REFERRAL EQUITY AND REFERRAL MANAGEMENT:
ESSAYS ON THE SUPPLIER FIRM’S PERSPECTIVE OF REFERRALS

A Dissertation in
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by
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ABSTRACT

The objective of my dissertation is to view referrals from the perspective of the supplier firm. Referrals influence potential customers to purchase (or not) from a specific supplier firm (e.g., Apple Inc.). Thus, referrals affect the supplier firm’s cash flow; and, in the first essay I argue that suppliers should view referrals as assets and liabilities. I develop the concept of referral equity to capture the net effect of all referrals on a supplier’s cash flow. Further, I recognize and define three types of referrals for a supplier - customer-to-potential customer referrals, horizontal referrals, and supplier-initiated referrals - that play a critical role in a potential customer’s purchase decision by influencing the potential customer in favor of, or against, the supplier.

In the second essay, I focus on the least studied referral type: supplier-initiated referrals. In business-to-business markets, suppliers aim to influence potential customers in the supplier’s favor with a positive recommendation from a specific referrer. Using a mixed-design experiment with purchasing managers as respondents I find that if the supplier has previous experience, versus no experience, with the potential customer, homophily between the referrer and potential customer significantly increases the referrals’ influence on the potential customer. I also find that if the referrer gives an unqualified positive referral, the referral’s positive influence on the potential customer decreases by only 5%; because potential customers perceive a bias in all-positive supplier-initiated referral, which reduces the supplier-initiated referral’s influence on the potential customer.

In the third essay, I take a deeper look at the effect of referrer characteristics on the referral’s influence on the potential customer in supplier-initiated referrals. I study the relative influence of a supplier-initiated referral for a startup compared with an established firm, contingent on the referrer’s societal status. With two experimental studies, I find that the effect of referrer status on the extent to which the referral influences the potential customer is greater for a
startup versus an established firm. This result indicates that while established firms can likely trade-off referrer status for other referrer and referral message characteristics, to influence potential customers startups should focus on selecting a high status referrer in supplier-initiated referrals. I also find that the potential customer’s expectation disconfirmation concerning referrer status reduces the benefit of referrer status for an established firm more than for a startup. Therefore, to positively influence the potential customer with a supplier-initiated referral, an established firm needs to manage the potential customer’s expectations concerning referrer selection.
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“A trusted referral influences people more than the best broadcast message. A trusted referral is the Holy Grail of advertising.”

- Mark Zuckerberg, Founder and CEO, Facebook, in an interview with Rolling Stones, 2008
Chapter 1
Introduction

Referrals influence potential customers’ purchase decisions. My dissertation consists of three essays that focus on how suppliers can manage referrals to influence their potential customers in the supplier’s favor. The three essays are:

1. Referral Equity and Referral Management: The Supplier Firm’s perspective
2. Trade-offs in Supplier-Initiated Referrals
3. David vs. Goliath: Startups vs. Established Firms and the Role of Supplier-Initiated Referrals

Within the conceptual framework of how referrals influence potential customers, the three essays focus on how the supplier can better manage referrals, such that referrals influence the potential customer in favor of the supplier. In this introduction to my dissertation, I (1) provide an overview of my conceptual framework for referrals, and (2) briefly discuss the motivation and main contributions of my dissertation.

1.1. Referrals: A Conceptual Framework

Today, referrals are considered as one of the important marketing strategies for firms to grow, and retain, their business. In my dissertation, I 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). Thus, in a referral, the referrer can influence the potential customer in favor of, or against, the supplier.
Referrals have predominantly been studied (as word-of-mouth) within the conceptual framework of influence (e.g., Arndt 1967; Wangenheim and Bayón 2007). This framework of influence, specifically interpersonal influence, focuses on two dimensions of a referral, (1) the actors involved in the information exchange – the source (i.e., the referrer) and the receiver (i.e., the potential customer) and (2) the information or message transmitted – and the effect of these dimensions on the referral’s influence on the potential customer (Figure 1-1).

Figure 1-1: Influence: Conceptual Framework and Summary of Extant Research

Early marketing research in this domain focused on the relative influence of referrals on potential customers compared to traditional media such as advertising (e.g., Sheth 1971). Subsequent research has focused on the referrer’s characteristics that increase the referral’s influence on the potential customer, such as expertise (e.g., Gilly et al. 1998), homophily with potential customer (e.g., Brown and Reingen 1987), and opinion leadership (e.g., Engel and Blackwell 1982). Extant research on the effect of the referral message on the referral’s influence on the potential customer has focused on factors such as the message’s valence (e.g., Anderson
1998) and vividness (e.g., Herr, Kardes, and Kim 1991) (please see Essay 1 for an in-depth literature review).

Studying referrals from the perspective of the referrer or the perspective of the potential customer, as has been the norm in marketing literature, often leads to research questions that ignore the supplier’s role in referrals. For example, when studying the consumer as the referrer, researchers have focused on investigating why does the consumer give a referral (e.g., Engel, Kegerreis, and Blackwell 1969) and which consumers are more likely to act as referrers (e.g., Bloch and Richins 1983). And, when studying referrals from the perspective of the potential customer, researchers have focused on investigating why potential customers seek referrals (e.g., Gilly et al. 1998), and what kind of information would be most useful to the potential customer (e.g., Herr, Kardes, and Kim 1991). In my dissertation, I focus on studying referrals from the perspective of the supplier, and not the referrer or the potential customer. This shift in perspective changes the research questions that researcher would investigate; for example, researchers can focus on how the supplier can manage the referral exchange, and whether the supplier’s referral management will diminish the referral’s influence on the potential customer.

Building on the conceptual framework of influence as applied to referrals, I focus on how suppliers can benefit from the referrals that are for the supplier. I argue that suppliers should not be passive actors in the referral exchange; rather, suppliers should manage referrals such that the referrer influences the potential customer in the supplier’s favor.

In Essay 1, I put forth propositions on the role of referrals in the potential customer’s purchase decision process and the influence of the referral at each decision stage (e.g., consideration), and on how product, purchase and supplier firm characteristics affect the referral’s influence on the potential customer. Thus, I lay the foundation for the role of referrals in marketing. Building on this foundation, I model how suppliers can measure the effect of referrals with the construct of referral equity; and how suppliers can manage referrals. To manage
referrals for a net positive referral equity, the supplier needs to focus on increasing (reducing) the number of positive (negative) referrals, and increasing (reducing) the influence of positive (negative) referrals. Building on extant research on influence, I suggest specific strategies based on referrer selection and referrer incentives that suppliers can adopt to manage referrals.

I also identify three types of referrals in the market – customer-to-potential customer referrals, horizontal referrals and supplier-initiated referrals. As the supplier selects the referrer in supplier-initiated referrals, the supplier has a unique opportunity to affect the referral’s influence on the potential customer. Therefore, in Essay 2 and 3, I investigate supplier-initiated referrals influence the potential customer in business-to-business markets.

Building on extant research on influence of referrals, in Essay 2, I investigate how the supplier’s referral management – selecting a referrer in supplier-initiated referrals – affects the influence of the referral on the potential customer. I also study the effect of the referral message category, and the referrer’s reputation and homophily with potential customer, on the referral’s influence on the potential customer within the context of supplier-initiated referrals. In Essay 3, I take a deeper look at how a key referrer characteristic, referrer status, affects the referral’s influence on the potential customer, contingent on supplier reputation. The investigation of how suppliers can benefit from the way referrals influence potential customers forms the basis of my dissertation.

1.2. Motivation and Contributions

Research on referrals in marketing has spanned more than 50 years. However, the focus has largely been on the consumer engaging in customer-to-customer referrals, and how referrals influence the potential customer (e.g., Zeithaml, Berry, and Parasuraman 1993). Considering
referrals from the supplier’s perspective - how referrals benefit or harm suppliers and how suppliers should manage referrals - has been largely ignored (c.f., Godes et al. 2005).

The core contribution of my dissertation lies in viewing referrals from the perspective of the supplier. As referrals can influence the potential customer’s purchase decision, they can positively or negatively impact the supplier. Building on extant research on influence as applied to referrals, in Essay 1 I study how suppliers can manage referrals such that the referrer influences the potential customer in favor of the supplier.

Perhaps, one of the best opportunities for a supplier to manage referrals (especially in business-to-business markets) is through supplier-initiated referrals, as the supplier can select the referrer. Researchers have shown that the influence of the referral on the potential customer is dependent on the referrer (or source). Therefore, in Essay 2 and 3 I investigate how supplier-initiated referrals can benefit suppliers in the sales process in business-to-business markets. From a theoretical perspective, I add to extant research on influence by empirically studying the relative effects of referrer characteristics, contingent on the supplier characteristics, on the referral’s influence on the potential customer. I also show how the supplier’s referral management reduces the influence of the referral on the potential customer, but not by a significant amount. I also add to extant research on firm status, by viewing the effect of firm status through the conceptual framework of influence.

For suppliers, I address the problem of referrer selection in supplier-initiated referrals. As the supplier selects the referrer in supplier-initiated referrals, my research shows how suppliers should select referrers based on their own characteristics (such as, reputation), such as to maximize the influence of the supplier-initiated referral on the potential customer.

The Marketing Science Institute’s 2010-2012 research priorities emphasize that “research is required to improve methods of measuring and communicating the effectiveness of marketing strategies in the long run”; in my dissertation, referral equity provides a metric that suppliers can
use to measure the impact of referrals on the effectiveness of marketing strategies, and on the supplier’s cash flow. Moreover, the growth of online and offline communication tools which enable customers to connect with, and influence, potential customers will likely increase the role of referrals in marketing; thus, suppliers increasingly need to focus on how they can manage referrals to increase their marketing effectiveness.
Chapter 2
Referral Equity and Referral Management: The Supplier Firm’s Perspective

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).

2.1. Introduction

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. My 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.

I conceptualize referrals from the supplier firm’s perspective in three steps. First, I 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, I introduce three types of referrals: (1) customer-to-potential customer referrals, where the referrer is a customer of the supplier firm, e.g., 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, e.g., 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, I 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. I 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.

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

2.2. 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, I
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 Figure 2-1).

My 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 the market: the supplier firm (C) (Gilly et al. 1998; Spurr 1988) (Figure 2-1). Second,
the definition highlights the role of referrals in marketing: to influence potential customers to
purchase, or not, from the supplier firm.\(^1\) Third, I 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

\(^1\) 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.
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 2-1). 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 and Nantel 2004). One of the reasons customers act as referrers is to reduce post-decision dissonance, i.e., doubts about whether they took the right decision (e.g., Engel, Kegerreis, and Blackwell 1969; Richins and Bloch 1986). Other reasons customers (or noncustomers) might act as referrers include the desire to gain attention or social status from potential customers (Gatignon and Robertson 1985). Therefore, in a referral exchange, the 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 2-1).
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 2-1). 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 2-1).

Table 2-1: Exchanges between Actors in a Referral

<table>
<thead>
<tr>
<th>Actor</th>
<th>Gives (to)</th>
<th>Receives (from)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Referrer</td>
<td>Information about supplier firm</td>
<td>Social status and attention</td>
</tr>
<tr>
<td></td>
<td>(potential customer)</td>
<td>(potential customer)</td>
</tr>
<tr>
<td>Potential Customer</td>
<td>Social status and attention</td>
<td>Information related to</td>
</tr>
<tr>
<td></td>
<td>(referrer)</td>
<td>supplier firm (referrer)</td>
</tr>
<tr>
<td>Supplier Firm</td>
<td>Service/product (referrer)</td>
<td>Referral (referrer)</td>
</tr>
</tbody>
</table>

Referrals represent one of 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 and Berry 2003), supplier firms should manage referrals as part of their communication process (Chen and Xie 2008), and should recognize the different sources referrals can come from.

\(^2\) 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.
2.3. Types of Referrals

Referrals for the supplier firm can come from both customers and noncustomers; 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). I define and review literature on all three types of referrals: customer-to-potential customer referrals (§ 3.1), horizontal referrals (§ 3.2), and supplier-initiated referrals (§3.3), summarized in Table 2-2.

Table 2-2: Types of Referrals

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

2.3.1. Customer-to-Potential Customer Referrals

Consider my 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 2-2).

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 non-user 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 and Mayzlin 2006; Godes and Mayzlin 2004). Below, I review the literature on word-of-mouth pertinent to customer-to-potential customer referrals.

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 2-3).

Table 2-3: Summary of Literature on Antecedents of Customer-to-Potential Customer Referrals

<table>
<thead>
<tr>
<th>Antecedents Studied</th>
<th>Mediators/ Moderators Studied</th>
<th>Representative Papers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Satisfaction or Dissatisfaction</strong></td>
<td>Cross-cultural differences; Perceived quality; commitment; anger; affect; strength of tie, attitude towards complaining.</td>
<td>Richins (1983); Anderson (1998); Bettencourt (1997); Bitner (1990); Grace (2007).</td>
</tr>
<tr>
<td><strong>Personal Characteristics</strong></td>
<td>Motivation; size of incentive; consumer knowledge; situational factors; value of firms offerings.</td>
<td>Singh (1990); Lau and Ng (2001); Walsh, Gwinner, and Swanson (2004); Gruen, Osmonbekov, and Czaplewski (2007).</td>
</tr>
<tr>
<td><strong>Product-Related</strong></td>
<td>Hedonic or utilitarian products; satisfaction; individual characteristics.</td>
<td>Singh (1990); File, Cermak, and Prince (1994); Brady and Robertson (2001); Carroll and Ahuvia (2006).</td>
</tr>
</tbody>
</table>

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 and Lett 1977) and car dealerships (Swan and 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; i.e., 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, and Graham 1998), the referrer’s involvement with the brand (Carroll and Ahuvia
2006), and others (Table 2-3).

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. Zeithmal, 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, and Kooyman 1984), consumer
services (Murray 1991), and high-risk innovations, such as mental health services (Speer et al.
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 and 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 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 and Clopton 1993; Moriarty
and Spekman 1984), without considering customer-to-potential customer referrals.
2.3.2. 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 and Konishi 2006).

In horizontal referrals, potential customers are usually the referrer’s potential or existing customers (Row 2, Table 2-2); in my 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 2-2).

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 and 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.

The 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.

2.3.3. 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 I call this type of referral a “supplier-initiated referral”. In this referral, the supplier firm knows both the existing and the potential customer, 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 2-2).

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 and 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 I must first address how referrals influence potential customers’ purchase decision.

2.4. 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 the potential customer’s 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 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 and 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 I take this purpose into account in the discussion.

I 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 on 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.

I argue that potential customers’ external information search through referrals depends on their 1) decision stages (§ 4.1) and 2) purchase situation (§ 4.2). Here I provide the conceptual development and in the Appendix A I present illustrative propositions for the role of referrals in potential customers’ purchase decision.

2.4.1. 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\(^3\) (Figure 2-2). 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 et al. 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 referrals (Figure 2-2). 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).

\(^3\) 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.
2.4.2. 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, i.e., product characteristics, purchase situation, supplier firm characteristics, referral attributes, and referrer characteristics (Figure 2-3).

*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 lifecycle (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 and Fornell 1988). Thus, the product’s
lifecycle stage should influence the likelihood of potential customers’ information search through referrals.

Figure 2-3: Role of Referrals in Marketing: Potential Customer’s Purchase Decision

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 and 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.
Potential Customer’s Perceived Purchase Situation. The characteristics of the potential customers’ purchase situation (prior knowledge, involvement and complexity) likely influences their external information search (Dowling and Staelin 1994).

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 and 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 and Wind 1972). Therefore, Potential consumers highly involved in the purchase decision are likely to search for external information about the purchase (e.g., Celsi and Olson 1988; Hunter, Bunn, and Perreault 2006). Thus, the likelihood of information search through referrals should depend on potential customers’ purchase involvement.

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.

*Referral Attributes.* I 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 and 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 (Figure 2-3).

*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 (1998) find that the referrer’s credibility and product expertise affect the referral’s influence on potential customers’ purchase decision (Figure 2-3).

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. I argue that researchers and managers should study and assess the aggregate effect of all referrals for the supplier firm.
2.5. 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 and 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. I 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. I model the net effect of all referrals for the supplier firm as the supplier firm’s referral equity (§5.1), which I define as the present value of the difference between the supplier firm’s expected cash flow due to its referral assets (§5.2) and referral liabilities(§5.3).

2.5.1. 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, and 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. I 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 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 and 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), I 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 and 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, I consider negative referrals an intangible liability of the supplier firm.

I 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.

I express referral equity of supplier firm j as,

\[ \text{Referral Equity}_j = (\text{Referral Assets})_j - (\text{Referral Liabilities})_j. \]

2.5.2 Referral Assets

I define referral assets as the present value of the supplier firm’s positive cash flow due to referrals for the supplier firm,

\[ \text{Referral Assets}_j = \text{PV}_t (\Delta_+\text{REF}[E(\text{Sale}_j)], \Delta_+\text{REF}[\text{Marketing Costs}_j]). \]

where,

\( \text{PV}_t \) is the present value of cash flow at time \( t \),
\( E(\text{Sale}_j) \) is the monetary value of supplier firm j’s expected sales,
\( \text{Marketing Costs} \) is the supplier firm j’s marketing expenditure, and
\( \Delta_+\text{REF} [.] \) is 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 I am elaborating on referral assets, I 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.

**Effect of Positive Referrals on Expected Sales**

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

\[ E(\text{Sale}_{ij}) = L(\text{Purchase by Customer}_{ij}) \times \text{Sale Value}_{ij}. \]
where, 

$L(Purchase\ by\ Customer_{ij})$ is the likelihood that customer i will purchase from supplier firm j, and 

$Sale\ Value_{ij}$ is the monetary value of the sale (e.g., in US$) the supplier firm j expects to earn from customer i.

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. I isolate the effect of positive referrals on supplier firm j’s expected sale to customer i:

\[
\Delta_{+REF}[E(Sale_{ij})] = \Delta_{+REF}[L(Purchase\ by\ Customer_{ij})] \times Sale\ Value_{ij},
\]

where,

$\Delta_{+REF}[L(Purchase\ by\ Customer_{ij})]$ 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). I 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:

\[
\Delta_{+REF}[L(Purchase\ by\ Potential\ Customer_{ij})] = f_1(Positive\ Referrals\ Received_{ij}),
\]

where,

$\Delta_{+REF}[L(Purchase\ by\ Potential\ Customer_{ij})]$ 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 I 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,

\[ \Delta_{\text{REF}} [L(\text{Purchase by Existing Customer}_{ij})] = f_i (\text{Positive Referral Behavior}_{ij}), \]

where,

\[ \Delta_{\text{REF}} [L(\text{Purchase by Existing Customer}_{ij})] \] is the increase in existing customer i’s likelihood of purchase from supplier firm j due to positive referrals, and

Positive Referral Behavior\textsubscript{ij} indicates that customer i gives positive referral(s) for supplier firm j.

**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, and 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, I can express reduced marketing costs due to positive referrals that contribute to the supplier firm’s referral assets (Equation 2) as:

\[ \Delta_{\text{REF}} [\text{Marketing Costs}_j] = \sum_i (\Delta_{\text{REF}} [\text{Reduction in Customer Acquisition costs}_{ij}]) + \Delta_{\text{REF}} [\text{Reduction in Customer Retention costs}_{ij})], \]
where,

\[ \sum \] indicates the summation over all customers \( i \) from 1, \( \ldots \), \( n \),

\( \Delta_{+\text{REF}} \) [Reduction in Customer Acquisition Costs] is the reduction in costs for acquiring potential customer \( i \) due to positive referrals received for supplier firm \( j \), and

\( \Delta_{+\text{REF}} \) [Reduction in Customer Retention Costs] is the reduction in costs for retaining existing customer \( i \) due to positive referrals given for supplier firm \( j \).

Substituting Equations 4 and 7 into Equation 2, I have:

\[
\text{Referral Assets}_j = PV_t \left( \sum_i (\Delta_{+\text{REF}}[L(\text{Purchase by Customer}_{ij})] \times \text{Sale Value}_{ij}) \sum_i (\Delta_{-\text{REF}}[\text{Reduction in Customer Acquisition costs}] + \Delta_{+\text{REF}}[\text{Reduction in Customer Retention costs}_{ij}]) \right)
\]

**2.5.3. Referral Liabilities**

I define referral liabilities as the present value of the supplier firm’s negative cash flow due to referrals for the supplier firm,

\[
\text{Referral Liabilities}_j = PV_t (\Delta_{-\text{REF}}[E(\text{Sale}_j)], \Delta_{\text{REF}}[\text{Marketing Costs}_j]),
\]

where,

\( \Delta_{-\text{REF}}[.] \) 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

\( \Delta_{\text{REF}}[.] \) is 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 I am elaborating on referral liabilities, I account for the *reduction* in supplier firm’s cash flow due to referrals. Therefore, \( \Delta_{\text{REF}}[E(\text{Sale}_j)] \) accounts for the *reduction* in supplier firm
j’s expected sales due to negative referrals, and \( \Delta_{\text{REF}} \) [Marketing Costs,] accounts for the increase in supplier firm j’s marketing expenditures due to positive or negative referrals.

**Effect of Negative Referrals on Expected Sales**

From Equation 3, I 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:

\[
\Delta_{\text{REF}}[E(Sale_{ij})] = \Delta_{\text{REF}}[L(Purchase by Customer_{ij})] \times \text{Sale Value}_{ij},
\]

where,

\( \Delta_{\text{REF}}[L(Purchase by Customer_{ij})] \) 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). I 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:

\[
\Delta_{\text{REF}}[L(Purchase by Potential Customer_{ij})] = f_1(\text{Negative Referrals Received}_{ij}),
\]

where,

\( \Delta_{\text{REF}}[L(Purchase by Potential Customer_{ij})] \) 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. Lacizniak, 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 referrals. As the base level, I 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:

$$
\Delta_{\text{REF}} [L(\text{Purchase by Existing Customer}_{ij})] = f_i (\text{Negative Referral Behavior}_{ij}),
$$

where,

$$
\Delta_{\text{REF}} [L(\text{Purchase by Existing Customer}_{ij})] \text{ is the reduction in existing customer } i \text{'s likelihood of purchase from supplier firm } j \text{ due to negative referrals, and}
$$

Negative Referral Behavior$_{ij}$ indicates customer $i$ giving negative referrals for supplier firm $j$.

**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 and 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 non-customers 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. I express the increased marketing costs due to referrals, which contribute to the supplier firm’s referral liabilities (Equation 3), as:

\[
\Delta_{REF} \text{[Marketing Costs]}_j = \sum_i (\Delta_{REF} \text{[Increase in Customer Acquisition Costs]}_ij + \Delta_{REF} \text{[Increase in Customer Retention Costs]}_ij + \Delta_{REF} \text{[Increase in CRM Costs]}_j + \text{(Referral Program Costs)}_j),
\]

where,

\(\Delta_{REF} \text{[Increase in Customer Acquisition Costs]}_ij\) is the increase in costs for acquiring potential customer \(i\) due to negative referrals received for supplier firm \(j\),

\(\Delta_{REF} \text{[Increase in Customer Retention Costs]}_ij\) is the increase in costs for retaining existing customer \(i\) due to negative referrals given for supplier firm \(j\),

\(\Delta_{REF} \text{[Increase in CRM Costs]}_j\) is supplier firm \(j\)’s increase in expenditure on customer relationship management due to positive or negative referrals or both, and

\(\text{Referral Program Costs}_j\) is supplier firm \(j\)’s expenditures on referral programs.
Substituting Equations 10 and 13 into Equation 9, I have:

\[
(14) \quad \text{Referral Liabilities}_j = PV_t (\sum_i (\Delta_{\text{REF}}[L(\text{Purchase by Customer}_i)]) \times \text{Sale Value}_{ij}),
\]

\[
\sum_i (\Delta_{\text{REF}}[\text{Increase in Customer Acquisition costs}] + \Delta_{\text{REF}}[\text{Increase in Customer Retention Costs}_{ij}]) + PV_t (\Delta_{\text{REF}}[\text{Increase in Customer Relationship Management costs}_j], \text{Referral program costs}_j).
\]

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

2.6. 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. (Patty Morrison, former CIO at Motorola, 2009)

Patty 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 the framework for building referral equity, I 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. I 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 (Figure 2-4). I propose three pillars of referral management as the means to achieve these objectives (Figure 2-4):

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

![Building Referral Equity Diagram]

Figure 2-4: Pillars of Referral Management

2.6.1. Referral Management through CRM Processes

Customer relationship management processes aim to achieve and maintain an ongoing relationship with customers (Payne and 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. I 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) (Figure 2-5).

Figure 2-5: Referral Management through Customer Relationship Management: Left Pillar (Figure 2-4).

Customer Service and After-Sales Support

Customers can contact a supplier firm for multiple reasons, such as inquiries about a product’s use, 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 and Narayandas 2001). Goodman and colleagues (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 and 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. 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 (2004), 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 (Figure 2-4). 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.

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)

find that loyalty and retention programs strengthen customers’ satisfaction and affect their word-of-mouth behavior. Therefore, I 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, and 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.

2.6.2. 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; I note the potential of nonmonetary (§ 6.2.1) and monetary (§ 6.2.2) incentives, for both customers and noncustomers (Figure 2-6).

Nonmonetary Incentives

The customer’s decision to refer a supplier firm or not depends on the perceived costs and benefits of the referral exchange. I 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 noncustomers together in a “network of referrers.”

Second, to manage negative horizontal referrals, supplier firms can rely on reciprocation norms.

Enhanced Social Status, and access to Information and Network:

“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 and 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 and 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 and 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. I 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 I 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 Figure 2-7). 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 Figure 2-7) (Mailath and 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.
Figure 2-6: Referral Management through Incentives to Referrer: Middle Pillar (Figure 4)
Figure 2-7: Demonstration of Reciprocation Norms as a Referral Management Strategy with a Prisoner's Delimma Game

**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 2-1). 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 and 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) (Figure 2-6).

**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 increase.

Another means to increase the effectiveness of referral reward programs comes from Biyalgorsky, 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 to (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 and 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.
2.6.3. Referral Management through Referrer Selection

“Identify the referrers who bring in the most referrals. Then capitalize on that knowledge.” (Kumar, Petersen, and Leone 2007).

Kumar, Petersen and Leone (2007) find that a supplier firm’s most loyal customers are not necessarily the customers who are likely to give positive referrals for the 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 (Figure 2-8).

Researchers suggest two types of customers who fit these criteria: opinion leaders and early adopters⁴ (Engel and 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 and Richins 1983). Early adopters are customers who have purchased the product in the early stages of its product lifecycle, and then actively diffuse information about their new products through product-related conversations (Engel, Kegerreis, and Blackwell 1969). Because potential customers perceive purchase uncertainty in the early stages of the product’s lifecycle, 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 (Figure 2-8).

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 (Figure 2-8). Gilly and colleagues (1998) find that referrals influence potential customers’

⁴ Fieck and Price (1987) also identify “market mavens,” i.e., 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.
purchasing decision when potential customers perceive referrers as similar to themselves. Kumar, Petersen, and Leone (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.

Figure 2-8: Referral Management through Referral Selection: Right Pillar (Figure 4)

Thus, supplier firms can build referral equity through referral management programs. Before supplier firms implement referral management programs, I 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,
Petersen, and Leone 2007). For supplier-initiated referrals, Kumar, Petersen, and Leone (2009) suggest using the business reference value (BRV) of a referrer, i.e., 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 Figure 2-4).

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, I 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.
Chapter 3

Trade-offs in Supplier-Initiated Referrals

3.1 Introduction

A referenceable customer is one of a company’s most valuable assets. Yet, too often, these assets are poorly managed and underutilized…. Are you certain that you always match the right reference to the right request?
—Boulder Logic (2006, p. 2)

As a customer acquisition strategy, suppliers in business to business (B2B) markets often rely on reference customers (or referrers) to give positive referrals to potential customers. The business press has noted the prevalence of this practice: “today it is virtually impossible to find a company that does not have its extensive reference customer program, often global in scope” (Steiner 2010, p.1). As Boulder Logic’s whitepaper emphasizes, the selection of the referrer is an important and nontrivial concern that is not well understood by practitioners or researchers.

Consider SAS Inc., which supplies complex, often customized business analytics solutions to a wide range of B2B customers, including the U.S. government and Citigroup. The complexity of the solutions creates uncertainty for SAS’s potential customers; to help reduce this uncertainty, SAS often asks its’ existing customers to be referrers, and give a referral to potential customers. In this case, the supplier has initiated a referral for itself - which I refer to as a supplier-initiated referral (Hada, Grewal, and Lilien 2010) - to influence the potential customer in favor of the supplier.

To exert the most influence, suppliers hope for a “star referrer” – a referrer that will always provide an excellent evaluation of the supplier, is highly reputed, and matches well with
the potential customer. However, this star referrer likely does not exist for most potential customers. In complex B2B solutions, for example, customers often face implementation and customization challenges, so a well-matched referrer might not give an unqualified excellent evaluation. A highly reputed referrer also might not match the potential customer’s demographics or needs; especially if the potential customer is a startup, in which case the supplier might select either a highly reputed referrer (e.g., IBM) or a well-matched referrer (e.g., another startup of the same size). Accordingly, the supplier must trade off across selection criteria to choose the right referrer for a potential customer. I investigate these trade-offs to determine how a supplier can maximize the benefit gained from a supplier-initiated referral.

To do so, I build on the message and source communication framework (e.g., Wilson and Sherrill 1993). I model the referral message as referral message category (i.e., an all-positive referral or a balanced referral) and referrer (source) characteristics as referrer reputation and referrer-potential customer homophily (e.g., Gilly et al 1998, Wangenheim and Bayon 2007). The dependent variable is potential customers’ evaluation of the supplier. Furthermore, I build on research on biased communication (e.g., Gunter and Schmitt 2006), to investigate how potential customers’ perception of bias in a referral can mediate the effect of the referral message category on potential customers’ supplier evaluation. I also examine the effect of referrer characteristics on potential customers’ supplier evaluation, contingent on whether the potential customer has previous experience with the supplier (insupplier) or not (outsupplier).

To study the trade-offs associated with referrer selection, I used a mixed design experiment with 453 responses from 115 purchasing managers. With the star referrer (i.e., highly reputed, well-matched, excellent evaluation) as a benchmark, I find that if the referrer provides a referral that contains some negative information in an overall positive assessment (i.e., a balanced referral), potential customers’ evaluation of the supplier diminishes by only 5%. Therefore, even
if a referrer is unlikely to give an unqualified positive referral, the supplier can trade off and select one that is likely to provide a balanced referral.

The supplier also may need to make trade-offs in referrer characteristics; this trade-off depends on whether the supplier is an insupplier or an outsupplier. My results show that it is more important for an insupplier than for an outsupplier to select a referrer that is well-matched, or similar, to the potential customer. If an insupplier selects a referrer with the same needs (versus dissimilar needs) as the potential customer, the potential customer’s supplier evaluation improves by 32%. However, for an outsupplier, a referrer with the same needs improves potential customers’ supplier evaluation by only 15%, compared with a referrer with dissimilar needs.

I develop my conceptual framework and research hypotheses in the next section. Then I test the hypotheses with data from a mixed-design experiment using purchasing managers in the electronics industry as respondents. After I specify the multilevel model, estimation approach, and the associated results, I discuss the theoretical and managerial implications of my study for referrals and organizational buying behavior.

3.2. Theoretical Development

As the literature on referrals in B2B firms is sparse, I conducted initial interviews with managers to ground my research in practice. I present an overview of these interviews here; then, I detail my conceptual framework and hypotheses.

3.2.1. Pre-Study Interviews

I conducted 15 pre-study interviews – with eight suppliers and seven potential customers (see Appendix B for interview procedure and quotes). In my interviews with the suppliers, I
focused on: (1) the use of supplier-initiated referrals in the sales process, (2) the circumstances in which where supplier-initiated referrals provide the most benefit, and (3) the criteria used to select referrers. For the potential customer interviews, I focused on (1) the use of supplier-initiated referrals in the purchasing process, and (2) the referrer characteristics that influence potential customers in favor of the supplier.

The interviews underscored the trade-offs that suppliers make with regard to supplier-initiated referrals. One supplier recognized that for some potential customers, a well-matched referrer would always be a direct competitor and thus inaccessible. Furthermore, the interviews revealed trade-offs pertaining to the referral message category and the role of perceived bias. A potential customer considered the presence of only positive information in the referral “suspicious,” but another believed any negative information would be “unacceptable.”

3.2.2. Conceptual Framework and Hypotheses

In supplier-initiated referrals, the supplier requests a referrer (existing customer) to give a referral to a potential customer. The supplier benefits when the referrer influences the potential customer in favor of the supplier. Extant research confirms that the influence of information depends on the message and the source (e.g., Darke, Ashworth, and Ritchie 2008; Wilson and Sherrell 1993), so I study how the referral content (i.e., message) and the referrer (i.e., source) characteristics influence the potential customer.

From the supplier’s perspective, a supplier-initiated referral is beneficial if it influences the potential customer in favor of the supplier and improves the potential customer’s evaluation of that supplier. Therefore, I consider potential customers’ evaluation of the supplier as the key dependent variable (Figure 3-1).
Figure 3-1: A Model of Supplier-Initiated Referral's Influence on Potential Customers' Supplier Evaluation: Referrer Characteristics and Referral Message
I model referral message with referral message category. In general, the referral message can be positive or negative in valence (Hada, Grewal, and Lilien 2010). However, in supplier-initiated referrals, it is unlikely that the supplier would select a referrer who might give an overall negative referral. Therefore, I study the effect of an all-positive referral, in which the referral message contains only positive information about the supplier (e.g., “we are delighted with the supplier”), versus a balanced referral, in which the referral message contains some negative information in an overall positive referral (e.g., “we are highly satisfied with the supplier, but their support was slow”). Because potential customers are aware of the supplier’s preference to select a satisfied customer as a referrer, they likely perceive the referral as biased. Building on research on biased communication (e.g., D’Alessio and Allen 2000) and the effects of negative information (e.g., Skowronski and Carlston 1989), I study how potential customers’ perceived bias mediates the effect of the referral message category on potential customers’ supplier evaluation (Figure 3-1).

To influence the potential customer in favor of the supplier, the referrer (i.e., the source) should be credible and provide information relevant to the customer’s purchase situation. Building on word-of-mouth literature (e.g., Gilly et al. 1998; Wangenheim and Bayón 2007), I study referrer characteristics with referrer reputation and referrer-potential customer homophily (demographic homophily and needs similarity). The referrer’s corporate reputation captures the referrer’s credibility (e.g., Lafferty and Goldsmith 1999), and referrer–potential customer homophily captures the extent to which the information in the referral is relevant to the potential customer’s purchasing situation (e.g., Brown and Reingen 1987).

Research on organizational buying behavior informs us that potential customers experience purchase uncertainty due to both, factors endogenous to the purchase situation (purchase novelty, complexity, and importance) (e.g., McQuiston 1989; Heide and Weiss 1995), and the potential customer’s familiarity or experience with the supplier (e.g., Li et al. 2006; Puto,
Patton, and King 1985). Because the supplier’s purpose is to influence the potential customer in favor of the supplier, I focus on the supplier-specific source of uncertainty and study the effect of referrer characteristics, contingent on whether the potential customer has previous experience with the supplier. For this research, I define a supplier with which the potential customer has previous experience as an insupplier and one with which the potential customer has no previous experience as an outsupplier (Figure 3-1).

I now develop the hypotheses. Hypotheses H1 and H2 posit the effect of referral message category on potential customers’ supplier evaluation. As the main effects of referrer reputation and referrer-potential customer homophily are established in extant research, I do not present formal hypotheses for the main effects; hypotheses H3, H4A and H4B posit the effect of referrer characteristics on potential customers’ supplier evaluation contingent on supplier status (insupplier or outsupplier); I depict the conceptual model in Figure 3-1.

**Referral Message Category**

I posit that the referral message category has an indirect effect on potential customers’ supplier evaluation through potential customers’ perceived bias, as well as a direct effect on potential customers’ supplier evaluation (Figure 3-1). As the supplier selects the referrer, the role of perceived bias is important as the potential customer is likely to perceive that the referrer’s information favors the supplier.

The influence of a supplier-initiated referral likely depends on the customer’s perception of the referral’s objectivity (e.g., Price and Feick 1984). If the potential customer perceives that the referral is biased in favor of the supplier, attribution theory suggests a discounting effect regarding the influence of the referral (e.g., Kelley 1973; Mayzlin 2006). Therefore, potential
customers’ perceived bias in the referral should have a negative effect on potential customers’ supplier evaluation.

The referral message category likely influences this perception of bias in the supplier-initiated referral. For example, the presentation of both pros and cons of an issue can reduce perceptions of bias in news reporting (e.g., D’Alessio and Allen 2000). Pechmann (1992) also finds that advertising messages that include negative information increase customers’ perceptions of the honesty of the source. Similarly, a referrer can reduce the potential customer’s perceived bias by addressing not only the positive, but also the negative, aspects of the supplier’s solution, that is, by giving a balanced referral. Therefore, I hypothesize,

**H1**: A balanced referral reduces potential customers’ perceived bias more than an all-positive referral.

A balanced referral, relative to an all-positive referral, also might have a direct positive effect on the potential customer’s supplier evaluation. As Calvert (1985) finds in a political decision-making context, when a biased advisor gives a recommendation opposite to the advisor’s known bias, the recommendation exerts more influence on the decision maker, than a recommendation that is expected. Research on two-sided advertising messages also suggests that as the negative information in supplier-initiated referrals is unexpected, potential customers likely pay more attention to the message in a balanced referral than they would to an all-positive referral (e.g., Crowley and Hoyer 1994; Eisend 2006b). As a balanced referral includes positive information, it likely has a higher positive effect on the potential customer’s supplier evaluation than an all-positive referral. Thus, this stream of research suggests that suppliers benefit directly from a balanced referral, compared with an all-positive referral.

However, an alternate research stream argues that potential customers weigh negative information more than positive information (e.g., Fiske and Taylor 1991). Negative information enables potential customers to categorize a supplier as low quality, more easily than positive
information enables them to categorize a supplier as high quality (e.g., Herr, Kardes, and Kim 1991). An all-positive referral also communicates that the referrer’s evaluation of the supplier is unequivocally positive, which should reduce potential customers’ uncertainty about the supplier’s capabilities. Thus, this stream of research suggests that suppliers benefit more from an all-positive referral than from a balanced referral.

In supplier-initiated referrals though, the effect of the referral message category likely depends on the potential customer’s attribution of the negative information. For example, in advertising, the supplier is also the message source, so the supplier benefits from customer perceptions of source honesty (e.g., Pechmann 1992). However, in supplier-initiated referrals, the supplier and the message source are distinct entities. Therefore, on receiving a balanced referral, the potential customer may attribute honesty to the referrer (which may reduce perceived bias) but negative information to the supplier (e.g., Kanouse and Hanson Jr 1972; Sen and Lerman 2007); which would diminish the potential customer’s supplier evaluation. Therefore, I present the following hypothesis for the total effect of referral message category on potential customers’ supplier evaluation:

\[ H2: \text{ A balanced referral has a negative effect on potential customers’ supplier evaluation, compared with an all-positive referral.} \]

**Supplier Status and Referrer Characteristics**

When negative outcomes are possible or uncertainty is high, potential customers perceive risk in their purchase decision. For an insupplier, because the potential customer has previous experience with the supplier, risk perceptions should be lower than for an outsupplier. The potential customer, perceiving this lower risk for the insupplier, is likely more concerned with the insupplier’s performance than with the likelihood of failure (e.g., Gürhan-Canli and Batra 2004).
Conversely, because the potential customer perceives higher risk for an outsupplier, issues of the outsupplier’s quality and reliability may be more salient than the outsupplier’s performance. Considering that the purpose of supplier-initiated referrals is to lower uncertainty and perceived risk for potential customers, I expect that the influence of referrer characteristics on potential customers’ supplier evaluation depends on the supplier’s insupplier/outsupplier status. Thus, I investigate the influence of referrer reputation and referrer-potential customer homophily on potential customers’ supplier evaluation contingent on supplier status.

Referrer Reputation. Referrer credibility is vital for supplier-initiated referrals to influence potential customers (e.g., Eisend 2006a; Harmon and Coney 1982). Lafferty and Goldsmith (1999) emphasize that for a firm, corporate reputation constitutes source credibility. I conceptualize referrer reputation as the referrer’s expertise in the product domain and image in the industry (e.g., Gürhan-Canli and Batra 2004).

Potential customers enter into relationships with suppliers when they believe the suppliers can deliver a solution effectively and reliably. Research on firm status further suggests that the potential customer likely trusts that a reputed firm can discern the capability or quality of the supplier (e.g., Stuart and Podolny 1995). Thus referrer reputation can signal the quality and reliability of the supplier’s capabilities; a reputed referrer then should reduce the potential customer’s uncertainty about the supplier’s capabilities. In line with extant literature, I expect referrer reputation to have a positive effect on the potential customer’s supplier evaluation.

Furthermore, when potential customers lack any experience to evaluate a supplier’s quality and reliability (i.e., for an outsupplier), they likely rely more on external signals such as referrer reputation (e.g., Stuart, Hoang, and Hybels 1999). That is, potential customers likely rely on referrer reputation more to evaluate an outsupplier than an insupplier. A referral from a highly reputed firm also sends a signal about the supplier’s quality and reliability, which should reduce the potential customer’s risk perceptions. As the potential customer perceives higher failure risk
for an outsupplier than an insupplier, so referrer reputation should have a stronger positive effect on potential customers’ supplier evaluation for outsuppliers than for insuppliers. Therefore, I hypothesize,

**H3:** The positive effect of referrer reputation on potential customers’ supplier evaluations is greater for an outsupplier than for an insupplier.

**Referrer–Potential Customer Homophily.** In line with research into the effects of homophily in referral behavior (e.g., Brown and Reingen 1987; Wangenheim and Bayón 2007), I consider two aspects of referrer–potential customer homophily: demographic homophily (e.g., industry, size) and needs similarity.

Price and Feick (1984) suggest that homophily facilitates the flow of information because it increases the ease of communication. Sales research also notes that demographic homophily enhances communication and increases the influence of one entity on the other (e.g., Lichtenthal and Teliefsen 2001). Furthermore, referrals are considered to be particularly useful to potential customers because referrers can describe and evaluate the solution from a customer’s perspective (e.g., usage situation instead of technical specifications) (e.g., Chen and Xie 2008). Solutions in B2B markets also often require customization to solve a specific customer’s problems (e.g., Tuli, Kohli, and Bharadwaj 2007); so, higher referrer-potential customer homophily increases the likelihood that the referral is relevant to the potential customer’s purchase situation, which can reduce uncertainty. Recent research has also shown that increased similarity between referrers and potential customers in B2B markets has a positive influence on the potential customer (Kumar, Petersen, and Leone 2011). Therefore, I expect referrer-potential customer demographic homophily and needs similarity to have a positive effect on potential customers’ supplier evaluation.

However, if the potential customer has previous experience with the supplier, i.e., in the case of an insupplier, the potential customer is likely concerned more about the insupplier’s
performance rather than its reliability. A referral from a similar referrer likely helps reduce potential customers’ uncertainty about the supplier’s capabilities to cater to its specific needs and to provide a well-performing solution. Because for an insupplier, the potential customer perceives risk related to performance (e.g., Gürhan-Canli and Batra 2004), referrer-potential customer demographic homophily and needs similarity should have a stronger positive effect on potential customers’ supplier evaluation for an insupplier than for an outsupplier. Therefore, I hypothesize, 

\[ H4: \text{ The positive effect of referrer–potential customer (A) demographic homophily and (B) needs similarity on potential customers’ supplier evaluations is greater for an insupplier than for an outsupplier. } \]

### 3.3. Methodology

#### 3.3.1. Empirical Context

Supplier-initiated referrals are an important part of the purchase process when the supplier’s solution is complex, customized to each customer’s needs, and lacks directly observable benefits prior to purchase. In such circumstances, potential customers seek additional information from existing customers to reduce uncertainty about the supplier’s capabilities. Therefore, to test the hypotheses, we require a purchasing situation in which (1) the solution is complex, (2) customers have varying needs related to the same solution, and (3) suppliers and potential customers use supplier-initiated referrals. The potential purchase of an enterprise resource planning (ERP) solution context satisfies these criteria. First, the solution is complex (Verville and Halingten 2003). Second, ERP solutions are customized to fit each customer’s unique needs; for example, SAP’s solution is used from creating electronic bill payment systems to standardizing global human resources programs, depending on the customer’s needs (SAP
Third, supplier-initiated referrals are common in ERP sales processes (IQMS 2007). Therefore, the empirical context refers to the purchase of an ERP solution in the networking, telecommunication, and electronics industry (standard industrial classification code 360). As the purpose is to assess the influence of the supplier-initiated referral on the potential customer in a purchase situation, I chose purchasing vice presidents and managers who are members of the Institute for Supply Management™ as the key respondents.

3.3.2. Design Details

To study the influence of supplier-initiated referrals, I must account for multiple information sources that potential customers use to evaluate the supplier (Bunn and Clopton 1993). To estimate the effect of the referral message category, I also must control for referral message. To achieve these specific requirements, I choose an experimental method that features hypothetical buying scenarios which the purchasing manager informants evaluate. As I predict moderating effects, I adopt a mixed design experiment. The experiment thus enables us to establish a causal relationship between the supplier-initiated referral and the potential customer’s supplier evaluation.

In the mixed design experiment, I manipulate the moderating supplier status (insupplier versus outsupplier) factor as a between-subjects design, such that each respondent gets one or the other supplier condition. I manipulate the within-subjects factors (referral message category, referrer’s reputation, demographic homophily, and needs similarity) in a format similar to a conjoint task (Smith, Bolton, and Wagner 1999), as I detail in Table 3-1.

To test for the effect of referral message category, I need two levels of the factor: a balanced referral and an all-positive referral. As an all-positive referral can vary in intensity of positive information, I can have two levels of intensity: a “good” referral (medium intensity) and
an “excellent” referral (high intensity.) I thereby model referral message category at three levels: balanced, good, and excellent (where ‘good’ and ‘excellent’ are all-positive referrals).

Table 3-1: Mixed-design experiment: Trade-offs in supplier-initiated referrals

<table>
<thead>
<tr>
<th>Supplier’s Experience with Potential Customer: Supplier Status</th>
<th>Insupplier</th>
<th>Outsupplier</th>
</tr>
</thead>
<tbody>
<tr>
<td>Referral message category (three levels)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Referrer’s reputation (two levels)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Referrer–potential customer needs similarity (two levels)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Referrer–potential customer demographic homophily (two levels)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

For referrer reputation, I consider two levels, medium and high, because no supplier is likely to select a referrer with a poor reputation. I manipulate referrer reputation according to its expertise (i.e., number of years the referrer has been in business and its market share in the product domain; Goldberg and Hartwick 1990) and corporate image (as viewed by peer and customer firms in the industry; Gürhan-Canli and Batra 2004).

I also manipulate demographic homophily at two levels, depending on whether the referrer’s size, in terms of annual sales, is greater than the potential customer’s (low) or the same as the potential customer’s (high). I similarly manipulate needs similarity as either different needs (low) or identical needs (high).

With these numerous factors and levels, a full-factorial design (3^12^3) with purchasing managers as respondents becomes intractable. Therefore, I employed a full-profile fractional factorial design, which demands an orthogonal design (so that the parameter estimates are

---

5 For low homophily, there are two options: The size of the referrer firm could be smaller or larger than the size of the potential customer firm. In our interviews, we found that suppliers tend to select referrers that are larger than the potential customer (according to one respondent, if a solution works for a bigger firm, it should work for a smaller firm, because ERP installation is more difficult at a larger scale). Therefore, we test only for a larger (low condition) versus same size (high condition) referrer.
uncorrelated), balanced (so that each level occurs equally often within each factor), and efficient 
(e.g., Kuhfeld, Tobias, and Garratt 1994). Considering the number of factors, the minimum 
number of profiles needed for a balanced, orthogonal and efficient design is 12 (a profile is one 
combination of the within-subject factors). However, 12 profiles is a lot for one purchasing 
manager to evaluate, so I split the design into three blocks of four profiles each, using a blocking 
factor that is not significantly correlated with the manipulated factors (e.g., Kuhfeld 2005). 
Details of this design are given in Table 3-2. Thus, one manager receives four profiles as a set to 
evaluate. Each set reflects the between-subjects manipulation for insupplier/outsupplier status, so 
I have six sets (three blocks \( \times \) two between-subject factors) of four profiles each. To control for 
order effects, I develop an additional version of each of the six sets by counterbalancing the order 
of the profiles. Thus, I have 12 sets, which I randomly assign to respondents.

Table 3-2: Experimental Design for Within-Subjects Factors: Full-profile Fractional Factorial, 
Orthogonal, Balanced and Efficient Design

<table>
<thead>
<tr>
<th>Block</th>
<th>Profile</th>
<th>Referral Message Category</th>
<th>Referrer Reputation</th>
<th>Referrer-Potential Demographic Homophily</th>
<th>Referrer-Potential Needs Similarity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1</td>
<td>Good</td>
<td>Low</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>Balanced</td>
<td>High</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>Excellent</td>
<td>High</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>Excellent</td>
<td>Low</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>2</td>
<td>5</td>
<td>Good</td>
<td>High</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td></td>
<td>6</td>
<td>Good</td>
<td>Low</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td></td>
<td>7</td>
<td>Balanced</td>
<td>High</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td></td>
<td>8</td>
<td>Excellent</td>
<td>Low</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>3</td>
<td>9</td>
<td>Balanced</td>
<td>Low</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td></td>
<td>10</td>
<td>Good</td>
<td>High</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td></td>
<td>11</td>
<td>Excellent</td>
<td>Low</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td></td>
<td>12</td>
<td>Excellent</td>
<td>Low</td>
<td>High</td>
<td>Low</td>
</tr>
</tbody>
</table>

**Questionnaire Structure.** The stimulus consists of three sections (see Appendix B). In the 
first section, I establish the purchase scenario by specifying that the respondent is a purchasing 
manager for the potential customer, evaluating ERP solutions. The purchase is new and important
for the potential customer; and the next step in the purchasing process is to create a shortlist for suppliers for an in-depth evaluation. To aid this decision the purchasing manager has asked the suppliers to provide a key reference customer to interview. In the second section, I present the manipulated profiles, one at a time. For each profile, the respondents provide responses regarding their perceived bias in the referral and supplier evaluation (a sample profile appears in Appendix B). In the third section, I include manipulation checks for the purchase scenario (importance, complexity, and scenario realism) and measure the respondents’ experience and involvement in similar purchasing processes.

**Dependent Variable.** Gunther and Schmitt (2006) emphasize that perceived bias consists of source trustworthiness, content balance, and information accuracy. I develop a three-item measure and ask respondents whether they perceived that the referrer (1) withheld negative information about the supplier, (2) gave only positive information about the supplier, and (3) was untruthful about the supplier.

To ensure my measure aligns with my purchase scenario, I assess the potential customer's supplier evaluation according to the likelihood of advancing the supplier to the next stage in the purchase process (see Appendix B). I measure this supplier evaluation with a two-item measure, and a one-item categorical measure (yes/no); I measure potential customers’ confidence in their supplier evaluation with a question that reads “how confident are you about your evaluation concerning the supplier”.

### 3.3.3. First Pretest: Assessing Manipulations

As the first step in the data collection, I assessed the manipulations in a pretest, so that I could keep the stimuli realistic and the length of the stimuli suitable for managers, without creating demand effects. I chose students in MBA and executive MBA programs in a business
school as the sample, because they likely have sufficient experience to assess the stimuli. I administered the stimuli to 150 students and received 43 responses; 22 responses were complete and usable (see Table 3-3 for manipulation details). I present the manipulation check results, where “M” indicates “mean”.

As expected, respondents perceived that an excellent referral indicated higher referrer satisfaction than a balanced or a good referral (M_{excellent} = 6.1, M_{balanced} = 5.0, M_{good} = 5.0, p < .01), whereas a balanced referral was more negative in valence than a good or an excellent referral (M_{balanced} = 4.95, M_{good} = 5.42, M_{excellent} = 5.75, p < .1). Respondents also rated the potential customers’ experience with an insupplier significantly higher than that for an outsupplier (M_{high} = 5.85, M_{low} = 1.76, t_{20} = 7.6, p < .01).

We assess the manipulations for referrer reputation on three dimensions: (1) expertise (M_{high} = 5.71, M_{low} = 4.28, t_{20} = 3.2, p < .01), (2) trustworthiness (M_{high} = 5.76, M_{low} = 4.57, t_{20} = 4.67, p < .01), and (3) corporate image (M_{high} = 6.42, M_{low} = 4.61, t_{20} = 7.38, p < .01). The manipulations for referrer reputation are successful, as are the manipulations for low versus high demographic homophily (M_{high} = 4.71, M_{low} = 2.95, t_{20} = 3.89, p < .01) and low versus high needs similarity (M_{high} = 4.57, M_{low} = 2.9, t_{20} = 2.71, p < .01).

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6 The sample for our manipulation checks did not come from the same population as our respondents for the data collection, so we consider the differences across the two samples, using the common item pertaining to the stimuli’s realism. We find no significant differences in the ratings of the stimuli’s realism (M_{pretest} = 5.13, M_{final data} = 5.24, t_{451} = .34, p > .1).
Table 3-3: Manipulations for Experiment to estimate Trade-offs in Supplier-Initiated Referrals

<table>
<thead>
<tr>
<th>Referral Message Category</th>
<th>Manipulations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balanced A: “We’re more than satisfied with Supplier’s ERP solution. Their solution fit our needs; but ERP solutions are complex, and customizing the application is time-consuming and difficult. We had to have a dedicated in-house team for customization, which increased our expense. But, we have a successful implementation. We achieved our 7% cost reduction target, thanks to Supplier’s ERP solution.”</td>
<td></td>
</tr>
<tr>
<td>Balanced B: “Supplier performed very well on their product, implementation and customization. We do feel that the extent of support they provide can be improved—for example, we’d like them to be accessible on weekends. However, we have a successful ERP implementation. We achieved 7% reduction in operation management costs, and the credit goes to Supplier’s ERP solution.”</td>
<td></td>
</tr>
<tr>
<td>Good A: “We are satisfied with Supplier’s ERP system. Their solution fit our requirements, and was delivered at our launch date. The integration process was without any major issues, and was done within the expected cost. Overall, we’ve reduced our operation management costs by around 5%, and it is because of Supplier’s ERP system.”</td>
<td></td>
</tr>
<tr>
<td>Good B: “Supplier’s ERP system has met our expectations. In terms of needs identification, integration and delivery time, they have performed satisfactorily. Customizing the ERP system to our specific requirements was also done within the stipulated time. We’ve cut costs in operations and administration by 5%, and we feel that credit goes to Supplier’s ERP solution.”</td>
<td></td>
</tr>
<tr>
<td>Excellent A: “We are more than satisfied with Supplier’s ERP solution. They really invested in understanding our requirements, and integrating the ERP system seamlessly into our setup. We’ve cut our operation costs by at least 8%, and have even saved time in several management tasks such as reports and documentation for quality certification. It’s because of Supplier’s ERP solution.”</td>
<td></td>
</tr>
<tr>
<td>Excellent B: “Our experience with Supplier has been nothing less than excellent. Their solution met our needs, and was within budget. We’ve reduced our operation management costs by around 8%, and even experienced some surprise benefits such as improved employee satisfaction. We feel the credit goes to Supplier’s ERP solution”</td>
<td></td>
</tr>
</tbody>
</table>

**Referrer Reputation**

**Low:** Referrer was established in 1965. Most of its products have been in the market for the last three years. Last year Referrer held 4% of the market share in the networking devices market. In its March 2009 edition, the trade journal Communications News presented the results of its latest “Industry Reputation Quotient” survey. In its survey, Communications News asks 2,000 executives and directors from peer firms and customer firms to rank companies in an industry on multiple aspects of company reputations. The Communications News survey gave Referrer a “Satisfactory Reputation” rating, with 65% of the 400
firms in the industry rated below Referrer. High: Referrer was established in 1961. Referrer introduced networking devices as part of its product portfolio 20 years ago, and last year held 30% of the market share in the networking devices market. In its March 2009 edition, the trade journal Communication News presented the results of its latest “Industry Reputation Quotient” survey. In its survey, Communication News asks 2,000 executives and directors from peer firms and customer firms to rank companies in an industry on multiple aspects of company reputations. The Communication News survey gave Referrer an “Excellent Reputation” rating, with 95% of the 400 firms in the industry rated below Referrer.

<table>
<thead>
<tr>
<th>Referrer–Potential Customer</th>
<th>Demographic Homophily</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low: Referrer is using Supplier’s solution for different requirements as compared to Potential customer. Referrer’s implementation is focused on standardizing manufacturing and business procedures to reduce costs. Potential customer’s requirements are to reduce costs by improving inventory planning and streamlining order fulfillment.</td>
<td></td>
</tr>
<tr>
<td>High: Referrer has the same requirements from Supplier’s solution as Potential customer—to reduce costs by improving inventory planning and streamlining order fulfillment.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Referrer–Potential Customer</th>
<th>Needs Similarity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low: In the course of your conversation with Referrer you realize that Referrer deployed the ERP system for a larger business size ($845 million in 2008 revenue) as Potential customer.</td>
<td></td>
</tr>
<tr>
<td>High: In the course of your conversation with Referrer you realize that Referrer deployed the ERP system for a similar business size ($150 million in 2008 revenue) as Potential customer.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Supplier’s Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low: Potential customer has earlier done business with Supplier, but for a simple accounting product, that is not related to the ERP solution.</td>
</tr>
<tr>
<td>High: Potential customer has never done business with Supplier.</td>
</tr>
</tbody>
</table>

3.3.4. Second Pretest and Final Data Collection

I conducted a second pretest with purchasing managers to assess the suitability of the stimuli and procedures for managers. Prior to conducting this pretest, I also interviewed two purchasing managers from the technology industry, who appraised the content and realism of the stimuli, and I incorporated their comments into the stimuli.
For the second pretest, I randomly selected 480 purchasing managers from the sample of 1500 members of the Institute for Supply Management™. I split the 12 profiles into blocks of 3 profiles each, with 1 holdout profile. I mailed the stimuli to the purchasing managers, including a cover letter on university letterhead that provided details of the study and asked respondents to attach their business cards if they wanted to receive a copy of the report. I also included a self-addressed, prepaid envelope and a $1 bill to increase the response rate. In the survey packet, I included a redirecting form that respondents could return to us if someone else in the firm was better suited to answer the stimuli. When I received such forms, I forwarded the survey to the identified alternate respondents. After three weeks, I mailed reminder letters, including the stimuli and another prepaid envelope. I received 21 rejections, whether because of address problems or concerns about responding. I received 65 manager responses and 2 redirection forms. Thus, the effective response rate is 14.2%, and the final pretest sample includes 165 responses.

For the final data collection, I repeated the preceding process for 960 randomly chosen purchasing managers from the remaining list of 1000 managers. I made two changes in the stimuli: increased the number of profiles per manager from three to four and added an item to measure potential customers’ supplier evaluation (as described in the design details section). I received 44 rejections due to address problems or other issues (e.g., concerns about responding, retirement). I received 117 responses and 3 redirection forms, for an effective response rate of 13.1%. Of these, 115 managers’ responses were complete and usable and provided 453 evaluations. In Table 3-4, I summarize the respondents’ descriptive characteristics.
Table 3-4: Respondent’s (Purchasing Managers) Descriptive Characteristics

<table>
<thead>
<tr>
<th></th>
<th>Sample Mean (standard deviation)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Years of experience</td>
<td>21 (8.64)</td>
</tr>
<tr>
<td>Years in current job</td>
<td>9 (6.62)</td>
</tr>
<tr>
<td>Involvement in similar purchasing solutions</td>
<td>5.52 (1.46) (on a scale of 1-7)</td>
</tr>
<tr>
<td>Experience in similar purchasing solutions</td>
<td>5.28 (1.78) (on a scale of 1-7)</td>
</tr>
<tr>
<td>Functional Domains (Titles)</td>
<td></td>
</tr>
<tr>
<td>Purchasing/procurement (manager, vice president)</td>
<td>28%</td>
</tr>
<tr>
<td>Sourcing/buyer (manager, lead buyer, project manager)</td>
<td>21%</td>
</tr>
<tr>
<td>Supply chain/logistics (manager, director, analyst)</td>
<td>11%</td>
</tr>
<tr>
<td>Commodity (manager)</td>
<td>7%</td>
</tr>
</tbody>
</table>

To compare early and late respondents, I used descriptive variables, such as the number of years of experience and years with the firm (Armstrong and Overton 1977). I defined the questionnaires returned within the first three weeks of the initial mailings as early (63% of returned questionnaires), and the rest as late (37%). I found no significant differences for total experience ($M_{\text{early}} = 22$, $M_{\text{late}} = 19$, $p > .1$) or years with the current company ($M_{\text{early}} = 10$, $M_{\text{late}} = 9$, $p > .1$). I repeated this test for a 50–50 split of the returned questionnaires and still found no significant difference. Thus, nonresponse bias does not appear to be a significant problem for the study.
3.4. Analysis and Results

3.4.1. Model Specification

To test the hypotheses, I model the effects of the manipulated variables (X) on potential customers’ perceived bias in the referral (Equation 1) and on potential customers’ supplier evaluation (Equation 2). In Equation 2, I also include the effect of perceived bias on potential customers’ supplier evaluation.

Because each manager respondent sees four profiles, and thus provides four responses, I account for unobserved heterogeneity in the dependent variables with a two-level model (e.g., Goldstein 2011). Level 1 corresponds to the response i, and level 2 corresponds to the manager j. Thus, the two-level model allows for variation in the dependent variable due to both, the response and the manager. I also account for unobserved heterogeneity due to managers with a manager-specific intercept ($\gamma_{0j}^B$ and $\gamma_{0j}^E$, Equations 1 and 2). Because supplier status (insupplier/outsupplier) is a between-subjects variable, I estimate its effect on potential customers’ perceived bias and supplier evaluation as a manager-specific effect ($\gamma_{sj}^B$ and $\gamma_{sj}^E$).

Therefore, for response i from manager j,

1) $Bias_{ij} = \gamma_{0j}^B + \gamma_{sj}^B \times Sup_j + \beta^B X^B_{ij} + \zeta^B Ctrl_{ij} + \epsilon_{ij1}$, and

2) $Eval_{ij} = \gamma_{0j}^E + \gamma_{sj}^E \times Sup_j + \delta^E \times Bias_{ij} + \beta^E X^E_{ij} + \zeta^E Ctrl_{ij} + \epsilon_{ij2}$,

where $\gamma_j$ denotes manager-specific effects, $\beta$ is the vector of coefficients for $X$, $\zeta$ captures the effect of the control variables, $\delta^E$ captures the effect of perceived bias on potential customers’ supplier evaluation, and $\epsilon_{ij}$ is the random error. The superscripts B and E specify Bias and Evaluation as the dependent variables, respectively. Furthermore, with $\gamma_{0j}^B$ and $\gamma_{0j}^E$, I denote the manager-specific intercepts; to account for the correlations across bias and evaluation in
managers’ responses, I model $\gamma_{0j}$ and $\gamma_{0j}$ as drawn from a bivariate normal distribution, $\gamma_{0j}$, with zero mean. Similarly, $\gamma_{sj}$ and $\gamma_{sj}$ denote the manager-specific effects for supplier status, and I account for correlations by modeling $\gamma_{sj}$ and $\gamma_{sj}$, as drawn from a bivariate normal distribution $\gamma_{sj}$ with zero mean.

**Testing for Total Effect.** To test H2, I must determine the total effect of the referral message category on potential customers’ supplier evaluations. Because each manager gives more than one response, I account and adjust for any bias in standard errors and statistical tests resulting from the non-independence of errors, using a multilevel model to estimate the coefficients (see Equations 1 and 2) (Krull and MacKinnon 2001). By hypothesizing a mediating effect of potential customers’ perceived bias, I have a lower-level mediation (i.e., at the response level) in the multilevel model (Kenny, Kashy, and Bolger 1998). In lower-level mediation, all meditational links can vary randomly across the upper-level units (i.e., managers). For example, for a manager sensitive to perceived bias in supplier-initiated referrals, the effect of referral message category on perceived bias ($\beta^B$) and the effect of perceived bias on potential customers’ evaluation of the supplier ($\delta^E$) are likely large. Thus, the assumption for single-level models, that the covariance between $\beta^B$ and $\delta^E$ ($\sigma(\beta^B, \delta^E)$) is zero, does not hold for multilevel meditational models. Assuming that the meditational effects have a bivariate normal distribution, the total effect of referral message category on potential customers’ supplier evaluations ($\beta_{Tij}^E$) can be decomposed as (Kenny, Korchmaros, and Bolger 2003):

3) $$\beta_{Tij}^E = \beta^E_{ij} + \beta^B_{ij} \cdot \delta^E_{ij} + \sigma(\beta^B, \delta^E).$$

The variance of the total effect, suppressing the subscripts $ij$, $\sigma_{\beta T}^2$ is:

$$\sigma_{\beta T}^2 = \sigma_{\beta E}^2 + \delta^E \cdot \sigma_{\beta E}^2 + \beta^E \cdot \sigma_{\delta E}^2 + \sigma_{\beta \delta}^2 + \sigma^2 + 2 \cdot \beta^B \cdot \delta^E \cdot \sigma(\beta^B, \delta^E) + 2 \cdot \beta^B \cdot \sigma(\delta^E, \beta^E) + 2 \cdot \delta^E \cdot \sigma(\beta^B, \beta^E).$$

4) $$\sigma_{\beta T}^2 = \sigma_{\beta E}^2 + \delta^E \cdot \sigma_{\beta E}^2 + \beta^E \cdot \sigma_{\delta E}^2 + \sigma_{\beta \delta}^2 + \sigma^2 + 2 \cdot \beta^B \cdot \delta^E \cdot \sigma(\beta^B, \delta^E) + 2 \cdot \beta^B \cdot \sigma(\delta^E, \beta^E).$$
where, \( \sigma_{\beta E}^2 \) denotes the variance of the estimation \( \beta^E \) (direct effect of referral message category on potential customers’ supplier evaluations), and \( \sigma(\beta^B, \beta^E) \) denotes the covariance between \( \beta^B \) and \( \beta^E \). Similar nomenclature holds for the other variance and covariance terms. Kenny, Korchmaros, and Bolger (2003) provide the estimation details.

### 3.4.2. Model Tests

I test for the underlying assumptions in the model (based on the conceptual framework) and manager-specific heterogeneity by comparing alternate models according to their model fit criteria. Specifically, I calculate the Akaike information criterion (AIC), Bayesian information criterion (BIC), and sample size-adjusted BIC (aBIC) (e.g., Lubke and Muthén 2005), as I show in Table 3-4.

**Testing for Assumptions.** The conceptual model specifies that referral message category affects potential customers’ perceived bias (Equation 1 with Bias as dependent variable). It is implicitly assumed that the effects of referrer characteristics are equal to zero or very small. To test this assumption, I estimate models that include referrer characteristics in Equation 1 and compare them with the hypothesized model. I find that including the effect of referrer reputation on Bias improves the model fit. Therefore, I include referrer reputation in Equation 1 and consider this model as the “proposed model”. My model also assumes that the referral message category affects potential customers’ supplier evaluation both directly and indirectly, through potential customers’ perceived bias. To test this assumption and ensure my perceived bias results are not due simply to a demand effect, I estimate a model without perceived bias (Smith, Bolton, and Wagner 1999). I find that the inclusion of potential customers’ perceived bias contributes significantly to the explanatory power of the model (Table 3-4).
Testing for Heterogeneity. First, I test for whether there is unobserved heterogeneity within managers or not by comparing a model with no manager-specific effects with the proposed model. I find the proposed model fits the data better than the model with no manager-specific effects (Table 3-4), which lends support to the two-level model specification. Second, I test for further possible effects of unobserved heterogeneity within managers. For example, some managers could be more sensitive to perceived bias than others. Therefore, I test for unobserved heterogeneity in how managers evaluate potential customers’ perceived bias by comparing a model that includes the effect of perceived bias as a manager-specific effect; however, the proposed model fits the data better (Table 3-4). I also model order and block effects as manager-level effects and find that the proposed model fits the data better.
### Table 3-5: Model Fit Statistics

<table>
<thead>
<tr>
<th>Model</th>
<th>Akaike Information Criterion (AIC)</th>
<th>Bayesian Information Criterion (BIC)</th>
<th>Sample Size-Adjusted BIC (aBIC)</th>
<th>Comments</th>
<th>Results</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proposed model</td>
<td>2862.038</td>
<td>2997.863</td>
<td>2893.132</td>
<td>Proposed model, based on Equation 1 and 2</td>
<td>Proposed model fits better, in support of the assumption that perceived bias is a mediator</td>
</tr>
<tr>
<td>Model without perceived bias</td>
<td>3270.433</td>
<td>3340.403</td>
<td>3286.451</td>
<td>To test for the assumption that potential customers’ perceived bias acts as a mediator, I estimate a model without perceived bias</td>
<td>Proposed model fits better, in support of the assumption that perceived bias is a mediator</td>
</tr>
<tr>
<td>Model with no manager-specific effects</td>
<td>12618.501</td>
<td>12737.862</td>
<td>12645.826</td>
<td>To test for the inclusion of manager-specific effects in the model, I estimate a model with no manager-specific effects</td>
<td>Proposed model fits better, in support of the model that accounts for manager-specific effects.</td>
</tr>
<tr>
<td>Model with manager-specific effects for intercepts, supplier status, or perceived bias</td>
<td>3123.372</td>
<td>3246.849</td>
<td>3151.639</td>
<td>To test for heterogeneity in how managers evaluate perceived bias, I estimate a model that includes potential customers’ perceived bias as a manager-specific effect.</td>
<td>Proposed model fits better, in support of potential customers’ perceived bias as an evaluation-level effect.</td>
</tr>
</tbody>
</table>
Results

I estimate two models: Model A with referral message category at three levels (balanced, good, and excellent) and Model B with referral message category at two levels (i.e., I combine the good and excellent referral conditions into one to represent the level of all-positive referral) (Table 3-5). Both models produce substantively identical results, but because Model B parallels my theory more closely, I discuss the results with the comparison of a balanced referral and an all-positive referral (Model B).

Referral Message Category. In support of H1, I find that a balanced referral significantly reduces potential customers’ perceived bias, compared with an all-positive referral ($\beta^B = -0.94, p < .05$).

For the test of H2, I calculate the total effect of referral message category on potential customers’ supplier evaluation, including the mediating effect of perceived bias. Potential customers’ perceived bias has a significant negative effect on their supplier evaluation ($\delta^E = -0.18, p < .05$), and a balanced referral reduces potential customers’ supplier evaluation compared with an all-positive referral ($\beta^E = -0.41, p < .05$). Furthermore, compared with a positive referral, a balanced referral has a total negative effect on potential customers’ supplier evaluation ($\beta^E_{\text{total}} = -0.25, p < .05$), in support of H2.

The results thus indicate a trade-off between reducing potential customers’ perceived bias and the detrimental effects of negative information. A balanced referral, compared with an all-positive referral, reduces potential customers’ bias but also diminishes their supplier evaluation. These results support my theory that with a balanced referral, the potential customer attributes negative information to the supplier (e.g., Kanouse and Hansen 1971), and perceived honesty to the referrer.
Referrer Characteristics and Contingent Effect of Supplier Status. As expected, referrer reputation has a positive main effect on potential customers’ supplier evaluation ($\beta^E = .51, p < .05$). I hypothesized that the positive effect of referrer reputation on potential customers’ supplier evaluation would be higher for an outsupplier than for an insupplier, but the interaction of referrer reputation and supplier status is not statistically significant (H3; $\beta^E = -.02, p > .10$).

Surprisingly, I find that referrer–potential customer demographic homophily does not have a statistically significant main effect on potential customers’ supplier evaluation ($\beta^E = .11, p > .10$). However, I find support for the hypothesis that referrer-potential customer demographic homophily is important for insuppliers; the positive effect of referrer–potential customer demographic homophily on potential customers’ supplier evaluation is higher for an insupplier than for an outsupplier (H4A; $\beta^E = .36, p < .05$). As expected, referrer–potential customer needs similarity has a positive main effect on potential customers’ supplier evaluation ($\beta^E = .52, p < .05$), and this positive effect is stronger for an insupplier than for an outsupplier (H4B; $\beta^E = .49, p < .05$). These results indicate that for an insupplier, it is particularly important to select a referrer with demographics and needs similar to those of the potential customer. In Figure 3-2, I graph the marginal effect of referrer–potential customer homophily on potential customers’ evaluation of both insuppliers and outsuppliers.

Other Results. A good referral has a negative effect on potential customers’ perceived bias, compared with an excellent referral (Model A, Table 3-6). This result lends further support to the theoretical foundation for H1. I had hypothesized that an all-positive referral would increase perceived bias, because the potential customer already expects a satisfied referrer and discounts the positive information to some extent. The finding that a good referral reduces perceived bias more than an excellent referral indicates that an intense positive referral message provokes greater perceptions of bias in the supplier-initiated referral.
Table 3-6: Results: Trade-offs in Supplier-Initiated Referrals

<table>
<thead>
<tr>
<th>Referral message category</th>
<th>Model A</th>
<th>Model B</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Perceived Bias:</td>
<td>Supplier Evaluation</td>
</tr>
<tr>
<td>Intercept</td>
<td>4.19*</td>
<td>3.92*</td>
</tr>
<tr>
<td>Insupplier (vs. outsupplier)</td>
<td>-.29</td>
<td>-.37</td>
</tr>
<tr>
<td>Balanced referral (vs. excellent in Model A and all-positive in Model B)</td>
<td>-1.02*</td>
<td>-.55*</td>
</tr>
<tr>
<td>Good referral (vs. excellent)</td>
<td>-.17*</td>
<td>-.30</td>
</tr>
<tr>
<td>Balanced referral × Insupplier</td>
<td>.21</td>
<td>.04</td>
</tr>
<tr>
<td>Good referral × Insupplier</td>
<td>-.01</td>
<td>-.04</td>
</tr>
<tr>
<td>Referrer characteristics</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Referrer reputation</td>
<td>-.03</td>
<td>.53*</td>
</tr>
<tr>
<td>Referrer reputation × Insupplier</td>
<td>-.02</td>
<td>-.05</td>
</tr>
<tr>
<td>Demographic homophily</td>
<td>N.A.</td>
<td>.11</td>
</tr>
<tr>
<td>Demographic Homophily × Insupplier</td>
<td>N.A.</td>
<td>.38*</td>
</tr>
<tr>
<td>Needs Similarity</td>
<td>N.A.</td>
<td>.54*</td>
</tr>
<tr>
<td>Needs Similarity × Insupplier</td>
<td>N.A.</td>
<td>.41*</td>
</tr>
<tr>
<td>Perceived Bias in Referral</td>
<td>N.A.</td>
<td>-.20*</td>
</tr>
<tr>
<td>Control variables</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Order</td>
<td>.00</td>
<td>.04</td>
</tr>
<tr>
<td>Block 1 (versus Block 3)</td>
<td>-.44*</td>
<td>.13</td>
</tr>
<tr>
<td>Block 2 (versus Block 3)</td>
<td>-.17</td>
<td>.38*</td>
</tr>
</tbody>
</table>
Yet referrer reputation does not have a statistically significant effect on potential customers’ perceived bias. The interaction between referral message category and supplier status is also not statistically significant for potential customers’ supplier evaluation.

**Figure 3-2:** Marginal Effect of Referrer-Potential Customer Homophily, Contingent on Supplier Status
Robustness Tests. I estimated models with the following additional control variables: (1) both versions of the referral message category, and (2) the length of each referral message (number of words; Eisend 2006). In all cases, the results remain robust.

I also test for the robustness of the results with the additional measures of potential customers’ supplier evaluation, including a dichotomous measure of the likelihood of considering the supplier and potential customers’ confidence in their evaluation. First, I estimate the current model with Equation 2 (for evaluation), using a logistic distribution for the dichotomous measure. The results are substantively the same as those in Table 3-6. Second, I include potential customers’ confidence in their supplier evaluation as a dependent variable in the current model. Again and substantively, the results are the same as those I present in Table 3-6.

3.5. Discussion

I investigate an important customer acquisition strategy in B2B markets: supplier-initiated referrals, focusing on the trade-offs that the supplier must make in selecting such referrers. I confirm that potential customers perceive a bias favoring the supplier in the supplier-initiated referral, which affects potential customers’ supplier evaluation. I show that the supplier can reduce a potential customer’s perceived bias in the referral by selecting a referrer that provides a balanced referral rather than an all-positive referral. However, such a balanced referral comes with a cost: it negatively affects a potential customer's supplier evaluation, an effect size I assess in this research. I also find that referrer reputation has a positive effect on potential customers’ supplier evaluation. Furthermore, I show that homophily between the referrer and potential customer has a significant influence on the potential customer, and that the effect is larger for an insupplier than an outsupplier.
3.5.1. Theoretical Implications

This study is the first, to the best of my knowledge, to investigate the effect of perceived bias in referrals. Because potential customers are aware of the supplier’s selection criteria for supplier-initiated referrals, they likely perceive a bias in the referral. This observation is applicable to the practice of referral rewards in consumer markets too. For example, when AT&T gives existing customers rewards for referring their friends to the company (AT&T 2009), the friends, or potential customers, likely perceive a bias in the referral if they know about the reward. Recent research in consumer markets considers optimal referral reward strategies and amounts (e.g., Biyalogorsky, Gerstner, and Libai 2001; Ryu and Feick 2007). Noting that perceived bias diminishes potential customers’ supplier evaluation in B2B markets, I consider it likely that this perceived bias also can affect the optimal referral reward amount a supplier offers.

A balanced referral, compared with an all-positive referral, also diminishes potential customers’ supplier evaluation. I had hypothesized that this negative effect would reflect the triadic structure of a supplier-initiated referral, but perhaps my finding actually indicates potential customers’ propensity to process negative information. Extant research on negativity bias shows that for products, customers weight negative information more than positive information when forming overall attitudes (e.g., Herr, Kardes, and Kim 1991). In contrast, when they evaluate services, this effect declines (Folkes and Patrick 2003), because customers do not consider an individual service provider’s behavior diagnostic of the firm. The B2B solutions I study fall between products and services, in that customers view them as combinations of relational processes (e.g., implementation, support) (Tuli, Kohli, and Bharadwaj 2007). Potential customers thus might consider relational processes representative of the supplier’s “traits,” rather than its “attributes,” which could induce greater weighting of negative information in referrals (Skowronski and Carlston 1989). Further research should consider the mechanisms by which the
referral message category influences potential customers’ supplier evaluation. For example, considering the manner in which the referral message is delivered, Kumar, Petersen and Leone (2011) find that the media in which the referral is given (e.g., video versus text) influences the value that the referrer provides to the supplier.

As a distinguishing feature of this research, I study supplier-initiated referrals in organizational purchasing, so the results also offer implications for research on organizational purchasing decisions. I elaborate on two key implications. First, researchers show that potential customers tend to select insuppliers over outsuppliers in purchasing decisions (e.g., Heide and Weiss 1995). I add to this finding by showing that the influence of supplier-initiated referrals on potential customers also differs between insuppliers and outsuppliers. In particular, the positive effect of referrer–potential customer homophily is greater in magnitude for an insupplier than for an outsupplier. Second, researchers have studied the multiple information sources that potential customers use to reduce their purchase uncertainty (e.g., Bunn and Clopton 1993; Hunter, Bunn, and Perreault 2006). The findings show that organizational buyers consider supplier-initiated referrals as an important source of information, though this source to date has been ignored in academic research.

3.5.2. Managerial Implications

My research provides several guidelines for suppliers that must select referrers and hope to maximize the benefits of a supplier-initiated referral. Consider a hypothetical supplier that must select among three potential referrers to provide to a potential customer (see Table 3-7):

Referrer A is a highly reputed firm in the industry and earns more revenue than the potential customer. Although Referrer A’s requirements of the supplier’s solution are different from those of the potential customer, Referrer A is likely to give an excellent referral, such as, “Our experience with Supplier has been nothing less than excellent. The solution was well integrated into our existing
systems, and our system was up before our launch date. We’ve reduced our operation management costs by around 8%, and even experienced some surprise benefits such as improved employee satisfaction."

*Referrer B* is not highly reputed in the industry and earns approximately the same revenue as the potential customer. Referrer B has used the supplier’s solution for the same purposes as the potential customer would and is likely to give a good referral, such as, “We are satisfied with Supplier’s system. Their solution fit our requirements, and was delivered at our launch date. Overall, we’ve reduced our operation costs by around 5%.”

*Referrer C* is highly reputed in the industry, earns more revenue than the potential customer, and has used the supplier’s solution to meet the same needs that the potential customer has. Referrer C is likely to give a balanced referral, such as “We’re more than satisfied with Supplier’s solution. But, customizing the application was time-consuming and difficult, and increased our expense. I achieved our 7% cost reduction target, thanks to the Supplier’s solution.”

For an insupplier, Referrers B and C offer the maximum benefits. The highly reputed and most satisfied Referrer A instead provides the least benefit and diminishes the potential customer’s supplier evaluation, on average, by 13% compared with Referrer B and C. This implication arises from my finding that for an insupplier, referrer-potential customer needs similarity provides the greatest lift in potential customer’s supplier evaluation (~32%). For an outsupplier, Referrer C provides the greatest benefit, followed by Referrer A. Referrer B may be well-matched and give a good referral, but it also diminishes the potential customer’s supplier evaluation, on average, by 7% compared with Referrer C. This implication arises because for an outsupplier, referrer reputation provides the maximum lift in supplier evaluation (~14%).
Table 3-7: Managerial Implications for Suppliers: Selecting a Referrer for Supplier-Initiated Referrals

<table>
<thead>
<tr>
<th>Referral Message Category</th>
<th>Referrer Reputation</th>
<th>Demographic Homophily</th>
<th>Needs Similarity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Referrer A: Excellent Referral: “Our experience with Supplier has been nothing less than excellent. The solution was well integrated into our existing systems, and our system was up before our launch date. I’ve reduced our operation management costs by around 8%, and even experienced some surprise benefits such as improved employee satisfaction.”</td>
<td>High</td>
<td>Referrer is bigger in size (revenue) than potential customer</td>
<td>Dissimilar needs from suppliers’ solution</td>
</tr>
<tr>
<td>Referrer B: Good Referral: “I am satisfied with Supplier’s system. Their solution fit our requirements, and was delivered at our launch date. Overall, I’ve reduced our operation costs by around 5%.”</td>
<td>Medium</td>
<td>Referrer is same size as potential customer</td>
<td>Same needs from suppliers’ solution</td>
</tr>
<tr>
<td>Referrer C: Balanced Referral: “I’m more than satisfied with Supplier’s solution. But, customizing the application was time-consuming and difficult, which increased our expense. I achieved our 7% cost reduction target, thanks to the Supplier’s solution.”</td>
<td>High</td>
<td>Referrer is bigger in size (revenue) than potential customer</td>
<td>Same needs from suppliers’ solution</td>
</tr>
</tbody>
</table>
Therefore, when suppliers trade off across their referrer selection criteria, they should consider their experience with the potential customer. If an insupplier has IBM as a highly satisfied customer, for example, it should not necessarily select IBM as its referrer. Instead, it should find a referrer with needs similar to those of the potential customer, even if this referrer expresses some negative information about the supplier.

3.5.3. Limitations and Further Research

I acknowledge several key limitations related to my research. First, because I considered an experimental study the best method for testing the theoretical framework, the results might not hold in a study that uses retrospective field methods. Second, the results likely are not generalizable to a purchasing context in which potential customers do not experience high uncertainty about the supplier’s capabilities. For example, a potential customer purchasing a solution for the first time (i.e., a “new buy” situation, as defined by Robinson, Faris, and Wind 1967) likely needs supplier-initiated referrals more than a potential customer purchasing an existing solution again (i.e., modified buy or re-buy).

Third, the variables I selected to study referrer selection might not be comprehensive. For example, I do not consider whether the relationship between the supplier and potential customer is marked by trust, which might moderate the influence of the supplier-initiated referral. To correct for this limitation, I based the conceptual framework on interviews with managers and an established message-source communication framework. I also ignore the interactions between the referral message and referral source characteristics, though research on communication and persuasion asserts that the referral message should have a stronger influence when the source is highly credible (e.g., Wilson and Sherrell 1993). Because my objective has been the trade-offs that suppliers make when selecting a referrer, I have focused on the interactions between supplier
status and the supplier-initiated referral’s characteristics. However, considering the complex nature of organizational buying, a study that builds on these findings to study potential interactions across referrer characteristics would be valuable.

Fourth, I assess the influence of the referral with individual purchasing managers, whereas organizational buying is typically the responsibility of a buying center. Research on buying centers suggests the engineering department dominates the product selection decision, whereas purchasing dominates supplier selection (e.g., Jackson, Keith, and Burdick 1984), and because I focus on supplier evaluation, purchasing managers are apt respondents. The dependent variable also is the purchasing manager’s supplier evaluation, not supplier selection (a buying center decision). Further, Kumar, Petersen and Leone (2011) find that referrals in B-to-B markets do significantly influence the potential customer’s purchasing decision when compared to other forms of marketing. Nevertheless, studying the influence of supplier-initiated referrals on different members of the buying center, as well as joint decisions of the buying center, could increase understanding of supplier-initiated referrals.
Chapter 4
David vs. Goliath: Startups versus Established Firms and the role of Supplier-Initiated Referrals

4.1. Introduction

Startup CEO’s have to wear many hats to be successful and possessing effective selling skills can make or break a new venture. Securing your first reference-able customer and getting venture funding.  

Suppliers often rely on specific customers to be referrers, and influence the potential customer in favor of the supplier – that is, they rely on supplier-initiated referrals (Hada, Grewal, and Lilien 2010). In essay 2 of my dissertation, I investigated the influence of referral source and message, contingent on supplier-potential customer’s previous experience, on how supplier-initiated referrals effect potential customers’ supplier evaluation. However, as the purpose of supplier-initiated referrals is to reduce potential customers’ purchase uncertainty for a specific supplier, the supplier’s reputation becomes an important factor. As the quote above indicates, supplier-initiated referrals are considered critical for startups to gain customers, as startups are “reputationless” suppliers (Aldrich and Fiol 1994). Thus, the effect of supplier’s reputation on the influence of a supplier-initiated referral gains importance in the case of startups versus established firms. Therefore, in Essay 3 of my dissertation, I take Essay 2 forward and focus on the influence of supplier-initiated referrals on potential customers’ supplier evaluation when the supplier is a reputation-less startup (e.g., Box.net - a startup in electronic storage solutions) or a reputed, established firm (e.g., IBM).

Startups are an important engine of growth for the U.S. economy (Timmons 1999). However, 38% of startups do not achieve profitability, and 40% of startups fail in their first two years (Shane and Foo 1999; Zimmerman and Zeitz 2002). Startups particularly face challenges in attracting customers. With no history to rely on, a startup must convince potential customers that it offers quality products or solutions. It must also convince potential customers that it will continue to offer quality products, as potential customers are likely uncertain about the startups’ likelihood of survival (Starr and MacMillan 1990). Potential customers’ uncertainty about startup survival is exacerbated in Business-to-Business (B2B) markets, as firms wish to build relationships with their supplier to make repeat purchases (DeKinder and Kohli 2008). The belief in the business and research community is that once startups gain a reference customer, they can leverage that reference customer to gain further customers, thus avoiding failure (e.g., Ruokolainen and Igel 2004). However, startups compete against reputed, established firms (e.g., IBM) to gain potential customers; and established firms have their own reference customers.

Given the importance of supplier-initiated referrals, this paper empirically investigates the benefit that supplier-initiated referrals provide to startups versus established firms.

To influence potential customers, suppliers are likely to select a referrer that the potential customer respects and defers to – that is, a high status referrer. Potential customers trust the discerning abilities of high-status firms in their supplier selection process (Stuart, Hoang, and Hybels 1999), and thus a high status firm as referrer can reduce potential customers’ uncertainty about the supplier. Extant research on status also indicates that a referral from a high status firm is important for startups (Stuart, Hoang, and Hybels 1999). However, as the potential customer is evaluating the supplier, it is likely that the potential customer’s expectations form the supplier will affect potential customer’s evaluation of the supplier. For example, research on status would predict that start-ups need high-status referrers more than established suppliers (Washington and Zajac 2005). However, it is likely that potential customers expect established firm to select a
high-status referrer, and might not have the same level of expectations from the startup. Building on research on how customers evaluate firms based on their expectations, I posit that the influence of the supplier-initiated referral also depends on the potential customer’s expectations from the supplier-initiated referral, specifically, expectations related to the status of the selected referrer.

I conduct two experimental studies that investigate the role of supplier reputation, referrer status and mediating effect of expectation disconfirmation on the extent of influence supplier-initiated referrals have on potential customers. I find that expectation disconfirmation of referrer status reduces the positive effect of an established firm on the supplier-initiated referral’s influence. I also find that, contrary to established research (Lin, Yang, and Arya 2009), low status referrers do not harm established firms more than they harm startups. And, as expected, the influence of the supplier-initiated referral is higher for a startup than for an established firm.

I proceed as follows: First, I provide a theoretical development of the key constructs in the paper – supplier reputation and referrer status; followed by the conceptual framework. Second, I present the hypotheses. Next, I present the results of the two studies, followed by discussion and implications.

4.2. Theoretical Development

As the focus of the paper is to investigate the benefit of supplier-initiated referrals for a startup relative to an established firm, I focus on the effect of referrer status contingent on supplier reputation (Figure 4-1). The dependent variable is the influence of the supplier-initiated referral on potential customer’s evaluation of the supplier. To capture this construct, I focus on the incremental change in potential customers’ supplier evaluation pre- and post- receiving the supplier-initiated referral.
Potential customers likely have differential expectations from suppliers, depending on supplier reputation. Smeltzer (1997) emphasizes that the potential customer’s expectations from the supplier are a consequence of the supplier’s reputation. Doney and Cannon (1997) also show that potential customers build their expectations for trusting the supplier based on supplier reputation; and Bennett and Gabriel (2001) show that the expectations of supplier’s capability and reliability is dependent on the supplier’s reputation. Therefore, in B2B markets, supplier reputation plays a key role in shaping the potential customer’s expectations about the supplier. I take this finding forward to suggest that potential customers likely also have expectations for referrer status in supplier-initiated referrals, as the supplier selects the referrer. Further, expectations lead to expectation disconfirmation once the potential customer has evaluated that aspect of the supplier (i.e., referrer status), which influences the potential customer’s subsequent evaluations (e.g., Anderson and Sullivan 1993; Cadotte, Woodruff, and Jenkins 1987). My interviews with potential customers also provide support to the proposed framework. As a potential customers’ purchasing manager interviewee said:

“If a startup can’t get me a highly reputed [high status] reference customer, I understand that. After all, the firm is new and maybe doesn’t have a highly reputed firm as its customer yet, or cannot ask that firm to give a referral. But if an established firm does not provide a highly reputed firm as a reference customer, I will wonder why.”

In summary, building on extant research and pre-study interviews, I propose that the influence of referrer status on potential customers’ supplier evaluation also depends on the expectations of the potential customer from a supplier in terms of referrer selection. Specifically, I posit that expectation disconfirmation with the referrer status mediates the effect of referrer status and supplier reputation on the influence of the supplier-initiated referral (Figure 4-1).

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8 I interviewed five potential customers’ managers prior to designing and conducting the study. The interviews were semi-structured, focused on the role of supplier-initiated referrals when the managers are evaluating startups and established firms, and lasted approximately 30 minutes. The managers had more than 10 years work experience, and came from the retail, technology, and consulting industries.
2.1. Supplier Reputation: Startup vs. Established firm

Reputation refers to an organization’s abilities with respect to delivering quality products or solutions (Washington and Zajac 2005). Reputation is valuable because it reduces customers’ uncertainty in evaluating firms as potential suppliers of needed products and services (Benjamin and Podolny 1999).

As startups have not built up a reputation (good or bad), they are “reputationless” (DeKinder and Kohli 2008). Therefore, potential customers cannot rely on reputation as an indication of the startups’ product quality. Established firms have built up a reputation (good or bad) in the industry. As it is unlikely that a potential customer would wish to purchase from a

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9 I differentiate between the economic notion of reputation which is derived from perceived quality, and the sociological notion of status that is a socially constructed and accepted ordering of organizations (Washington and Zajac 2005, Lin, Yang and Arya 2009). As the potential customer is evaluating the supplier’s product quality, reputation is the appropriate construct for the supplier. As the potential customer is evaluating the supplier based on the perceived social standing of the referrer in the industry (e.g., prominence), status is the appropriate construct for the referrer.
supplier with a bad reputation, I consider the case when a supplier is established and has a good reputation for their products and solutions (e.g., IBM).

Irrespective of the supplier’s reputation, potential customers will encounter some uncertainty about the suppliers’ quality for two reasons. One reason is that irrespective of the average level of quality, there will be some variance around that level. This is especially true for B2B complex products and solutions. The second reason is that it is too expensive for firms to collect reliable, complete information and thus potential customers will perceive some uncertainty about the supplier’s solution. Thus, even though established firms possess a reputation for quality products, potential customers likely still perceive some uncertainty concerning the established firm’s capabilities in delivering the solution. However, as startups are reputationless, potential customers will likely perceive higher uncertainty for a startup compared with an established firm.

Thus, I focus on an evaluation-level view of the influence of referrer status on potential customers’ perceived capabilities of the supplier (and not the potential customer’s perceived status of the referrer).

### 4.2.2. Referrer Status

Status refers to a firm’s position in a hierarchical order in a social system. In particular, I focus on societal status. Lin, Yang and Arya (2009) define societal status as the “social ranking of esteem that is ascribed by the society on the basis of a firm’s conformity to social norms: social responsibility, financial soundness, innovativeness, long-term investment value, and so on”. Thus, a referrer’s societal status concerns a firm’s standing in a social hierarchy as determined by respect and deference (Podolny 1993); hereafter, I simply call referrer’s societal status as “referrer status”.
Referrer Status as a Signal. According to Spence (1974), a signal is an observable indicator of an unobservable quality that meets the following criteria: (1) the indicator must be at least partially manipulable by the actor, and (2) the marginal cost or difficulty of obtaining the indicator must be inversely correlated with the actor’s quality level. For example, a warranty is a signal of quality because (1) the firm can offer a warranty or not, and (2) it is more costly for a firm that manufactures a low quality product to offer a warranty than it is for a firm that manufactures a high quality product (Purohit and Srivastava 2001).

Similarly, referrer status can also be a signal of the supplier’s quality because (1) the supplier can opt to select a high-status referrer or not, and (2) it is likely more costly for a low quality supplier to access a high-status firm as a referrer than it is for a high quality supplier. Therefore, referrer status can act as a signal for the supplier’s quality. Further, in supplier-initiated referrals as the referrer communicates with the potential customer for the supplier, the supplier-initiated referral also signals a strong relationship between the supplier and the referrer. Thus, a supplier-initiated referral from a high-status referrer goes beyond a positive effect on the supplier due to “association” (which a supplier can signal by listing its high-status customers on its website), and indicates that the supplier can not only provide quality products, but can also build a relationship with a high-status firm.

4.2.3. Effect of Referrer Status

Relationships with high status firms generate high visibility, signal increased status to customers, buyers and suppliers, and distinguish firms from their competitors (Stuart 2000). As relation with a high-status firm increases supplier’s visibility, it likely reduces potential customer’s search and monitoring costs associated with finding a partner (Lin, Yang, and Arya
2009). Stakeholders, such as potential customers, also closely watch choices of high status firms because of their perceived superiority in evaluating firms (Rao 1994).

In complex B2B solutions, where the quality of products is difficult to evaluate, referrer status becomes important as it is easier to observe affiliation than to observe differences in quality (Benjamin and Podolny 1999). Stuart (1998) contends that an alliance with a high status firm is an endorsement of the supplier’s quality. Therefore, extant research suggests that referrer status should have a positive main effect on the influence of a supplier-initiated referral on potential customers’ supplier evaluation.

**Effect of High Status Referrer Contingent on Supplier Reputation**

A high-status firm as a referrer also grants legitimacy to the supplier. Legitimacy is important for all firms, but it is more important for startups due to the liability of smallness or newness (Stinchcombe 1987). Further, Lin, Yang and Arya (2009) show that young firms benefit more from associating with high-status firms than do high-status firms. For instance, a startup like Box.net will likely gain more from a referral from General Electric than will IBM.

Building on expectation disconfirmation theory, I expect that the potential customer will expect a high-status referrer more from an established firm than from a startup. Because the potential customer expects a high-status referrer from an established firm, the established firm will likely not gain the advantage of selecting a high-status referrer. That is, potential customer’s high expectations will likely reduce the positive effect of a high status referrer for an established firm. Therefore, I hypothesize:

*H1:* Expectation disconfirmation with an established firm will have a competitive mediation effect with the positive effect of supplier reputation on the influence of the supplier-initiated referral.
H1 also implies that if the established supplier does not select a high-status referrer, it will likely lead to potential customers’ negative expectation disconfirmation; whereas if an established firm does select a high-status referrer, it will likely lead to potential customers’ expectation confirmation (and not positive expectation disconfirmation). Thus, the positive effect of referrer status on potential customers’ supplier evaluation will reduce for an established firm in conditions for negative expectation disconfirmation versus expectation confirmation. Therefore, I hypothesize, as a result of the increased expectation disconfirmation for an established firm:

\[ H2: \text{The positive effect of high referrer status on the influence of the supplier-initiated referral will be lower for an established firm as compared to a startup.} \]

**Effect of Low Status Referrer contingent on Supplier Reputation**

The second competing effect for the influence of referrer status indicates that high-status firms would experience a loss of status when they associate themselves with low-status firms. For example, Washington and Zajac (2005) find that if high-status basketball teams continuously compete with lower-status basketball teams, the high-status basketball teams face an erosion of their status and performance over time. Lin, Yang and Arya (2009) also find that a high-status firm’s performance is harmed by association with a low-status firm. Expectation disconfirmation theory would also indicate the same effect - taking into account the expectations of potential customers, it is likely that the potential customer punishes an established firm for not selecting a highly reputed referrer. That is, for an established firm a low-status referrer would increase negative expectation disconfirmation with the supplier more than it would for a startup. The detrimental effects of negative expectation disconfirmation would result in the negative effect of a low status referrer on potential customer’s supplier evaluation to be higher for an established firm than for a startup.
H3: The negative effect of a low status referrer on the influence of a supplier-initiated referral will be higher for an established firm as compared to a startup.

4.3. Methodology

To investigate the influence of the referrer on the potential customer’s supplier evaluation, the method has to allow a record of the potential customer’s supplier evaluation prior to receiving the referral and post receiving the referral. This allows an investigation of only the referral influence. Further, I also need to examine whether the potential customer has differential expectations for referrer status from a startup versus an established firm, and the disconfirmation after receiving the referral. To satisfy these specific requirements, I opt for an experimental method that enables me to record potential customer’s expectations of referrer status, expectation disconfirmation and referral influence. Further, an experimental method also allows a clear manipulation of supplier reputation and referrer status.

4.3.1. Design

The experimental design is a 2 (low-high referrer status) x 2 (referrer reputation: startup vs. established supplier) as it allows to test the effect of a low and high status referrer contingent on supplier reputation. The dependent variable is change in potential customers’ supplier evaluation (Eval) prior and post the supplier-initiated referral.

Next, I describe two studies. In Study 1, with a business student population, I focus on testing the main hypothesis. In Study 2 I test that my results are robust to population and context with a small sample of purchasing managers.
Manipulations and Measures for Studies 1 and 2

Supplier Reputation. A fictional firm created for the stimuli would likely not tap into the expectations respondents hold for established firms versus startups. Therefore, I select a real established firm and startup to assess the effects of referrer reputation. The stimuli presented the information about the suppliers (see Table 4-1 for the description given).

In Study 1, for an established advertising agency, I select Ogilvy & Mather – an agency frequently counted in the top 3 advertising agencies in the world, and winner of several awards. For a startup, I selected an advertising agency, The Engine Is Red, which was launched in 2008 and offered all the services required for an integrated marketing communications campaign (Table 4-1).

In Study 2, for an established ERP solution firm, I select Oracle Inc. – a firm considered one of the top two ERP firms in the world. For a startup, I selected an ERP solution firm, BlueStripe Software, which was launched in 2008, and offers ERP solutions (Table 4-1).

Referrer Status. I manipulated referrer status to reflect a low or high status referrer. Lin, Yang and Arya (2009) use Fortune’s “Most Admired Corporations” ranking as a measure for a firm’s status as the ranking is based on the average score of explicit criteria that capture a firm’s social standing. Descriptions for low and high referrer status are given in Table 4-1 for Studies 1 and 2.
Table 4-1: Manipulations for Studies 1 and 2

<table>
<thead>
<tr>
<th>Supplier Reputation</th>
<th>Study 1: Integrated Marketing Communication Context</th>
<th>Study 2: ERP Solution Context</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supplier Reputation</td>
<td>Established Firm: Founded in 1948, Ogilvy &amp; Mather is one of the largest marketing communications companies in the world. Through its specialty units, the company provides a comprehensive range of marketing services including: market research, advertising; public relations and public affairs; branding and identity; shopper and retail marketing; communications; direct, digital, promotion services. Ogilvy &amp; Mather services Fortune Global 500 companies as well as local businesses through its network of more than 450 offices in 120 countries.</td>
<td>Established Firm: Founded in 1977, Oracle is one of the leading international providers of business software and, the world's third-largest independent software manufacturer. Oracle has more than 370,000 customers including all Fortune 100 companies, in over 145 countries and employs 105,000 people. Oracle is headquartered in California, USA.</td>
</tr>
<tr>
<td>Referrer Status</td>
<td>Startup: Founded in March 2009, The Engine Is Red (TEIR) is a startup that focuses on developing IMC campaigns for its clients. TEIR was founded by entrepreneurs who have experience in the advertising and marketing communications industry. The company provides a comprehensive range of marketing services including: market research, advertising; public relations and public affairs; branding and identity; communications; direct, digital, promotion services. TEIR has around 10 employees and around 20 clients. TEIR is headquartered in California, US.</td>
<td>Startup: Founded in 2008, BlueStripe is a startup that develops and provides ERP solutions to organizations in multiple industries. BlueStripe was founded by entrepreneurs who have lead some of the industry’s leading ERP software companies. Today, BlueStripe has around 40 employees and 20 customers. BlueStripe is headquartered in North Carolina, US.</td>
</tr>
</tbody>
</table>

Referrer Status
- Low: Each year, Fortune published the world’s “Most admired Companies”. These rankings are based on a survey that polls more than 10,000 financial analysts, senior executives, and Wall Street investors from more than 580 large companies. This ranking is an average score of ratings on criteria such as community and environmental responsibility, innovativeness, financial soundness, quality of management and quality of products and services. In the instruments and related products industry, Fortune ranked only 8 firms. Sems Systems’s score was 1.86/10 (the highest score was 7.95/10). Sems Systems score was not high enough for it to be ranked by Fortune. Sems Systems has never been ranked in Fortune’s Most Admired Companies list.
- High: Each year, Fortune published the world’s “Most admired Companies”. These rankings are based on a survey that polls more than 10,000 financial analysts, senior executives, and Wall Street investors from more than 580 large companies. This ranking is an average score of ratings on criteria such as community and environmental responsibility, innovativeness, financial soundness, quality of management and quality of products and services. In the instruments and related products industry, Fortune ranked only 8 firms. Sems Systems’s score was 6.86/10 (the highest score was 7.95/10). Sems Systems was ranked #3 in Fortune’s Most Admired Companies survey in 2010. Sems Systems has been ranked in the top 3 firms since 2008.
Expectation Disconfirmation about Referrer Status. After the respondent evaluates the supplier, I ask the respondent about their expectations from the supplier’s referrer. I asked them whether they thought that the referrer would be highly respected in the industry, and would be admired by peers. As a check and to manage against hypothesis guessing, I also asked them whether they expect that the referrer will give only positive information about the supplier. After the respondent received information on the referrer status, I asked them the same questions again. I model expectation disconfirmation as the difference between referrer status ratings after respondents received information and before they received information about the referrer (Table 4-1).

Influence of Supplier-initiated Referral. To measure the influence of the supplier-initiated referral, I ask respondents about their supplier evaluation (likelihood of considering supplier) when they have information only about the supplier, and after they have received information about the referrer. The change in potential customer’s supplier evaluation pre- and post- the referral enables me to capture the influence of the referral on potential customers’ evaluation about the supplier.

4.3.3. Study1: Testing the conceptual framework

Study 1 performs a test of the hypotheses with a undergraduate student population belonging to a major U.S. Business School.

Empirical Context

To test my hypotheses, I needed an empirical context which satisfied the following criteria: (1) the purchasing situation is complex such that the supplier’s capabilities in delivering
the solution cannot be completely determined prior to purchase, (2) the potential customer typically regards such a purchase as a long-term relationship, as one key difference between start-ups and established firms is the risk concerning the start-ups’ long-term viability, and (3) the empirical context is such in which start-ups and established firms do compete with each other. Further, the target population should also be able to relate to the empirical context. Therefore, for Study 1, I selected an exercise equipment manufacturer selecting an advertising and communication agency to launch a new consumer product line, with the purpose of building a long-term relationship with them (See Appendix B for stimuli).

Questionnaire Structure. The stimulus consists of four parts (see Appendix B). In the first section, I establish the purchase scenario by specifying that the respondent is a purchasing manager for the potential customer, evaluating advertising and communication agencies to provide an integrated marketing communications solution for the potential customer. The purchase is important for the potential customer; and the next step in the purchasing process is to create a shortlist for agencies for an in-depth evaluation, called a “creative shootout”. To aid this decision the purchasing manager has asked the agencies to provide a key reference customer to interview. In the second section, I present information on an agency. The respondents provide responses regarding their evaluation of the agency, and their expectations from the reference customer that the agency will select (status and content of the referral) (please see Appendix B). In the third section, I present details on the reference customer and the reference customer’s status. To make the situation realistic, I include information, and thus, control for the size of the referrer (same as the potential customer), the needs of the referrer (same as that of the potential customer) and the referral message (highly positive). In the fourth section, I include manipulation checks for the purchase scenario (importance, complexity, and scenario realism), supplier reputation and referrer status.
**Measurement and Manipulation Checks**

I measure respondents’ perception of the supplier’s reputation to assess whether respondents recognized the advertising agency as an established supplier or a startup. As expected, I find that respondents distinguished between the established firm (EST) and the startup (STP) in considering the supplier an established firm in the industry ($M_{EST} = 6.62$, $M_{STP} = 4.32$; $t_{118} = 11.83$, $p < .01$), and the supplier’s reputation for providing quality solutions in the industry ($M_{EST} = 6.37$, $M_{STP} = 4.91$; $t_{118} = 8.8$, $p < .01$). As expected, I also find that respondents differentiated between low referrer status and high referrer status on dimensions of referrer’s social ranking ($M_{HI} = 5.36$, $M_{LOW} = 2.64$; $t_{118} = 13.36$, $p < .01$), status ($M_{HI} = 5.41$, $M_{LOW} = 2.47$; $t_{118} = 14.09$, $p < .01$), and respect ($M_{HI} = 5.79$, $M_{LOW} = 2.98$; $t_{118} = 12.62$, $p < .01$) in its industry.

**Model**

As potential customers’ supplier evaluation is measured by one item, that is, whether the purchasing manager will recommend that the potential customer consider the supplier (Yes/No), the influence of the referral is highest when the purchasing manager changes supplier evaluation from “No” to “Yes”, or vice-versa. I model change in supplier evaluation as an ordinal logistic variable (1-4). Where, the highest positive influence is when the potential customer changes likelihood of considering supplier from “No” to “Yes” (category=4), and the highest negative influence is from “Yes” to “No” (category=1); “Yes” to “Yes” (category=3) and “No” to “No” (category=2) record where the supplier’s evaluation stays the same pre- and post- the referral. Table 4-2 shows the ordering of the dependent variable.
As I have hypothesized a mediating effect of expectation disconfirmation on how supplier reputation and referrer status affect the referral’s influence, I model expectation disconfirmation (ExpDisc; Equation 1) and referral’s influence on potential customers’ supplier evaluation (Eval; Equation 2) simultaneously. Using bootstrap method of calculating errors, I am able to estimate the direct and indirect effect of supplier reputation and referrer status on referral’s influence on potential customer. Thus, I have:

(1)  \[ \text{ExpDisc} = \gamma^D_0 + \beta^D \text{X}^D + \varepsilon_1, \text{ and} \]

(2)  \[ \text{Eval}_{ij} = \gamma^E_0 + \delta^E \text{ExpDisc} + \beta^E \text{X}^E + \varepsilon_2, \]

where \( \gamma_0 \) denotes the intercept, \( \beta \) is the vector of coefficients for the manipulated variables \( \text{X} \), \( \delta^E \) captures the effect of perceived bias on potential customers’ supplier evaluation, and \( \varepsilon \) is the random error. The superscripts D and E specify ExpDisc and Evaluation as the dependent variables, respectively.

<table>
<thead>
<tr>
<th>Potential customers’ likelihood of considering supplier before receiving supplier-initiated referral</th>
<th>Potential customers’ likelihood of considering supplier after receiving supplier-initiated referral</th>
<th>Influence of Referral on Potential customers’ supplier evaluation (Model A)</th>
<th>Influence of Referral on Potential customers’ supplier evaluation (Model B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>1</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>1</td>
<td>1</td>
<td>2</td>
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</tbody>
</table>
Results

H1 posits that expectation disconfirmation will reduce the positive effect of an established firm selecting a high-status referrer on the referral’s influence. This hypothesis rests on the assumption that potential customers have higher expectations concerning referrer status from an established firm compared with a startup; thus, I first test this assumption and find that it holds true ($\beta = 1.05, p < 0.01$; established firm versus startup). Next, with Equations 1 and 2, I perform a direct test for H1, and find support for the hypothesis. First, I find that supplier reputation has a statistically significant effect on potential customers’ expectation disconfirmation concerning referrer status ($\beta = -1.10, p < 0.01$; established firm versus startup; Table 4-3). Thus, as shown in Figure 4-2 (a plot of least square means), when the referrer status is low potential customers display higher negative expectation disconfirmation for a established firm than for a startup; and, when the referrer status is high, potential customers display positive expectation disconfirmation for a startup, but not for an established firm (they display expectation confirmation). These findings show support for the theory that potential customers expect established firms to select a high status referrer. Second, I find that the direct effect of supplier reputation on the referral’s influence is positive and significant ($\beta = 1.05, p < 0.01$), and the indirect effect of supplier reputation on the referral’s influence is negative and significant ($\beta = -0.18, p < 0.1$). Although, the total effect of supplier reputation on referral’s influence on potential customer’s supplier evaluation is positive and significant ($\beta = 0.60, p < 0.05$), the effect is diminished because of expectation disconfirmation, as hypothesized (see Table 4-3 for results).
Figure 4-2: Effect of Supplier Reputation on Potential Customer's Referrer Status Expectations

Figure 4-3: Potential Customer's Expectation Disconfirmation with Referrer Status
To test hypotheses H2 and H3, I calculate the predicted probability that the supplier-initiated referral will influence the potential customers’ supplier evaluation positively (that is predicted probability of category = 4 of the dependent variable as shown in Table 4-3). Next, I estimate if the average of the predicted probability of category=4 is significantly different depending on the supplier reputation and referrer status. Please see Figure 4-3 for a graphical representation of the predicted probability of category=4. For H2, I test if the average predicted probability when referrer status is high is significantly lower for an established firm (Prob(category=4) = .103, std dev=.02) versus a startup (Prob(category=4) = .307, std dev=.08); and find support for H2. For H3, I test if the average predicted probability when referrer status is low is significantly lower for a startup (Prob(category=4) = .01, std dev=.01) versus an established firm (Prob(category=4) = .03, std dev=.02), and, find that there is no statistically
significant difference; therefore, I do not find support for H3.

Figure 4-4: Study 1 Results with Model A: Supplier-initiated referral's influence

Figure 4-5: Study 1 Results with Model B: Supplier-initiated referral's influence
4.3.4. Study 2: Verification of results with Managers

In Study 2, I replicate Study 1 with purchasing managers as respondents. I also investigate the facets of the uncertainty related to purchasing from startups versus established firms, and whether the supplier-initiated referral reduces one facet of uncertainty more than another.

**Empirical Context**

Supplier-initiated referrals provide potential customers with information regarding the supplier’s solution that cannot be directly observed by the potential customer. Thus, supplier-initiated referrals are an important part of the purchase process when the supplier’s solution is complex, and often customized to each customer’s needs such that the potential customer cannot necessarily access a referrer who uses the same solution. Therefore, for testing the conceptual model I need a purchasing situation which fulfills the following criteria: (1) the solution being considered for purchase should be high in product complexity, (2) customers should have varying needs from the same solution, (3) both small and large firms are likely to purchase the solution, so that I can meet the required sample size, and (4) the practice of supplier-initiated referrals should be prevalent for the solution’s purchase.

An Enterprise Resource Planning (ERP) solution as the purchase context satisfies the criteria as the solution is high in complexity, is customized to fit customers varying needs, and is used in multiple industries at large enterprises and small and medium enterprises (Verville and Halingten 2003). Further, the use of supplier-initiated referrals is common in the sales process (according to my interview with the CEO of a mid-sized ERP solution). Therefore, I have chosen the purchase of an ERP solution by a potential customer in the instruments industry (SIC Code
as my empirical context. As the purpose is to assess the influence of the referral on the potential customer’s purchase decisions, I chose purchasing vice-presidents and purchasing managers of who are members of the Institute for Supply Management™ as the key respondents.

Questionnaire Structure. The structure of the stimuli was the same as that of Study 1 (Please see Appendix B for the stimuli); however I also included questions related to potential customer’s evaluation of specific capabilities about the supplier – fulfilling requirements, providing integration and support, capability of building a long-term relationship, and likelihood of including new features that the potential customer needs in future releases. Two purchasing managers evaluated the stimuli. I incorporated their suggestions in the stimuli.

Pre-test: Stimuli and Manipulation Check

As the respondent sample is purchasing managers, including items to measure supplier reputation and manipulation checks for referrer status in the stimuli would (1) make the stimuli too lengthy for purchasing managers, (2) adversely affect the realism of the stimuli and (3) likely create demand effects. Therefore, I first conducted a pre-test for assessing the manipulations. I chose students in an undergraduate business program in a business school as the sample.

For supplier reputation, I find that the respondents differentiated between the established firm (Oracle) and the startup (BlueStripe) on whether the supplier was an established firm in the industry (M_{EST} = 6.21, M_{STP} = 2.29; t_{46} = 14.09, p < .01), was a well-known firm (M_{EST} = 6.46, M_{STP} = 2.04; t_{46} = 15.89, p < .01), and for how long it had supplied ERP solutions (M_{EST} = 5.36, M_{STP} = 2.64; t_{46} = 10.83, p < .01). Therefore, the selection of supplier firms was successful. As expected, I also find that respondents differentiated between low referrer status and high referrer status on dimensions of referrer’s social ranking (M_{HI} = 5.79, M_{LOW} = 1.79; t_{46} = 12.81, p < .01),
status ($M_{HI} = 5.83, M_{LOW} = 1.79; t_{46} = 12.38, p < .01$), and respect ($M_{HI} = 5.95, M_{LOW} = 2.08; t_{118} = 11.67, p < .01$) in its industry. Therefore, the manipulations for referrer status were successful.

**Final Data Collection**

For the final stage of data collection, I selected 1000 purchasing managers in the instruments industry who are members of the ISM™. I mailed the stimuli to the purchasing managers, including a cover letter on the university letterhead that provided details of the study and asked respondents to attach their business cards if they desired a copy of the report. I also included a self-addressed, prepaid envelope and a $1 bill to increase the response rate. In the survey packet, I included a redirecting form that respondents could return to us if they believed someone else in the firm was better suited to answer the stimuli. When I received these forms, I forwarded the survey to the identified alternate key respondents. After three weeks, I mailed reminder letters which included the stimuli and the prepaid envelope. The response rate was very low due to multiple reasons. First, over 250 envelopes were returned because of address problems (unable to forward). 30 surveys were returned by respondents because the purchasing manager did not work in that firm, or had retired. I also received 6 redirection forms. Finally, to date, I received 27 usable responses.

**Model**

As the Study 2 data is sparse for each category of the logistic model (as used in Study 1, see Table 4-1), I estimate a regression model with the difference in potential customer’s evaluation of the supplier pre- and post-referral as my dependent variable in Equation (2). Similar
to Study 1, I model expectation disconfirmation (ExpDisc; Equation 1) and referral’s influence on potential customers’ supplier evaluation (Eval; Equation 2) simultaneously.

**Results**

The results of the small sample manager study provide support to findings from Study 1. First, similar to Study 1 I find that potential customers have higher expectations concerning referrer status from an established firm compared with a startup (Figure 4-7). Although, because of the small sample size the mediating effect of expectation disconfirmation is not statistically significant (H1; please see Table 4-4), like Study 1, I find that potential customers exhibit lower positive expectation disconfirmation for established firms as compared to startups (Figure 4-5). I find support for H2, the effect of high referrer status is stronger for a startup than an established firm on the supplier-initiated referral’s influence on the potential customer (Figure 4-8); and similar to Study 1, I do not find support for H3. Therefore, these results (with managers as the respondents in a different empirical context) lend support to the results from Study 1 with students as respondents.

Table 4-4: Study 2 Results: Replication with Managers

<table>
<thead>
<tr>
<th></th>
<th>Expectation Disconfirmation</th>
<th>Supplier-Initiated referral's influence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td>-2.28**</td>
<td>.64</td>
</tr>
<tr>
<td>Supplier reputation</td>
<td>.41</td>
<td>-.34</td>
</tr>
<tr>
<td>Referrer status</td>
<td>3.28**</td>
<td>.73</td>
</tr>
<tr>
<td>Supplier reputation X Referrer Status</td>
<td>-.98</td>
<td>-.96*</td>
</tr>
<tr>
<td>Expectation Disconfirmation</td>
<td>N.A.</td>
<td>.12</td>
</tr>
</tbody>
</table>
Figure 4-6: Study 2: Effect of Supplier Reputation on Potential Customer's Expectations of Referrer Status

Figure 4-7: Study 2: Potential Customer's Expectation Disconfirmation with Referrer Status
Figure 4-8: Study 2 Results: Supplier-Initiated Referral's Influence on Potential Customer

4.4. Discussion

The objective of this paper was to test the effect of supplier reputation on the efficacy of a supplier-initiated referral. I compare the relative benefit of a supplier-initiated referral for an established firm (i.e., a supplier with high reputation) versus for a startup (i.e., a reputation-less supplier). Building on status theory and expectation disconfirmation theory, I present and explain the differential effect of referrer status when the supplier is an established firm versus a startup. I find that expectation disconfirmation for referrer status reduces the positive effect of an established firm on the supplier-initiated referrals’ influence on the potential customer. I also find that, contrary to status theory, a low status referrer does not reduce the performance of an established firm more than that of a startup, as potential customers’ purchase uncertainty is lower for an established firm that it is for a startup.
4.4.1. Theoretical Implications

This paper draws on theories related to buyer behavior (reducing purchase uncertainty and the role of expectation disconfirmation) and status. I investigate a context in which the mechanisms as suggested by status theory are in contrast to the mechanisms suggested by buyer behavior theory. This allows a test of status theory in a context where potential customers are evaluating the capabilities of suppliers; and thus, the discussion moves beyond looking at general stakeholders to evaluating a specific, and a very important stakeholder, the potential customer. Below, I offer implications of the results for status theory.

In recent years, there has been a concentrated effort to decouple reputation and status (Washington and Zajac 2005). The potential customer’s purchase uncertainty is directly related to the reputation of a supplier for delivering quality products, and thus allows us to delineate reputation from status. To the best of my knowledge, this is the first paper which considers the reputation of a supplier and the status of its alliance partner, that is, its customer. Extant papers have always looked at asymmetries in status, ignoring the role of reputation of the focal firm (Lin, Yang, and Arya 2009; Podolny and Morton 1999). By focusing on supplier reputation and referrer status in a B2B marketing context, I can decouple reputation and status by showing how referrer status reduces purchase uncertainty related to supplier reputation. For example, recent research (Lin, Yang and Arya 2009, Washington and Zajac 2005) has found that when high-status, versus low-status, firms form an alliance with a low-status firm, the alliance has a negative effect on the firm’s performance. In contrast, I find that the potential customer’s evaluation of an established firm does not reduce when the referrer is a low status referrer, more than it reduces for a startup. This effect occurs because the reputation of an established firm is still positive, and higher than that of a startup.
Another well-documented effect in status theory is the “Matthew effect” (Merton 1968; Rao 1994) which shows that high-status firms will benefit more from associations with high-status firms than will low-status firms. As reputation and legitimacy can be reflected through a firm’s status (Lin, Yang and Arya 2009), an established firm likely has higher status than a reputationless startup which also lacks in legitimacy. By focusing on the influence of referrer status in a purchasing context, I am able to assess whether the Matthew effect is applicable to the reputation of a firm, and not its status. And I find that it is not – established firms do not gain more from a high status referrer as compared to startups.

This is also the first paper, to the best of my knowledge that directly compares startups with established firms. Extant research has either looked at how startups’ alliances with high status firms can gain them legitimacy (Zimmerman and Zeitz 2002), or how alliances with status asymmetry affect low and high status firms (Lin, Yang, and Arya 2009). In marketing, when considering supplier reputation as well, researchers have studied low and high reputation firms. For example, Purohit and Srivastava (2001) compare a highly reputed manufacturer with a low reputed manufactures and find that a good warranty is useful as a signal of product quality for highly reputed manufacturers, and not for manufacturers that have low reputation. However, startups do not have a low reputation, they are reputationless. I find that, contrary to Purohit and Srivastava’s (2001) findings, referrer status is more useful as a signal of product quality for a reputation less firm than for a highly reputed firm.

4.4.2. Managerial Implications

As supplier-initiated referrals are considered critical for startups to gain potential customers, and thus, survive, my findings offer useful implications for startups. First, I find that supplier-initiated referrals do positively affect potential customers’ evaluation of a startup.
However, when a startup is competing with an established firm, I find that a low-status referrer is not particularly beneficial for the startup. Therefore, when competing with established firms, it is not simply enough for startups to have a referrer (or reference customer), they need a high-status referrer.

With purchasing managers as respondents I also investigate the specific sources of uncertainty that potential customers perceive for startups. I find that potential customers are more uncertain about the startup’s, versus established firm’s, capabilities related to building a long-lasting relationship, compared with capabilities related to satisfying requirements. Therefore, startups need to assure potential customers that they have the required funding and stability to build a relationship with the potential customer. I also find that, statistically, potential customers do not perceive any difference between the startups’ and established firm’s capabilities to add features as needed by the potential customer. Therefore, startups can emphasize this aspect in the sales process when they are competing against established firms.

For salespersons of established firms, the results indicate that salespersons need to be cautious when selecting referrers in supplier-initiated referrals. Potential customers expect established firms to select high-status referrers, and expectation disconfirmation with referrer status reduces the positive effect of the supplier-initiated referral for an established firm.

4.4.3. Limitations and Future Research

I acknowledge key limitations related to my research. First, as I used an experimental study the best method for testing the theoretical framework, the results might not hold in a retrospective field study. However, it is likely that with a retrospective method, the potential customers’ supplier selection decision would have distorted their recollection of the supplier-initiated referral’s influence.
Second, I study referrer status and supplier reputation, ignoring the potential customer’s status. It is likely that the potential customer’s status will also affect their expectations of referrer status – for example, a high-status potential customer will likely expect a high-status referrer. Future research should study status asymmetries between the three entities involved in a supplier-initiated referral – the supplier, the referrer and the potential customer.

Third, it is likely that there are interactions between referrer status and referral message (which I hold constant in this paper). However, focusing on status as a signal necessitates holding the other attributes constant. Despite these limitations, I rely on established theories to build hypotheses, and offer important theoretical and managerial implications.
Chapter 5

Conclusion

In my dissertation, I regard a referral as a triadic exchange relationship among the referrer, the potential customer, and the supplier; I also highlight that a referral is a recommendation for a supplier firm. The three essays deal with different, but connected, aspects of how the supplier can manage referrals to influence the potential customer in favor of the supplier. Building on extant research on influence as applied to referrals, I focus on those characteristics of the referrer and the referral message which the supplier can manage to benefit from referrals. In Essay 1, I provide a conceptual framework to view referrals from the suppliers’ perspective, and present an agenda for future research on referrals.

In Essays 2 and 3, I empirically investigate how a supplier can affect the referral’s influence on the potential customer by selecting a specific referrer, contingent on the supplier’s own characteristics. With essays 2 and 3, I take forward the literature of influence of referrals in two key areas. First, I show that a referral’s influence on the potential customer is contingent on the supplier’s own characteristics (namely, insupplier/outsupplier status and supplier reputation); and not just on the characteristics of the referrer or the potential customer. Second, I show that as the supplier selects the referrer in supplier-initiated referrals, the potential customer does perceive a bias in the referral, which reduces the referral’s influence on the potential customers’ evaluation of the supplier. However, this negative effect of perceived bias does not diminish the positive effect of selecting the right referrer to influence the potential customer in the supplier’s favor.

In Essay 1, I argue that referrals affect the supplier’s expected sales by influencing a potential customer to purchase or not from the supplier. To understand how supplier firms can manage referrals, I discuss their role in terms of their influence on potential customers who face
purchase decisions (see Appendix A). With the concept of referral equity, I link referrals to the firm’s financial performance and thus contribute to research on the marketing–finance interface (Srivastava, Shervani, and Fahey 1998). I argue that supplier firms should manage referrals and provide referral management strategies that can build a supplier firm’s referral equity. I also define three types of referrals through which referrers can influence potential customers in favor of, or against, the supplier: customer-to-potential customer referrals, horizontal referrals, and supplier-initiated referrals.

Supplier-initiated referrals play an important role in business-to-business markets as suppliers increasingly use supplier-initiated referrals in the sales process to influence the potential customer in favor of the supplier. Practitioners increasingly invest in formal customer reference programs to manage supplier-initiated referrals. According to a senior vice president of Forrester Research, “many firms have also discovered that effective management of their Customer Reference management function… is on the critical path to both sustained business from the base and growth in new accounts” (Adrian 2008, p.1). In Essays 2 and 3, I focus on how the supplier can manage supplier-initiated referrals such that the referral influences the potential customer in favor of the supplier.

In Essay 2 I investigate the tradeoffs that suppliers must make in selecting a referrer, such as to increase the positive influence of the supplier-initiated referral on the potential customer. I find that because the supplier selects the referrer, the potential customer perceives a bias in the referral; and, thus the positive influence of the referral on the potential customer reduces. However, the positive aspect of this finding is that there is less differentiation between an all-positive referral and a balanced referral on the referral’s influence on the potential customers’ supplier evaluation. Therefore, suppliers can trade-off a referrer who would give an all-positive referral for a referrer who would give a balanced referral. I also find that if the supplier is an insupplier, the supplier should focus on selecting a referrer homophilous to the potential
customer; because for an insupplier, homophily between the referrer and the potential customer has higher positive influence on the potential customer than for an outsupplier.

The role of supplier-initiated referrals in the sales process becomes highly important for startups – as startups are reputation-less and potential customers harbor increased uncertainty about their capabilities to deliver the solution as needed. In Essay 3, I focus on how the supplier’s reputation affects the influence of the supplier-initiated referral on the potential customer. I find that referrer status is critical for suppliers that are reputationless to positively influence the potential customer, but not so for suppliers with positive reputations. Thus, these findings imply that to influence the potential customer in favor of the supplier, startups cannot trade-off referrer status for other referrer characteristics (such as homophily), but an established firm can. Therefore, by effectively managing referrer selection in supplier-initiated referrals, suppliers can affect the referral’s influence on the potential customer.

The three essays view a referral’s influence on the potential customer from the perspective of the supplier. After all, the ultimate goal of marketing is to generate sales for the supplier. And as Bennett (2004, p. 607) says: “In sales, a referral is the key to the door of resistance.”
Appendix A

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, I develop illustrative propositions that summarize how the role of referrals depends on (1) purchase decision stage (§ A.1; Figure 2-2) and (2) purchase situation characteristics (§ A.2; Figure 2-3). 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 (Figure 2-2).

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 (Figure 2-2).

Consideration Set. Potential customers create the consideration by adding supplier firms to or discarding them from their awareness set (Hauser and 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), i.e., 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; I 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, versus 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, I describe how purchase situation factors affect the role of referrals in potential customers’ purchase decision. I consider the following factors: product characteristics (§A.2.1), potential customer’s purchase characteristics (§A.2.2), supplier firm’s characteristics (§A.2.3), referral attributes (§A.2.4), and the referrer’s characteristics (§A.2.5) (Figure 2-3).
A.2.1. Product Characteristics

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

Product Lifecycle Stage. A product’s lifecycle 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 and Fornell 1988).

As customer-to-potential customer referrals reduce purchase uncertainty in the earlier stages of the product lifecycle (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 and Igel 2004). For products in the earlier stages, product diffusion theory finds that customer-to-potential customer referrals (the contagion effect, in diffusion theory\(^\text{10}\)) have a significant influence on potential customers’ decision to buy a product (e.g., Bass 1969; Krishnan, Bass, and Kumar 2000). Therefore, I expect that the influence of referrals on potential customers is higher during earlier, versus later, stages of the product lifecycle. 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 lifecycle.

\(^{10}\) 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.
P3B: Influence of referrals on potential customers’ purchase decision should be higher at the early stages than at the late stages, of the product lifecycle.

*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 and 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 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, I discuss how potential customers’ (1) prior knowledge or perceptions of novelty, (2) purchase complexity, and (3) purchase involvement affects 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 and Spreng 1996), and I 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 re-purchasing 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 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 and 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, I 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 and 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 and 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, I 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 and 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. 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 and 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, they 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, and 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 the 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 and Taylor 1991), I 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 and 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 (Figure 2-3). Referrer credibility pertains to the potential customer’s perception of the trustworthiness and expertise of that referrer (Sternthal, Dholakia, and 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. 1998).
Appendix B

Stimuli Data Collection for ERP Study
Please place yourself in the following situation

About Ascent Networking Inc. and Your Role at Ascent

You are the Purchasing Manager at Ascent Networking Inc.

Founded in Denver, CO in 1996, Ascent Networking Inc. provides networking devices such as Ethernet adapters (as shown in the image on the right), network storage devices, and firewalls for broadband service providers and other firms. Ascent Inc.’s 2008 annual revenue was $153 million and has been growing by 4% for the last three years. Ascent operates in 10 countries through distributors and is focusing on expanding its international presence.

To meet the planning challenges resulting from its global growth, Ascent has decided to purchase an Enterprise Resource Planning (ERP) system. Their goals for the system are to integrate and simplify their business flow from purchase order to order shipment, including production processes. With the ERP system, Ascent aims to reduce costs by improving inventory planning and streamlining order fulfillment. Ascent expects the ERP system to make a significant improvement in their operations. Ascent seeks a vendor to provide the complete ERP solution; that solution must include understanding and defining Ascent’s requirements, customizing components of the solution, deploying and integrating the ERP system into existing systems, and providing postdeployment support.

Current Purchasing Stage

Ascent Inc.’s purchase process for the ERP system is given below.

1. Need Recognition
2. Request for Proposals to ERP Vendors
3. Preliminary Technical Evaluation of Vendors
4. Choosing Vendors for Detailed Technical Assessment
5. Detailed Technical Assessment
6. Choice of Vendor for Purchase

The technical team has identified and qualified eight competing ERP vendors who appear to meet all of Ascent’s technical requirements (stage 3), and their quoted price is within Ascent’s budget. The next step is to develop a short-list of ERP vendors for final consideration (stage 4). These vendors will undergo a detailed technical assessment; that consists of evaluation of system architecture and performance, a detailed comparison of each vendor’s technical specifications against the other vendors, followed by assessment of each vendor’s customization and integration proposal.

The detailed technical assessment requires a four-member team to evaluate all the vendors, and is expected to take approximately eight to ten weeks. This is a significant investment in time and personnel for Ascent. Your responsibility is to evaluate the ERP vendors that have cleared the technical evaluation process and propose a short-list of vendors for detailed assessment prior to vendor selection. You have asked each firm that passed step 3 above (Technical Evaluation) to provide a key reference customer who you are planning to interview as part of your vendor choice process. The following pages provide the results of your discussions.

Given this information, please evaluate the following ERP solution vendors. Please consider each vendor independently. You do NOT have to choose between these vendors.
ERP Solution Vendor: Centra Software Inc.
Centra Software Inc., founded in 1974 in Chicago, IL, is one of the vendors you are considering for detailed technical assessment. Centra Software employs 1200 people and operates in the US. Their quoted price is within Ascent Inc.’s budget and expectations. Ascent Inc. has earlier done business with Centra Software, but for a simple accounting software, that is not related to the ERP solution.

Centra Software has referred you to one of their existing customers, Sigma Inc., to discuss their experience with Centra Software’s ERP solution.

About Centra Software’s Customer, Sigma Inc.
Sigma Inc. was established in 1965. Sigma Inc. introduced networking devices as part of its product portfolio four years ago, and last year held 5% of the market share in the networking devices market.

Sigma Inc.’s Reputation: In its March 2009 edition, the trade journal, Communications News, presented the results of its latest “Industry Reputation Quotient” survey. In its survey, Communications News asks 2,000 executives and directors from peer firms, and customer firms to rank companies in an industry on multiple aspects of company reputations. Communications News survey gave Sigma Inc. an “Satisfactory Reputation” rating, with 65% of the 400 firms in the industry rated below Sems Systems.

Your conversation with Bill Davis, Sigma Inc.’s director of procurement
In the course of your conversation with Bill you realize that Sigma Inc. deployed the ERP system for a larger business size ($900 million in 2008 revenue) than Ascent. Plus, Sigma Inc. is using the ERP system for different requirements as compared to Ascent’s needs. Sigma Inc.’s ERP system is focused on standardizing materials requirements planning to reduce costs. Ascent wants to reduce costs by improving inventory planning and streamlining order fulfillment.

Bill’s statement about Centra Software’s ERP solution:
“We are satisfied with Centra Software’s ERP system. Their solution fit our requirements, and was delivered at our launch date. The integration process was without any major issues, and was done within the expected cost. Overall, we’ve reduced our operation management costs by around 5%, and it is because of Centra Software’s ERP system.”
Given the information above about Centra and its key reference customer, Sigma:

Please indicate the extent to which you agree or disagree with the following statements:

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<tbody>
<tr>
<td>1</td>
<td>Sigma Inc. withheld negative information about Centra Software</td>
<td>disagree</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>2</td>
<td>Sigma Inc. gave only favorable information about Centra Software</td>
<td>disagree</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>3</td>
<td>Sigma Inc. was not truthful about Centra Software.</td>
<td>disagree</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
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Please answer the following questions:

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<tbody>
<tr>
<td>1</td>
<td>How likely would you be to include Centra Software Inc. for the short list?</td>
<td>Not at all</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>2</td>
<td>How likely would you be to consider Centra Software for purchase of your ERP solution?</td>
<td>Not at all</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>3</td>
<td>Would you recommend your firm to purchase the ERP solution from Centra Software (please choose one)?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>How confident are you about your evaluation concerning Centra Software?</td>
<td>Not at all</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
</tbody>
</table>
Thank you for responding as Ascent Inc.’s purchasing manager. Please answer the below questions as related to your current role in your firm.

Please indicate the extent to which you agree or disagree with the following statements:

<table>
<thead>
<tr>
<th></th>
<th>Statement</th>
<th>Degree of Agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>ERP solutions are difficult to implement</td>
<td>disagree agree</td>
</tr>
<tr>
<td>2</td>
<td>There is personnel training required to use ERP solutions</td>
<td>disagree agree</td>
</tr>
<tr>
<td>3</td>
<td>Choosing the wrong ERP vendor would cost the firm time and money</td>
<td>disagree agree</td>
</tr>
<tr>
<td>4</td>
<td>Reliability of the ERP solution is important for a firm’s business</td>
<td>disagree agree</td>
</tr>
<tr>
<td>5</td>
<td>I could relate to the purchasing situations given in this survey</td>
<td>disagree agree</td>
</tr>
<tr>
<td>6</td>
<td>The purchasing situations given in this survey were realistic</td>
<td>disagree agree</td>
</tr>
</tbody>
</table>

About You and Your Firm:

<table>
<thead>
<tr>
<th></th>
<th>Statement</th>
<th>Degree of Agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>We have experience in making software solution purchases such as ERP systems</td>
<td>disagree agree</td>
</tr>
<tr>
<td>2</td>
<td>I am knowledgeable about my firm’s requirements for software solutions</td>
<td>disagree agree</td>
</tr>
<tr>
<td>3</td>
<td>I am usually involved in the decision to choose vendors</td>
<td>disagree agree</td>
</tr>
<tr>
<td>4</td>
<td>I am usually involved in the decision making process of choosing vendors</td>
<td>disagree agree</td>
</tr>
</tbody>
</table>

Please think back to the last time you were involved in a software solution purchase like an ERP system:

How many members were involved in the buying team? _______

How much time did the buying team take to evaluate all vendors, and make the purchase? _______

General Information

Years of Industry experience _______

Position and Department at your firm _______

No. of years you have worked in your firm _______

Total number of employees in your firm _______

Thank You for Your Time
Stimuli Data Collection for IMC Study
Please place yourself in the following situation
You are the Marketing Director at Ascent Worldwide Inc.

Founded in Denver, CO in 1986, Ascent Worldwide Inc. is a manufacturer of fitness equipment for the medical and fitness markets. Ascent builds and supplies fitness equipment and parts of the fitness equipment such as, treadmills, incline trainers, and elliptical machines to other firms. Ascent Inc.’s 2008 annual revenue was $453 million and has been growing by 4% for the last three years.

Ascent has made a strategic decision to market its products directly to consumers. To launch its products in the consumer market, Ascent wishes to understand the consumers’ needs and roll out an integrated marketing communications (IMC) program.

Ascent is seeking an advertising and marketing communication agency to provide the complete IMC campaign; the IMC campaign includes market research, advertising, branding, public relations, and promotions, with a focus on the internet and social media such as facebook, twitter and blogs. Ascent plans to use the advertising agency they select now for all their future needs – at least for the next five to seven years. The top management at Ascent (including you as Marketing Director of Ascent) believes that the advertising agency will have a significant effect on whether Ascent is successful in the consumer market or not. Selecting the right advertising agency is a very important decision for Ascent; and as Marketing Director it is your responsibility.

Selecting an Advertising and Marketing Communication Agency
Ascent is evaluating a number of advertising and marketing communication agencies before making the final selection. The chart below describes Ascent’s process for selecting an advertising and marketing communication agency.

You and your team have viewed the presentation by all the agencies. The next step is to develop a short-list of agencies for final consideration (stage 3). These agencies that have been short-listed will undergo a detailed assessment, called a “creative shootout”; the creative shootout involves the agency and your team to work together to understand Ascent’s requirements, Ascent’s potential market and develop a tentative IMC campaign.

The creative shootout involves significant investment in effort and time for the agency and for Ascent. To aid your decision to select five agencies for the creative shootout, you have asked each agency that passed step 2 above (Presentation) to provide a key reference customer who you are planning to interview.

Next, you will be given information on one of the advertising and communication agencies, followed by information on their reference customer. Please answer the questions as presented.
Advertising and Marketing Communication Agency: Ogilvy & Mather

Founded in 1948, Ogilvy & Mather is one of the largest marketing communications companies in the world. Through its specialty units, the company provides a comprehensive range of marketing services including: market research, advertising; public relations and public affairs; branding and identity; shopper and retail marketing; communications; direct, digital, promotion services. Ogilvy & Mather services Fortune Global 500 companies as well as local businesses through its network of more than 450 offices in 120 countries.

In the recent 2010 CLIO awards (CLIO are worldwide awards honoring creativity in advertising in all media, and are considered one of the most prestigious industry awards), Ogilvy & Mather won 17 awards.

Ogilvy & Mather is headquartered in New York, USA.

Ascent has been dealing directly with Ogilvy & Mather’s headquarters. Ascent has never done business before with Ogilvy & Mather.

You have seen Ogilvy & Mather’s presentation which proposes an IMC campaign for Ascent. On the basis of those presentation, Ogilvy & Mather has advanced to the current stage of the your purchasing process.

The potential agreement with Ogilvy & Mather will also include long-term plans for developing Ascent’s brand in the consumer market. The pricing submitted by Ogilvy & Mather is within Ascent’s budget and is around the average for an IMC campaign.

Given the information till now, please give your current evaluation of Ogilvy & Mather’s as an advertising and marketing communication agency for Ascent:

<table>
<thead>
<tr>
<th></th>
<th>How likely would you be to include Ogilvy &amp; Mather for the short list for a creative shootout?</th>
<th>Not at all</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>Very likely</th>
<th>6</th>
<th>7</th>
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<td>1</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>How likely would you be to consider Ogilvy &amp; Mather for running Ascent’s IMC campaign?</th>
<th>Not at all</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>Very likely</th>
<th>6</th>
<th>7</th>
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</tbody>
</table>

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<tr>
<th></th>
<th>Would you recommend your firm to select Ogilvy &amp; Mather for the IMC campaign (please choose one)?</th>
<th></th>
<th></th>
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<td>3</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>How confident are you about your evaluation concerning Ogilvy &amp; Mather?</th>
<th>Not at all</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>Very confident</th>
<th>6</th>
<th>7</th>
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</tbody>
</table>
Next, you will talk to Ogilvy & Mather’s Reference Customer. Note that Ogilvy & Mather has selected a Reference Customer to give a positive referral for Ogilvy & Mather, such that you are influenced in Ogilvy & Mather’s favor.

Before you read further, please take a moment to think about what expectations you would have from Ogilvy & Mather's Reference Customer.

Please answer the following questions:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th>Very unlikely</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th>Very likely</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Ogilvy &amp; Mather’s reference customer would be a firm that is highly respected in the industry</td>
<td>1  2  3  4  5</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>6  7</td>
</tr>
<tr>
<td>2</td>
<td>Ogilvy &amp; Mather’s reference customer would be a firm that is admired by its peers and others in the industry</td>
<td>Very unlikely</td>
<td>1  2  3  4  5</td>
<td></td>
<td></td>
<td></td>
<td>6  7</td>
</tr>
<tr>
<td>3</td>
<td>Ogilvy &amp; Mather would likely select an established firm as its reference customer</td>
<td>Very unlikely</td>
<td>1  2  3  4  5</td>
<td></td>
<td></td>
<td></td>
<td>6  7</td>
</tr>
<tr>
<td>4</td>
<td>Ogilvy &amp; Mather’s reference customer would likely give positive information about Ogilvy &amp; Mather</td>
<td>Very unlikely</td>
<td>1  2  3  4  5</td>
<td></td>
<td></td>
<td></td>
<td>6  7</td>
</tr>
</tbody>
</table>
Ogilvy & Mather has referred you to one of their existing customers, Sems Equipment Inc., to discuss their experience with Ogilvy & Mather’s IMC campaign planning and execution.

About Ogilvy & Mather’s Customer, Sems Equipment Inc.

Sems Equipment Inc. was established in 1979, and is headquartered in Massachusetts, USA. Sems Equipment supplies sports equipment and apparel to other firms and directly to consumers under their “SlimSems” brand. Sems Equipment is leading the development of new absorbent and breathing material in the fitness apparel industry.

Sems Equipment’s Ranking: Each year, Fortune published the world’s “Most admired Companies” list. These rankings are based on a survey that polls more than 10,000 financial analysts, senior executives, and Wall Street investors from more than 580 large companies. This ranking is an average score of ratings on criteria such as community and environmental responsibility, innovativeness, financial soundness, quality of management and quality of products and services. In the fitness and sports industry, Fortune ranked only 8 firms. Sems Equipment’s score was 6.86/10 (the highest score was 7.95/10). Sems Equipment’s was ranked #3 in Fortune’s Most Admired Companies survey in 2010. Sems Equipment's has been ranked in the top 3 firms since 2008.

Your conversation with Mike Copeland, Sems Equipment Inc.’s Vice President, Marketing

Mike and his team are responsible for marketing and IMC campaigns at Sems Equipment. In the course of your conversation with Mike you realize that Sems Equipment started their relationship with Ogilvy & Mather for the same reason as Ascent – to market Sems Equipment apparel directly to consumers.

Mike’s statement about Ogilvy & Mather’s execution of the IMC campaign:

“We are more than satisfied with Ogilvy & Mather’s execution of IMC Campaigns for us. They really invested in understanding our requirements and our target market. They delivered a really creative IMC campaign for us to launch our apparel. We achieved our objective of gaining market share of around 5%, and even achieved higher brand awareness in the online community than we’d expected. It’s because of Ogilvy & Mather.”
Given the information above about Ogilvy & Mather and its key reference customer, Sems Equipment:

Please give your current evaluation of Ogilvy & Mather’s ERP solution for Ascent:

1. How likely would you be to include Ogilvy & Mather for the short list for a creative shootout? Not at all 1 2 3 4 5 Very likely 6 7
2. How likely would you be to consider Ogilvy & Mather for running Ascent’s IMC campaign? Not at all 1 2 3 4 5 Very likely 6 7
3. Would you recommend your firm to select Ogilvy & Mather for the IMC campaign (please choose one)?
   Not at all □ □
   Very confident □ □
4. How confident are you about your evaluation concerning Ogilvy & Mather? Not at all 1 2 3 4 5 Very confident 6 7

Please indicate the extent to which you agree with the following statements concerning Ogilvy & Mather’s Reference Customer, Sems Equipment Inc.:

1. Ogilvy & Mather’s reference customer is a firm that is highly respected in the industry Highly disagree 1 2 3 4 5 Highly agree 6 7
2. Ogilvy & Mather’s reference customer is a firm that is admired by its peers and others in the industry Highly disagree 1 2 3 4 5 Highly agree 6 7
3. Ogilvy & Mather has selected an established firm as its reference customer Highly disagree 1 2 3 4 5 Highly agree 6 7
4. Ogilvy & Mather’s reference customer gave positive information about Ogilvy & Mather Highly disagree 1 2 3 4 5 Highly agree 6 7

Please respond to the following statements

1. Ogilvy & Mather’s reference customer, Sems Equipment’s, status in the industry was
   Worse than I expected 1 2 3 4 5 Better than I expected 6 7
2. Ogilvy & Mather’s reference customer, Sems Equipment’s, position in the industry was
   Worse than I expected 1 2 3 4 5 Better than I expected 6 7
Please indicate the extent to which you agree or disagree with the following statements:

<table>
<thead>
<tr>
<th></th>
<th>Statement</th>
<th>Scale</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Selecting the agency for the IMC campaign is an important decision for Ascent</td>
<td>1 2 3 4 5 6 7</td>
</tr>
<tr>
<td>2</td>
<td>There is investment required from Ascent to select the right agency for the IMC campaign.</td>
<td>1 2 3 4 5 6 7</td>
</tr>
<tr>
<td>3</td>
<td>Choosing the wrong agency would cost Ascent time and money</td>
<td>1 2 3 4 5 6 7</td>
</tr>
<tr>
<td>4</td>
<td>Success of the IMC campaign is important for Ascent's business</td>
<td>1 2 3 4 5 6 7</td>
</tr>
<tr>
<td>5</td>
<td>Ogilvy &amp; Mather is an established firm in the advertising and marketing communications industry</td>
<td>1 2 3 4 5 6 7</td>
</tr>
<tr>
<td>6</td>
<td>Ogilvy &amp; Mather has a good reputation for producing quality campaigns in the advertising and marketing communications industry</td>
<td>1 2 3 4 5 6 7</td>
</tr>
<tr>
<td>7</td>
<td>I have heard of the advertising agency, Ogilvy &amp; Mather, before today.</td>
<td>1 2 3 4 5 6 7</td>
</tr>
<tr>
<td>8</td>
<td>Ogilvy &amp; Mather is a startup.</td>
<td>1 2 3 4 5 6 7</td>
</tr>
<tr>
<td>9</td>
<td>Sems Equipment has high social ranking in the fitness and equipment industry.</td>
<td>1 2 3 4 5 6 7</td>
</tr>
<tr>
<td>10</td>
<td>Sems Equipment has higher status than most other firms in its industry.</td>
<td>1 2 3 4 5 6 7</td>
</tr>
<tr>
<td>11</td>
<td>Sems Equipment is respected in the industry by its peers.</td>
<td>1 2 3 4 5 6 7</td>
</tr>
</tbody>
</table>

Thank You for Your Time


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Goldstein, Harvey (2011), *Multilevel Statistical Models* (1sts ed.). West Sussex, United Kingdom: John Wiley & Sons Ltd.


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VITA
Mahima Hada

Education
2006-Current  PhD Candidate in Marketing, ISBM Doctoral Fellow
Smeal College of Business, The Pennsylvania State University,
August 2011 (expected)

2006  MBA, Post Graduate in Software Enterprise Management
Indian Institute of Management, Bangalore, India

1999  Bachelor of Engineering (Mechanical)
Army Institute of Technology, Pune University, India

Publications
paper

Cases
Hada, Mahima and Arvind Rangaswamy (2007), “Positioning the Blackberry Pearl”, in
Lilien, Arvind Rangaswamy and Arnaud De Bruyn.

Business Press Coverage of my Research

Honors and Research Awards
- Winner, 2009 ISBM Dissertation Support Award Competition (February 2010).
- 2010 Marketing Science Doctoral Consortium (June 2010)
- ISBM Fellowship, Penn State (2006 – Current)
- Smeal Doctoral Research Award, Dean’s Office, Penn State (2009)
- David and Joan Wilson Award for Outstanding Scholarship in Marketing, Penn State (2009)
- Haring Symposium Fellow, Indiana University (2008)
- Jerome Scott Award for Outstanding Scholarship in Marketing, Penn State (2007)
- Best Candidacy Exam Award, Marketing Department, Penn State (2007)
Silver Award, Final PGSEM MBA Project, Indian Institute of Management, Bangalore (2006)

Industry Experience
Consultant, Dassault Systemes  Germany and India [2000 –2006]
Application Engineer , Optech Solutions Pvt. Ltd.  Delhi, India [1999- 2000]