

The Impact of Consumers' Functional Goals on Referral Effectiveness

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Abstract

Word-of-mouth (WOM) is one of the most powerful determinants of consumer behavior and reduces perceived risk, reinforces brand equity, and drives sales. One option for firms to influence consumer behavior through WOM is through customer referrals. We argue that consumers have different functional goals when they make purchase decisions and show that referrals need to match these goals influence future decisions. A secondary dataset from the German automotive market provides information on customer referral behavior. Matching this information to automotive sales allows us to determine the impact of functional matching on market share. We group name brands in value and premium brands to estimate the effect of matching referrals. The results show that matching referrals have a stronger positive effect on market share compared to non-matching referrals. From a managerial perspective, we show that managers should take differences in functional motivation into account when they design referral programs.

Keywords: Referral management, Word of mouth, Market share

Track: Relationship Marketing

1. Introduction

Word-of-mouth (WOM) communication has a greater and longer-lasting impact on consumer behavior than many other marketing tactics (Villanueva, Yoo & Hanssens 2008). Compared to advertising, WOM referrals produce substantially higher response elasticities (Trusov, Bucklin & Pauwels 2009). As a result, WOM is as a key driver of customer value (Schmitt, Skiera & Van den Bulte 2011). The literature on WOM campaigns has either focused on measures to improve the diffusion of WOM information among consumers (e.g. Stephen and Lehmann 2016), or on optimal targeting of WOM campaigns to increase sales (e.g. Trusov et al. 2009). In this research, we focus on the latter and investigate why effective referral campaigns should emphasize the functional value of WOM. In particular, we argue that referrals that match consumers' functional consumption goals are more effective. They have the ability to drive future sales and thereby build value for the firm.

Investments in WOM communication are valuable, because they not only drive early-stage product success, but also exert a lagged impact on demand after the effects of advertising have already worn out (Bruce, Foutz & Kolsarici 2012). As a result, many firms aim to strategically manage WOM through customer referral programs. WOM referral programs are “a form of stimulated WOM that provides incentives to existing customers to bring in new customers” (Schmitt et al. 2011). Rewards increase the likelihood that consumers voice a referral, but they may have an adverse effect on receiving consumers' behavior. In this research, we focus on instances of non-rewarded referrals where consumers simply receive a recommendation on a specific car brand or model.

To illustrate, consider the following situation: You are currently looking to buy a new car. Most likely, you will consult car magazines and websites to inform your decision. After some time, you have an idea about decisive attributes and the functional purpose of your car. Before you make a decision, you are also likely to talk to your friends, family, or colleagues about the decision and possibly ask for a recommendation. We argue that whether a referral provides valuable advice to you will depend on its specific content. If you are looking for a luxury car and the referral mentions storage space and reliability as key value drivers, this might not really cater to your functional need. On the other hand, when the referral mentions leather seats and a high-end car entertainment system, this could be much more valuable for your decision. In other

words, the first referral was a mismatch with regard to your decision, while the second referral provided information that matched your needs. This example highlights the major pitfall of referral management programs, namely, when a referral will drive behavior or not.

We draw on the functional matching principle (Petty and Wegener 1998) to shed more light on referral effectiveness. Functional matching describes conditions under which persuasive messages, such as referrals or advertisements, influence attitudes and decision-making. Thus, the main objective of this research is to investigate the need for fit between referral type and product function. To address this objective, we combine input from time-series survey responses of new car buyers and market share data from official car sales records for a seven-year period (2000 to 2007). We develop an empirical model to draw inferences about whether matching referrals are more effective in driving customer acquisition. Our results indicate that referrals increase market share, but more so for functionally matching referrals.

2. Literature review

2.1. Customer acquisition through referrals

Consumers often make decisions without full knowledge of the costs and benefits of their decision. In such situations, they rely on external sources of experience information that helps them to build some of that knowledge. Making the right choice therefore is often a function of receiving recommendations generated by others. Referrals are a specific form of WOM, where consumers recommend products or services to other consumers in order to help them make a decision. Referrals may come about unsolicited, i.e. without a reward, or solicited, i.e. motivated through a reward (Verlegh, Ryu, Tuk, & Feick 2013). Because their generation can be motivated through giving rewards for successful referrals, much of the existing literature has focused on referral reward programs (Schmitt et al. 2011). Referral programs offer rewards to customers who make recommendations.

However, in order for a referral to drive customer acquisition, it needs to affect the behavior of other consumers who follow the recommendation. There is some speculation that rewarded referrals are less effective than unrewarded referrals (Trusov et al. 2009). For example, receivers infer the recommender's motives and suspect the recommender of having ulterior (e.g. monetary) motives for providing the recommendation. Such inferences in turn diminish referral success

(Verlegh et al. 2013). In contrast, unrewarded referrals are likely to be genuine and thus appear unbiased. There is some empirical evidence that gives companies an idea of how well a certain type of reward structure will perform in driving referral generation but there is little information about the effectiveness of non-rewarded referrals that occur as during conversations between consumers. In this particular case, the central question is what type of referral would drive new customer acquisition. Since consumers looking to make a decision are uncertain about the different options to choose from, they make inferences about a recommendation's functional value (Berger 2014). Particularly, they infer whether a recommendation contains information that caters to their functional needs in relation to the decision. We draw on the literature on the functionality of attitudes and, more specifically, the functional matching effect to develop predictions about which type of referral should provide value.

2.2 Functional attitudes and the value of information

Functional attitude theory suggests that attitudes and opinions influence various psychological and behavioral functions (Katz 1960). Briefly, functional theories propose the following mechanism: When consumers face a decision situation, they derive functional goals from their current needs and preferences. To determine product fit to functional goals, consumers rely on information stored in attitudes and expectancies towards products (Katz & Lazarsfeld 1995). In particular, the literature distinguishes between evaluative (also referred to as utilitarian / instrumental) and expressive (also known as symbolic / hedonic) attitude functions. For example, a customer seeking value for money is likely to purchase a product for its evaluative function, while a customer looking to signal wealth and status is likely to purchase a product for its expressive function. The advertising literature provides empirical evidence that matching message appeals to consumers' functional attitudes increases persuasiveness (Petty & Wegener 1998). Importantly, functional matching of appeals increases persuasion more than other features such as communication source and channel (Katz & Lazarsfeld 1995). Within evaluative attitudes functions, objects (e.g. products such as cars) are means to achieve functional utility. In other words, advertising appeals highlighting expressive-relevant characteristics (e.g., social status) will be more persuasive for products that serve expressive functions. In turn, whereas utilitarian appeals highlighting evaluative-relevant characteristics (e.g., safety assistance systems) of the product will be more persuasive for products that serve evaluative functions.

2.3 Functional matching of referrals

Evidence on functional matching of persuasive appeals from advertising research suggests that this mechanism has the potential to influence market outcomes. Recent research adopts this perspective but focuses on the characteristics of the communicator rather than the functional type of appeal (see e.g. Von Wangenheim & Bayón 2007; Yang, Hu, Winer, Assael, and Chen 2012). Therefore, it is not clear how functional matching of persuasive messages, such as referrals, will affect market outcomes.

We extend the existing research towards this gap. Specifically, we propose that referrals affect consumer decisions when the referral appeals to consumers' functional goals associated with the focal product. While both functional matching and word-of-mouth have been extensively studied, evidence on the interaction between the type of referral and consumers' functional goals could generate more detailed information about referral effectiveness. Considering that consumers perceive product value differently based on the product's functional purpose, we posit that referral effectiveness is higher (lower) in cases where the functional appeal of the message matches (mismatches) the recipient's functional goal. Our argument is as follows: When the functional goal is evaluative, referrals that transport information that relates to specific functional characteristics (e.g., a referral of a specific car model) is more relevant to the decision and will thus impact sales. In turn, when the functional goal is expressive, referrals that transport information that relates to symbolic characteristics (e.g., a referral of a specific brand) will influence sales. Formally, beyond a general positive baseline effect of referrals, we predict a moderating influence of referral type on the influence of referrals on market share.

3. Empirical Study

3.1. Empirical Setting

Our primary objective is to understand the moderating role of functional matching between referrals and sales. To this end, the automotive industry is well suited for two reasons: 1) high WOM activity and 2) variance in product function. First, customers in the automotive sector use recommendations to inform their purchase decisions (Allsop, Bassett, and Hoskins 2007). Therefore, referrals by other consumers are likely to have some meaningful impact on the market share of car brands. Second, cars can serve different attitude functions to consumers. For

example, car manufacturers often choose one of two strategies to advertise their cars: On the one hand, they focus on significant features of the specific car model to illustrate the benefits of choosing this particular model, such as fuel efficiency or safety assistance systems. On the other hand, they focus on image appeals to underline the superior attributes associated with the brand, such as luxury and status (Parment 2008). Thus, different message appeals seem to be more relevant for different functional goals associated with car models and brands. Existing segmentation patterns within the car industry further facilitate our objective to match referrals and sales. While prestige cars are purchased for symbolic, expressive reasons, non-prestige cars are purchased for their utilitarian benefit (Kirmani, Sood and Bridges 1999). A survey of German car buyers (Burda Network 2008) reveals that prestige car owners view their car as an expression of their lifestyle and value design and status (i.e., expressive function), while non-prestige car-owners view their cars as objects of utility and value reliability (i.e., evaluative function).

3.2. *Data and modelling approach*

Referral data. We draw insights on referrals from the German Car Buyer Satisfaction Survey. The more than 80,000 observations from continuous telephone surveys between January 2000 and June 2007. The data consists of information on eleven different brands, including seven non-prestige brands and four prestige brands. The available information is monthly structured aggregated data collected from new car buyers. Customers take part in the survey within a one month period following their purchase. Car owners report overall satisfaction with the new vehicle (“Overall, how satisfied are you with your new automobile?”). Additionally, they report their intention to give an expressive referral focusing on the brand (“Given your experience with your new automobile, how likely will you be to recommend this brand to friends, relatives or colleagues?”) or an evaluative referral focusing on a specific model (“Given your experience with your new automobile, how likely will you be to recommend this specific car model to friends, relatives or colleagues?”). We use this information to measure the type of referral.

Sales data. We obtain information on the number of officially recorded car sales from the German Federal Motor Transport Authority. The data is at the brand level and captures fluctuations in sales units across time. We compute brand-specific monthly market shares to estimate the relative influence of referrals on market shares. The data accounts for a sizeable portion of the German private car market (65 %), thus giving indication of generalizable

implications for the complete market size. In sum, the data includes 90 months and 11 brands (4 prestige and 7 non-prestige). Brands in the prestige segment hold a market share of 28.5% compared to 38.2% for brands in the non-prestige segment. Average market share per brand is 7.12 % (prestige segment) and 5.46% (non-prestige segment)

Modeling approach. Since prior research indicates that satisfaction is causal for the existence of referrals, we include customers' satisfaction with their new car as the initial driver of referrals (Yang et al. 2012). We apply a general dynamic panel model to the brand-specific data described in the previous section, based on the following two complementary equations. Referrals influence market share (equation 1) and, in turn, referrals are driven by satisfaction (equation 2). Hence, our model assumes a connection between equation 1 and equation 2, which requires simultaneous estimation. Studies show that the previous level of referrals is the most important driver of current referrals (Villanueva et al. 2008), and our model captures this effect ($t^* = t-1$). This also helps us to ensure that the measured influencing factors (REF and SAT) are not linked to their own purchases within a single time period. We adjusted our model to capture a similar reinforcement effect of past market share. Multiple checks of the data revealed autocorrelation and heteroscedasticity. To alleviate these issues, we apply a Generalized Method of Moments (GMM) estimator (Luo & Homburg 2007). Since we take an aggregated view of the WOM process, it seems highly plausible that a minimum baseline level of referrals needs accumulate before an effect manifests in market share. Therefore, regarding equation 1, we apply an adapted logit-type market share model (Cooper and Nakanishi 2010). Thus, different type of referrals (S) explain market share.

$$MS_{m,t}^s = \exp\{\alpha_m + \beta \cdot REF_{m,t}^s + \tilde{u}_{m,t}\} \cdot \left[1 + \sum_{m=1}^{M^s} \exp\{\alpha_m + \beta \cdot REF_{m,t}^s + \tilde{u}_{m,t}\} \right]^{-1} \quad \text{Eq. 1}$$

Past research suggests that the link between satisfaction and referral is best captured as a non-linear relationship (Von Wangenheim & Bayón 2007), and that higher levels of satisfaction lead to stronger increases in referrals. We expect that these findings will be confirmed in our data using the following equation:

$$REF_{m,t}^s = \mu \cdot (SAT_{m,t}^s)^\gamma \cdot \exp\{\hat{u}_{m,t}\} \quad \text{Eq. 2}$$

We use Hansen’s J-statistic and evaluate our modeling approach against competing models of other (linear and non-linear) forms and find that our model is correctly specified and fits the data well.¹

4. Results and discussion

As expected, we find a significant positive effect of satisfaction on referral intentions, pointing towards a strong relationship to referral intention of both the car brand and specific models (Eq 2). Results for Eq. 1 in both segments show significant positive effects of at least one referral type (brand or model) on segment-specific market share. Due to space restrictions, we show only an excerpt of the segment-specific results for the market share equation (Table 1).

Variable	Prestige segment			Non-prestige segment		
	Estimate	SE	P	Estimate	SE	P
INT	-2.245	0.517	<.001	-3.622	0.301	<.001
REF ^{brand}	0.071	0.008	<.001	0.033	0.008	<.001
REF ^{model}	0.003	0.059	n.s.	0.082	0.036	<.05

Table 1. Segment-specific results for Eq. 1

Comparing the segment-specific results reveals the moderating effect of referral type. Prestige market share shows a significant positive relationship with car brand referral intention only (REF^{brand}), while non-prestige market share has a stronger positive relationship with car model referral intention (REF^{model}). For the prestige segment, we find decisive results, such that there does not seem to be any support for a general baseline effect of positive word of mouth in this segment. When it comes to the non-prestige segment, we note that there is a small but significant influence of brand referrals on non-prestige sales (mismatch). This effect might occur because non-prestige cars are generally less expensive (and thus lower in risk and involvement) than prestige cars which could perhaps decrease consumers’ sensitivity to the credibility and relevance of product information. In other words, non-prestige buyers may be less likely than prestige buyers to dismiss mismatching WOM referrals as irrelevant.

¹ Due to space restrictions, we do not discuss comparative model evaluation in more detail. Detailed results are available from the authors upon request.

Overall, our results provide us with strong evidence that functional matching of referral type to consumers' functional goals results in a greater influence on the effect of intent to refer on market share. Thus, exposure to referrals is not sufficient to drive market share effectively. Tailored incentive rewards program could offer utilitarian rewards for products that have primarily evaluative functionality, and symbolic/status rewards for products with expressive functionality to ensure that referrals drive purchase behavior. In this empirical study of the automotive market, the decisive effects of matching and nonmatching effects on sales volume indicate that it may be especially beneficial for marketers of durable goods to tailor rewards programs based on product type. A 'one-referral-fits-all' approach will likely have a suboptimal, if any, impact on market shares. We provide initial evidence that functional matching gives a perspective on these effects. Clearly, more process evidence can provide further insight into how firms can leverage functional matching to influence consumer behavior.

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