



KnightLine

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“By understanding the lifetime value you could now place your cost of acquiring that client into proper perspective.”

Referral Sales Make Dollars and Sense

by Ray Knight

Challenging economic times require each business to be resourceful and creative. Learning to identify all company assets and talents to develop new ways to keep existing customers happy while pursuing and acquiring new customers is a smart way to focus your time and energies.

Every business's number 1 asset is their existing customer base. Our first two articles made the case for [Rewarding Your Customers First](#) and how basic [Market Research Drives Results](#). This article explains why [Referral Sales Make Dollars and Sense](#) and shows why and how to initiate your own low-cost referral program to sell more of your products and services.

Why are Referral Sales so Important?

Last month, we calculated the level of sales you make to a particular client *over a span of time* to determine the *value* of that client to your business. By understanding the *lifetime value* you could now place your *cost of acquiring* that client into proper perspective. In the simplest of cases, your acquisition cost include the cost of generating the prospect—whether through advertising, direct mail or other marketing program and the *conversion rate* (number of prospects you present/offer your products or services to) and, other related costs like sales commissions. For example:

- Your product sells for \$200
- Your marketing cost to generate a qualified prospect is \$10 each.
- Your sales process converts 1 out of every 5 prospects to a customer (1:5 or 20% conversion)
- Your sales commission is equal to 10% of sales or \$20 in this example.

Your cost per sale is calculated as follows:

You must generate 5 prospects to achieve sale= 5 x \$10 lead cost= \$ 50

Sales commission equates to 10% of revenues= \$ 20

Total Direct Costs \$ 70

Cost of Sale is determined by dividing revenue earned by total costs from the sale of \$200= %35

However, based on the lifetime value of that client, the cost is actually much less. If you assume that this new customer actually purchases your product or service each quarter, the actual cost of sale to acquire the customer is a significantly lower. So, what if a referral

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"...they do so knowing full well that this referral is in the prospect's best interest-otherwise why would they risk impacting his/her relationship with the prospect by actively promoting your business? This is the magic of referrals—it is the trust or bond between them that is transferred to your business which regularly translates to the prospect trusting your business or being positively disposed to become your customer"

from your customer generates a new customer at no marketing cost?

Recognizing that the new customer also has a lifetime value to your business, it is readily apparent why and how Referral Sales Make Dollars and Sense!

In most industries, a typical marketing program is comprised of several *different types of lead generation programs*, with different costs per lead and *different conversion ratios*. To improve your business bottom line, you have a few strategic options to shoot for with your marketing plan.

- 1/ Increase the **number of qualified leads** from any particular lead generation program
- 2/ Improve the **conversion rate** on any particular or several lead generation programs (examine the above example and increase the conversion rate to 3 out of 5 and see the impact on your cost of sales)
- 3/ Increase the **amount of product/service sold** (examine the above example if the prospect that (buys selects two products/services at the \$200 cost-examine cost of sales)
- 4/ A combination of the above three options.

The Psychology Behind Referral Sales

Referral sales are derived by getting your existing customers to spread the good word about your products and services. In earlier articles, we presented how informal surveys—either verbal or written can be used to identify your most probable sources of referral leads—your happiest, or longest duration customers. How to get referral leads—ASK! When your customer actively recommends a friend, family member or associate (the prospect) to your business, they do so knowing full well that this referral is in the prospect's best interest—otherwise why would they risk impacting his/her relationship with the prospect by actively promoting your business? This is the magic of referrals—it is the **trust or bond** between them that is transferred to your business which regularly translates to the prospect **trusting your business** or being **positively disposed** to become your customer. This can have a significant impact on two parts of the overall equation---the cost of acquiring the lead (\$0) or conversion ratio as it takes less referral prospects normally to achieve a sale than the conversion ratio of most other lead generation programs.

Clearly, the greater the number of referral sales the larger the potential impact on your overall sales levels, increasing revenues and reducing your cost of sales.

How do you Increase the Number of Referral Prospects?

Over the years I have had clients in various industries use one of, or a combination of the following types of referral programs:

- 1/ Asking for Referrals-with no financial incentive
- 2/ Asking for Referrals with an **internal incentive**
- 3/ Asking for Referrals with an **external incentive**

Recognize that regardless of the type of strategy applied; only a percentage of your customers will actively go out of their way to help your business. Also realize that numerous studies and stories abound to reinforce that you get what you pay for or you get what you reward! So, realizing the power of referral programs don't be short-sighted, it's a

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“Referral sales will almost always be your most cost-effective source of sales. If you don't have a marketing plan or have not already incorporated this strategy into your marketing plan, make this your top priority”

wise investment in your customer base and your business.

Any of the above programs requires a communication plan- (signage, newsletter, direct mail, email) to explain, ask for and obtain referrals. An *internal incentive involves your offering your existing customer a coupon, credit or gift certificate valid in your store or business only*. It could be for more of what the customer already buys—or for another part of your product/service line (to stimulate trial). An *external incentive can take the same form as the internal except the offer is valid as someone else's business*. These types of offers will typically require a little more time or research to organize the terms of the program with the other business. **TIP: Remember a \$50 coupon for someone else's business should not cost you \$50 to buy. Use your negotiating smarts since the other business wants new customers too!**

Referral sales will almost always be your most cost-effective source of sales. If you don't have a marketing plan or have not already incorporated this strategy into your marketing plan, make this your top priority. Set a goal to harness the power of your customers' referrals to generate 20%-25% of your upcoming revenues.

In the next article in our series we will focus on how to Use Newsletters to Build Your Business.

Ray Knight, President & CEO of Knight Consulting, has over 20 years of in marketing research, marketing, business development and sales experience gained internationally and domestically as both a corporate executive and an entrepreneur in a variety of industries. Much of the content included in KnightLine incorporates strategies and tactics he has personally applied to growing his and clients' businesses. Ray lives and works in Miami Springs and can be reached at 305-888-1905 or by email at knytlyfe@hotmail.com. Read past articles and learn more techniques at www.shadow.net/~rayknight/
