of nonmonetary (Section 6.2.1) and monetary (Section 6.2.3) incentives, for both customers and noncustomers (Fig. 8).

6.2.1. Nonmonetary Incentives

The customer's decision to refer a supplier firm or not depends on the perceived costs and benefits of the referral exchange. We consider two strategies to increase the benefits to the referrer through nonmonetary incentives. First, supplier firms can offer incentives to customers to act as referrers by enhancing their social status and granting them access to information, as well as the opportunity to build their own network. For example, referral programs can bring a community of supplier firms' customers and

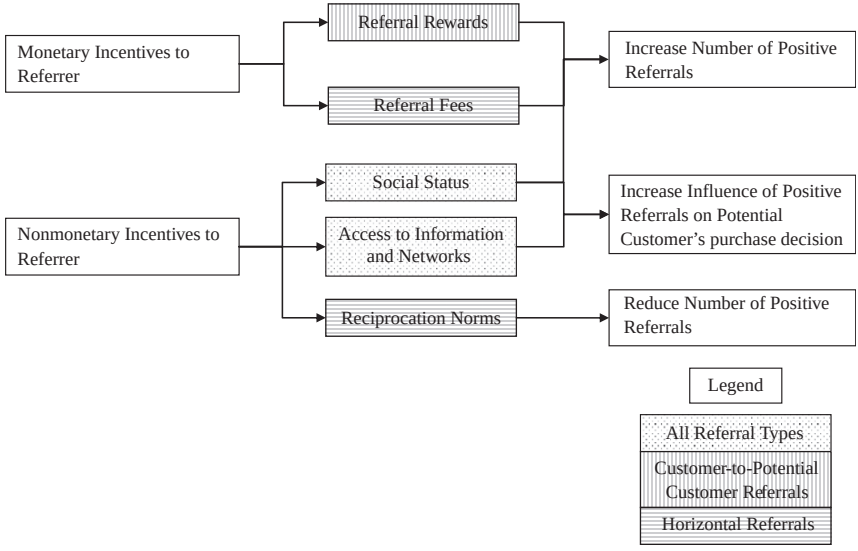

Fig. 8. Referral Management Through Incentives to Referrer: Middle Pillar (Fig. 6).

noncustomers together in a ''network of referrers.'' Second, to manage negative horizontal referrals, supplier firms can rely on reciprocation norms.

6.2.2. Enhanced Social Status, and Access to Information and Networks

> The e-THRIVE/VISTA comparison technique is one of the many aspects of breast MRI that Dr. Newstead is sharing with other physicians. As a member of the Philips Breast MR Ambassadors Network, she conducts educational programs such as Web seminars and hands-on courses.
>
> (Newstead, 2009, p. 12)

Philips Medical Devices builds referral equity by creating networks of opinion leaders and elevating the social status of the referrers within the medical community. Members of Philips' Ambassadors Network consider themselves ''key opinion leaders'' (Newstead, 2009, p. 11). This positioning enhances their self-image and perceived social status, and thus, increases their likelihood of giving positive referrals for the supplier firm (Gatignon & Robertson, 1985). In Philips' network, the chosen medical specialists also educate other potential customers about Philips' latest techniques and products. This information reduces potential customers' purchase uncertainty (Chen & Xie, 2005), and thus increases the potential customers' likelihood of purchase from the supplier firm.

Networks of referrers also provide customers and noncustomers with incentives to give positive referrals because referrers gain access to information and the opportunity to build their own networks with their peers. Referrers value having potential customers' view of them as pioneers (Feick & Price, 1987), and by giving referrers information about the latest innovations, supplier firms help them maintain their pioneering position. In B-to-B markets, Woodside (1994) shows that potential customers considering the purchase of a new technology are influenced by referrals from third-party firms, such as consultants. We therefore recommend that supplier firms create networks of referrers of third-party companies as well, to increase the number of positive horizontal referrals for the supplier firm.

Reciprocation Norms. From a competitive perspective, it is in the supplier firm's interest to give negative horizontal referrals for another supplier firm, but we posit that the likelihood of such negative horizontal referrals depends on the norms of the industry. Astley and Fombrun (1983) find that common strategies, agreed upon by group members, overwhelm the strategy of an individual supplier firm, and supplier firms comply with

the norms of their industry. Therefore, in an industry group with norms against negative horizontal referrals, supplier firms should not have to manage such negative referrals. However, in industries without strong norms against negative horizontal referrals, supplier firms can use reciprocation threats. If competing supplier firms demonstrate that they can reciprocate against each other's negative referrals, they should recognize that such a strategy would lead to reduced referral equity for both supplier firms. In this situation, they likely will avoid giving negative referrals.

Economists have formalized this concept as the prisoner's dilemma (Tucker, 1950), in which the dominant strategy for both supplier firms, X and Y, is to cooperate and not give negative referrals. However, in the equilibrium condition, when self-interest overrules this dominant strategy, both supplier firms give negative referrals, and the referral equity of both supplier firms declines (see cell I in Fig. 9). Because both supplier firms theoretically play the game repeatedly, the threat of reciprocation and reduced referral equity should lead both supplier firms to cooperate (see cell IV in Fig. 9) (Mailath & Samuelson, 2006). For both supplier firms to cooperate, each must believe that the other can reciprocate. Therefore, to reduce negative horizontal referrals, the supplier firm should display its capability to reciprocate against negative horizontal referrals with negative horizontal referrals for the other supplier firm.

		Firm X	
		Negative Referral for Y	No Referral for Y
Firm Y	Negative Referral for X	I Reduced referral equity, reduced referral equity	II No change in referral equity, reduced referral equity
	No Referral for X	III Reduced referral equity, no change in referral equity	IV No change in referral equity, no change in referral equity

Fig. 9. Demonstration of Reciprocation Norms as Referral Management Strategy with a Prisoner's Dilemma Game. *Note:* Cell II indicates that if supplier firm X does not give a horizontal referral for supplier firm Y, there will be no change in Y's referral equity, and if supplier firm Y gives a negative horizontal referral for supplier firm X, X's referral equity will reduce.

6.2.3. Monetary Incentives

Offering a monetary incentive to the referrer changes the referral exchange among the referrer, the potential customer, and the supplier firm (from the exchanges shown in Table 1). As with all referrals, the referrer provides information about the supplier firm to the potential customer. However, if this referral causes the potential customer to purchase from the supplier firm, the supplier firm rewards the referrer, such that the referrer receives a benefit from the supplier firm (the reward), and from the potential customer (indirectly) (Ryu & Feick, 2007).

Supplier firms are unlikely to offer monetary incentives to referrers in supplier-initiated referrals because the effectiveness of the referral depends on the referrer's reputation. Receiving monetary incentives might damage the referrer's reputation, and thus, decrease the effectiveness of the referral. Therefore, supplier firms should invest in monetary incentives only for customer-to-potential customer referrals (referral rewards) and horizontal referrals (referral fees) (Fig. 8).

Referral Rewards. A referral reward is a monetary incentive that the supplier firm issues to a referrer who gives a positive referral to a potential customer, after the potential customer purchases from the supplier firm. Referral rewards might include discounts on the product or service (e.g., Caesar's Pocono Resorts offers a $50 discount for future stays) or cash and gifts (e.g., AT&T offers existing customers up to $75). Referral reward programs increase the supplier firms' referral equity by increasing the number of positive referrals; however, they also reduce referral equity by increasing marketing costs. The goal is thus to build referral equity through referral rewards with minimum increases in marketing costs.

Ryu and Feick (2007) show that referral rewards increase the likelihood that customers give positive referrals to potential customers, which should increase the number of positive referrals for the supplier firm. However, they also note that referral rewards are irrelevant when strong ties exist between referrers and potential customers (e.g., family members). Because referrers tend to offer recommendations to potential customers with whom they have strong ties first, Ryu and Feick (2007) suggest increasing the referral reward as the number of referrals from a referrer increases.

Another means to increase the effectiveness of referral reward programs comes from Biyalogorsky, Gerstner, and Libai (2001), who suggest supplier firms should not give referral rewards to (1) customers with a low "delight threshold," as they are easily satisfied and therefore may give positive referrals even without rewards, or (2) customers with a high delight

threshold, who are not easily satisfied, because referral rewards will not influence them sufficiently to give positive referrals. To lower the cost of referral programs, supplier firms should offer referral rewards only to those customers who fall between the two extremes of delight thresholds. Further, Ryu and Feick (2007) show that an increase in reward size does not increase the referrer's likelihood to issue a positive referral to a potential customer. Supplier firms should determine and use the optimal reward size that provides incentives for customers to give positive referrals at minimum cost.

Referral Fees. The software supplier firm SAP targets small and medium-sized businesses through horizontal referrals. Its "SAP Referral Program" offers other firms (value-added resellers and system integrators) a referral fee of 5% of the revenue generated from a positive referral for SAP. The referrers also gain an opportunity to sell services to the potential customer in concert with SAP's offering. Since the launch of the program in the United States in August 2006, the program has produced 350 opportunities for SAP (Linsenbach, 2008).

A referral fee (i.e., a monetary payment to the referrer by the supplier firm for providing a positive referral that results in a customer acquisition) is an incentive for a firm to refer a potential customer to the supplier firm. As the SAP example indicates, this referral is often mutually beneficial for the referrer and the supplier firm. Referral fees based on fee splitting or a percentage of the revenue generated also benefit potential customers, because the referral fee provides incentives for the referrers to refer the best suited, specific supplier firm for that potential customer (Garicano & Santos, 2004). Arbatskaya and Konishi (2006) show that even for flat commission referral fees, supplier firms offer positive referrals to potential customer if they cannot provide the solution themselves. Therefore, referral fees in horizontal referrals result in qualified potential customers with a high likelihood of purchasing from the supplier firm; they also reduce the supplier firms' customer acquisition costs and thus build the supplier firm's referral equity.

6.3. Referral Management through Referrer Selection

> Identify the referrers who bring in the most referrals. Then capitalize on that knowledge. (Kumar et al., 2007)

Kumar et al. (2007) find that a supplier firm's most loyal customers are not necessarily the customers who are likely to give positive referrals for the

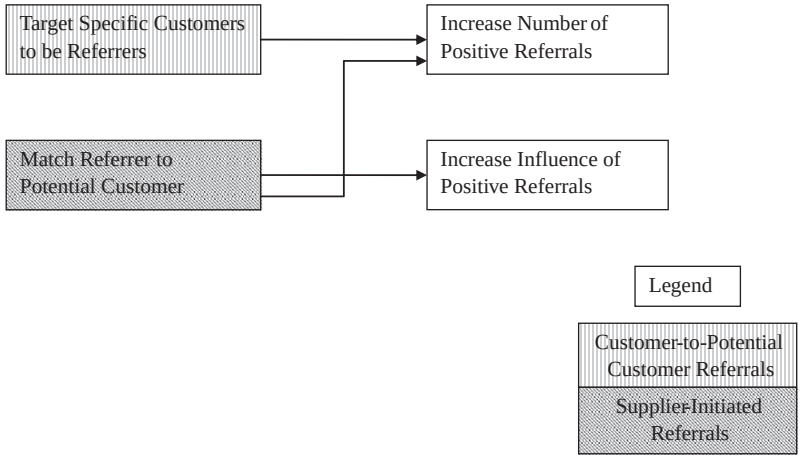

Fig. 10. Referral Management Through Referrer Selection: Right Pillar (Fig. 6).

supplier firm. To build referral equity, the supplier firm should target select customers who give positive referrals, and influence potential customers to purchase from the supplier firm (Fig. 10).

Researchers suggest two types of customers who fit these criteria: opinion leaders and early adopters[4] (Engel & Blackwell, 1982). Opinion leaders, first identified by Lazarsfeld, Berelson, and Gaudet (1948), act as information brokers who intervene between mass media sources and popular opinion; they tend to act as referrers because of their high involvement with the product (Bloch & Richins, 1983). Early adopters are customers who have purchased the product in the early stages of its life cycle, and then actively diffuse information about their new products through product-related conversations (Engel et al., 1969). Because potential customers perceive purchase uncertainty in the early stages of the product's life cycle, early adopters' referrals should have significant influence on their purchase decisions. By targeting these specific customers, supplier firms can increase the number of positive referrals, as well as the influence of those positive referrals on potential customers' purchase decision (Fig. 10).

In supplier-initiated referrals, the supplier firm has an opportunity to match the referrer and the potential customer, such that the referral influences the potential customer's purchasing decision (Fig. 10). Gilly and colleagues (1998a) find that referrals influence potential customers' purchasing decision when potential customers perceive referrers as similar to themselves. Kumar et al. (2009) confirm this effect in B-to-B markets;

they also find that referrers' size and industry influences potential customers' purchasing decision. Therefore, matching referrers to potential customers in supplier-initiated referrals should build the supplier firm's referral equity by increasing the influence of referrals.

Thus, supplier firms can build referral equity through referral management programs. Before supplier firms implement referral management programs, we recommend that supplier firms conduct a *referral audit*. In a referral audit, the supplier firm examines its referral assets and referral liabilities to determine problem areas and opportunities, and recommends a plan of action for building referral equity.

The supplier firm should also quantify and track the effectiveness of the referral management programs through *referral metrics*. One metric supplier firms could use to assess the effectiveness of their referral reward programs is customer referral value (CRV) (see Kumar et al., 2007). For supplier-initiated referrals, Kumar et al. (2009) suggest using the business reference value (BRV) of a referrer, that is, the amount of profit that an existing client (i.e., the referrer) generates through positive referrals to potential clients who purchase products and services as a result of the positive referral. A referrer's CRV and BRV can also help the supplier firm in referrer selection (right pillar of referral management in Fig. 6). Further, measuring the change in the supplier firm's customer satisfaction and loyalty metrics between the pre- and post-implementation audits should indicate the change in referral equity.

As an important research priority, we call for methods to measure referral equity. The first step could be to assess the incremental change in customer acquisitions and retentions due to negative and positive referrals. Conjoint studies can isolate the effect of referrals, and the relative effect of the three types of referrals, on customers' purchase likelihood. The next step is more challenging, to track and study the aggregate effect of all referrals on the supplier firm. Reingen and Kernan's (1986) method for sampling referral chains in the supplier firm's network and Goldenberg, Libai, and Muller's (2001) approach with stochastic cellular automata methods to study word-of-mouth effects offer some pertinent starting points for the development of methods to measure referral equity.

7. CONCLUSION

We regard a referral as a triadic exchange relationship among the referrer, potential customer, and supplier firm; we also highlight that a referral is a

recommendation *for* a supplier firm. Referrals affect the supplier firm's expected sales by influencing a potential customer to purchase or not from the supplier firm. To understand how supplier firms can manage referrals, we discuss their role as an information channel for potential customers who face purchase decisions (see the appendix). We posit that three different types of referrals – customer-to-potential customer referrals, horizontal referrals, and supplier-initiated referrals – provide different channels through which potential customers access information and supplier firms get referrals. By proposing the concept of referral equity, we link referrals to the firm's financial performance and thus contribute to research on the marketing–finance interface (Srivastava et al., 1998). We argue that supplier firms should manage referrals and provide referral management strategies that can build a supplier firm's referral equity. Although many of the ideas we express here may seem familiar, our contribution is to integrate them into a comprehensive framework for referrals.

Our purpose has been to focus on referrals from the supplier firm's perspective. After all, the ultimate goal of marketing is to generate sales for the supplier firm. And as Bennett (2004, p. 607) says: "In sales, a referral is the key to the door of resistance."

NOTES

1. A referral differs from an information flow between A and B that does not relate to B purchasing from C. For example, if A and B discuss the iPhone, and A provides information about its functionalities and applications to B, this information flow represents information transfer through word of mouth or buzz marketing, but it is not a referral.

2. Other information sources might also recommend products or supplier firms to potential customers. Online recommendation agents such as travel recommendation agents recommend specific products to users. Online reviews by customers on Web sites such as Yelp.com also provide information in the form of recommendations. By definition though, we require a referral to involve a one-to-one exchange between the referrer and the potential customer, so for our purposes here, we do not consider impersonal or one-to-many information sources as referrals.

3. Potential customers need not go through all these stages; they can skip a stage or move from problem recognition directly to final choice. Referrals act as an information source for potential customers in such scenarios too.

4. Feick and Price (1987) also identify "market mavens," that is, consumers who communicate frequently about the marketplace and purchasing in general, though not specifically about purchasing from a particularly firm. Because this communication does not relate to a specific firm, we do not consider market mavens pertinent to referrals.

5. The contagion effect in the product diffusion literature consists of interpersonal information transfer (the potential customer becomes aware of the product), interpersonal indirect influence (the potential customer sees another customer using the product and is influenced), and customer-to-potential customer referrals.

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APPENDIX. THE ROLE OF REFERRALS IN POTENTIAL CUSTOMERS' PURCHASE DECISIONS: ILLUSTRATIVE PROPOSITIONS

Potential customers perceive purchase uncertainty before buying a product or service, and to reduce their purchase uncertainty, they conduct an external information search through referrals. In this appendix, we develop illustrative propositions that summarize how the role of referrals depends on (1) purchase decision stage (Section A.1; Fig. 2) and (2) purchase situation characteristics (Section A.2; Fig. 3). Those propositions should be viewed both as summaries of extant knowledge and as potential, testable hypotheses for research.

Referrals affect potential customers' purchase decisions on three dimensions. First, potential customers can search for information through referrals about multiple supplier firms (extensive search), or they can search for in-depth information about one supplier firm (intensive search) (Rees, 1966). Second, potential customers likely use different referral types – customer-to-potential customer referrals, horizontal referrals, and supplier-initiated referrals – in their search. Third, referrals can either influence or not influence potential customers' purchase decision.

A.1. Decision Stages

In the purchase process, potential customers proceed through the stages of problem recognition, creation of awareness set, creation of consideration set, and choice (Fig. 2).

Problem recognition. Potential customers become aware of the problem and develop a desire to solve the problem through a purchase. Referrals do not play a role as this stage is prior to the potential customer's search for information.

Creation of awareness set. To create the awareness set, which consists of all alternatives of which a potential customer is aware (Shocker et al., 1991), potential customers access information from various information channels, such as advertising, consumer reports, catalogs, and word-of-mouth information. This information is stored in the potential customer's memory (individual or organizational) and accessed to create the awareness set. Referrals do not play a role here because potential customers are not conducting an external information search (Fig. 2).

Consideration set. Potential customers create the consideration by adding supplier firms to or discarding them from their awareness set (Hauser & Wernerfelt, 1990; Shocker et al., 1991). To create the consideration set, potential customers likely search for additional products from supplier firms through an extensive information search (Rees, 1966). Further, potential customers are likely to access information from referrers whom they know are current or previous customers of the supplier firm(s), that is, through customer-to-potential customer referrals (Martilla, 1971). Through horizontal referrals, potential customers also access referrers who know more about the industry than existing and potential customers, and referrers can recommend supplier firms that are likely to solve the potential customers' problem. As in the consideration stage, referrals help potential customers add to or limit their consideration set; we expect that the influence of referrals is similar to that of potential customers' other external information sources. In summary:

P1A: At the consideration stage, potential customers are more likely to conduct an extensive information search, than an intensive information search through referrals.
P1B: At the consideration stage, potential customers are likely to search for external information through customer-to-potential customer referrals and horizontal referrals.
P1C: At the consideration stage, influence of referrals should be similar to influence of other information channels on potential customers' decision to consider a supplier firm.

Choice. Potential customers conduct an intensive external information search in the choice stage to evaluate each alternative in their consideration set (Rees, 1966). They seek information through customer-to-potential referrals to engage in in-depth conversations about the supplier firm(s). In B-to-B markets, potential customers often cannot access the supplier firm's existing customers, so they may rely on supplier-initiated referrals. Further, potential customers perceive referrers as more credible than commercial information sources (Murray, 1991), so referrals should have a significant influence on their purchase decision. Therefore:

P2A: At the choice stage, potential customers are more likely to conduct an intensive information search, than an extensive information search, through referrals.

P2B: At the choice stage, potential customers are likely to search for information through customer-to-potential customer referrals and supplier-initiated referrals.
P2C: At the choice stage, referrals are likely to have a significant influence on potential customers' purchase decision.

A.2. Purchase Situation

In this section, we describe how purchase situation factors affect the role of referrals in potential customers' purchase decision. We consider the following factors: product characteristics (Section A.2.1), potential customer's purchase characteristics (Section A.2.2), supplier firm's characteristics (Section A.2.3), referral attributes (Section A.2.4), and the referrer's characteristics (Section A.2.5) (Fig. 3).

A.2.1. Product Characteristics

We consider two product characteristics that are likely to affect potential customers' purchase uncertainty – product life cycle stage and product type (as defined by its search, experience, and credence attributes).

Product life cycle stage. A product's life cycle consists of four stages: introduction, growth, maturity, and decline. In a product's introduction or growth stage (i.e., early stages), potential customers know little about the product's attributes or how to evaluate them, so they perceive high purchase uncertainty. During the maturity or decline stage (i.e., late stages), potential customers are familiar with the products and how to evaluate them, and they perceive low purchase uncertainty (Tellis & Fornell, 1988).

As customer-to-potential customer referrals reduce purchase uncertainty in the earlier stages of the product life cycle (Arndt, 1967), potential customers are likely to search for information through these referrals. Supplier-initiated referrals perform the same function for potential customers in B-to-B markets (Ruokolainen & Igel, 2004). For products in the earlier stages, product diffusion theory finds that customer-to-potential customer referrals (the contagion effect, in diffusion theory[5]) have a significant influence on potential customers' decision to buy a product (e.g., Bass, 1969; Krishnan, Bass, & Kumar, 2000). Therefore, we expect that the influence of referrals on potential customers is higher during earlier, versus later, stages of the product life cycle. In summary:

P3A: Potential customers are likely to search for information through customer-to-potential customer referrals and supplier-initiated referrals

more for products in the early stages, than for products in late stages, of the product life cycle.
P3B: Influence of referrals on potential customers' purchase decision should be higher at the early stages than at the late stages of the product life cycle.

Product type: search, experience, and credence. Products can be classified according to their search, experience, and credence attributes. Potential customers can perceive the quality of search products prior to purchase (e.g., books, furniture), they can ascertain the quality of experience products after purchase (e.g., cruises, restaurants), and they cannot ascertain the quality of credence goods even after purchase (e.g., automobile services, financial investments) (Darby & Karni, 1973; Nelson, 1970). Because potential customers cannot ascertain the quality of experience and credence products easily, they likely conduct an intensive information search for these products. Mangold, Miller, and Brockway (1999) find that in professional services, which are characterized by experience and credence attributes, referrals have a greater influence on the potential customers' purchase decision than do other information sources. In summary:

P4A: Potential customers are more likely to conduct an intensive search for information through referrals for experience and credence products than for search products.
P4B: The influence of referrals on potential customers' purchase decisions is greater for credence and experience products than for search products.

A.2.2. Purchase Situation

In this section, we discuss how potential customers' (1) prior knowledge or perceptions of novelty, (2) purchase complexity, and (3) purchase involvement affect their external information search through referrals.

Prior knowledge/novelty. Objective prior knowledge refers to what potential customers know about the intended purchase; subjective prior knowledge indicates their perceptions of the amount of knowledge they have about the intended purchase (Brucks, 1985). These two constructs are distinct but closely related (Schmidt & Spreng, 1996), and we consider the holistic construct of potential customers' prior knowledge.

Potential customers' experience with the product significantly influences their prior knowledge (Brucks, 1985). In B-to-B markets, Robinson, Faris, and Wind (1967) identify three types of purchase situations, based on potential customers' experience with the product or the novelty of the buying task: new buy, modified rebuy, and straight rebuy. In a new task buy

situation, potential customers are involved in the purchase of a new product; in a modified rebuy, they are either looking for a new supplier firm for an existing product or upgrading/downgrading an existing product; and in a straight rebuy, they are repurchasing the same product with the same supplier firm. Thus, potential customers have lower prior knowledge in a new task buy than in a modified rebuy, and lower prior knowledge in a modified rebuy than in a straight rebuy.

Highly knowledgeable potential customers likely narrow their consideration set on the basis of detailed information about specific product attributes, and they possess the ability to ask in-depth questions about the product (Schmidt & Spreng, 1996). Therefore, the higher the potential customers' prior knowledge, the more likely they are to conduct an intensive, rather than extensive, information search through referrals. Because in horizontal referrals, referrers should know more about the industry's other supplier firms than do customers, we expect that highly knowledgeable potential customers are more likely to search for information through horizontal referrals.

The lower the potential customers' prior knowledge, the lower is their self-confidence in their knowledge and ability to take the right decision (Brucks, 1985). Because referrers help evaluate the purchase for the potential customer (Chen & Xie, 2005), the lower the potential customers' prior knowledge, the greater is the influence of referrals on their purchase decision. In summary:

P5A: The higher the potential customers' prior knowledge, the more likely they are to conduct an intensive, than an extensive, external information search through horizontal referrals.
P5B: The lower the potential customers' prior knowledge, the greater the influence of referrals on potential customers' purchase decision.

Purchase complexity. Potential customers perceive purchase complexity when the process associated with the product's use is complex or the product requires them to evaluate many attributes (Brucks, 1985; McQuiston, 1989). By evaluating the purchase for the potential customer (Chen & Xie, 2005), referrers minimize potential customers' perceived purchase complexity, increasing their influence on potential customers' purchase decision. Further, Brucks (1985) finds that the relationship between the extent of potential customers' prior knowledge and the amount of their external information search grows stronger with potential customers' perceived purchase complexity. Thus, we expect that the effect of low prior knowledge

on potential customer's external information search through referrals increases with increased purchase complexity. In summary:

P6A: The higher the purchase complexity, the higher the influence of referrals on potential customers' purchase decision.
P6B: The higher the purchase complexity, the stronger the positive effect of prior knowledge on potential customers' external information search through referrals.

Purchase involvement/importance. Potential consumers' involvement with the purchase decision reflects their perception of the purchase as personally relevant (Wangenheim & Bayón, 2007). The construct of product involvement in consumer markets is similar to the construct of purchase importance in B-to-B markets. Purchase importance is the "buyer's perception of the significance of the buying decision and/or the potential impact of the purchase on the functioning of the firm" (Bunn, 1993, p. 43).

Dowling and Staelin (1994) find that the higher the potential customers' purchase involvement, the higher their perceived risk from the purchase is. Further, Moriarty and Spekman (1984) find that personal, noncommercial information sources (such as referrers) help reduce potential customers' perceived purchase risk. Therefore, the influence of referrals on potential customers' purchase decision should increase as purchase involvement increases. Further, potential customers' lower prior knowledge also increases their perceived purchase risk (Dowling & Staelin, 1994). Thus, the lower the potential customers' prior knowledge, the greater is the effect of purchase involvement on the influence of referrals on potential customers' purchase decision. In summary:

P7A: The higher the potential customers' purchase involvement, the greater the influence of referrals on potential customers' purchase decision.
P7B: The lower the potential customers' prior knowledge, the greater the effect of purchase involvement on influence of referrals on potential customers' purchase decision.

A.2.3. Supplier Firm Characteristics

Purchase situations in which potential customers do not have previous experience with the supplier firm determine the supplier firm's capabilities to deliver the product on the basis of its reputation. The lower the reputation of the supplier firm, the higher is the potential customers' perceived uncertainty. Therefore, potential customers attempt to reduce purchase uncertainty by gathering in-depth information about the supplier firm

through intensive search (Puto, Patton, & King, 1985). In contrast, potential customers can rely on the signal of a supplier firm's good reputation to lower their perceived purchase uncertainty. Therefore:

P8A: The lower the reputation of the supplier firm, the greater the likelihood of potential customers conducting an intensive external information search through referrals.
P8B: The lower the reputation of the supplier firm, the greater the influence of referrals on potential customers' purchase decision.

A.2.4. Referral Attributes

Referral attributes, valence and intensity, affect the role of referrals in potential customers' purchase decision. As potential customers pay more attention to negative information than positive information (Fiske & Taylor, 1991), we expect that negative referrals will have a higher influence on the potential customer's purchase decision than positive referrals. Further, the referral's intensity (how strongly the referrer gives the recommendation) can send a signal to the potential customer about the referrer's strength of feelings about the supplier firm's product (Banerjee & Fudenberg, 2004). A strong signal should have a higher influence on potential customers' purchase decision than a weak signal. Therefore:

P9A: Negative referrals are likely to have a higher influence on potential customers' purchase decision than positive referrals.
P9B: The higher the referral intensity, the greater the influence of the referral on the potential customers' purchase decision.

A.2.5. Referrer Characteristics

Referrer characteristics, such as credibility and product expertise, affect the referral's influence on the potential customer's purchase decision (Fig. 3). Referrer credibility pertains to the potential customer's perception of the trustworthiness and expertise of that referrer (Sternthal, Dholakia, & Leavitt, 1978). Murray (1991) finds that credible referrals have a significant influence on purchase decisions. Referrers with high product expertise are also likely to increase the referral's influence on potential customer's purchase decision (Gilly et al., 1998a).