

Advantages of Employee Referral Programs

In case you didn't already know it, employee referral programs are simply the most effective recruiting tool, period. That's not an opinion. It's a position supported by nearly everyone who has investigated and researched the far-reaching impacts of recruiting activities. If you believe in making fact-based recruiting decisions, this article is a must read.

Business Impacts of Referral Programs

Various academic and internal corporate research has found that employee referral programs can:

- **Produce employees who are more productive on the job.** MIT Sloan School of Management Professor Emilio J. Castilla discovered that employees recruited through employee referral programs can have significant performance differentials from employees who were sourced via other channels. While Professor Castilla's research focused on a single call center, his findings are similar to those of a growing list of companies including FirstMerit Bank, Tenet Healthcare, and Allstate, to name a few.
- **Produce employees who have higher retention rates.** Professor Castilla also noted that employees who were recruited via employee referral programs also stayed longer than employees recruited through other sources, providing the employee who referred them did not separate. This is a trend that many corporate program managers have also noticed in such companies as SRA International, PricewaterhouseCoopers, Allstate, Texas Instruments, and Southwest Airlines.
- **Produce fewer non-qualified applicants.** Baptist Healthcare and Allstate have both found that referrals produce a lower percentage of "non-qualified" applicants, a characteristic that reduces the screening delay inherent in most recruiting systems and enables recruiters to focus on getting the right candidates in front of the right managers in the shortest possible time.
- **Function successful across borders in global organizations.** Few recruiting programs can function across global borders without tweaks to tune the program to the local environment. Employee referral programs are one of the shining exceptions. Numerous global companies with operations in the United States, Europe, Asia, and the Middle East have deployed referral programs that function identically in nearly every location. The source has become so popular that within many companies operating in India, it has become the predominate source. The India Times reports that Indian firms often hire as many as 40 percent of their new hires via employee referral. Companies there have noted that such programs produce higher quality candidates, higher offer acceptance rates, and hires compatible with the work environment. Agilent Technologies found that the program worked just as well in Asia and Europe as it did in the U.S., despite a multitude of cultural differences.
- **Reduce the burden on recruiting departments.** It is not uncommon for managed referral programs to produce more than 50 percent of an organization's total new hires. Because managed programs focus on tuning the program to produce only qualified applicants, a great deal of the labor that the recruiting department would usually expend screening and sorting applicants is eliminated.
- **Produce a high ROI.** While on sabbatical from the university, I spent some time at Agilent as the Chief Talent Officer. In making the business case for implementing an employee referral program, we discovered that the ROI for an employee referral program could be well over 500 percent if the performance differential could be quantified and included. Obtaining that level of ROI did not include branding value (employees talking positively to strangers about the firm and its products). The vice president of marketing said that the value of employees talking up the company to friends, colleagues, and family to a company the size of Agilent could top \$100 million. Such a return would have produced an ROI in excess of 3,000 percent.

(Continued on page 2)

Advantages of Employee Referral Programs, cont'd

- **Produce hires more quickly than alternate sources.** Employee referral programs when managed properly produce candidates that are, for the most part, prescreened for "culture" and skills fit by the employee. In organizations that tag applicants with source of hire, the impact of this characteristic is telling. Such applicants require less rigorous formal screening and therefore advance through recruitment processes much more quickly than candidates from other sources. European communications giant Vodafone found that by focusing recruiting activities on employment brand management and employee referral, the average recruiting cycle time per position could be reduced by more than two-thirds.

Increase manager satisfaction with the recruiting department. Because employee referrals prove more reliable and productive, management satisfaction with the recruiting department tends to increase as the percentage of requisitions filled via referral programs increase. Managers are generally highly satisfied with requisitions filled through the referral program. This trend has been noticed by Nationwide Insurance and CMP Media.

One Organization's Dramatic Results

One of the largest healthcare chains in the nation collected metrics on the value of using referrals versus other sources. Here is the referral versus use-of-the-Internet comparison as an example:

Measure	Referral	Internet	Improvement of Referral over Internet
Cost of source	\$2,796	\$1,877	-\$919
Offer Acceptance Rate	95.4%	81.2%	+14.5% higher
Voluntary Turnover < 1 yr	9.3%	22.1%	+2.3 times better
Voluntary Turnover > 1 yr	3.2%	12.5%	+3.9 times better
Termination rate < 1 yr	1.2%	4.4%	+3.6 times better
Performance*	4.14	3.62	+14.36% higher

Clearly the referral outperforms in every area except costs, but you can't stop there. You need to be able to demonstrate to senior managers the economic impact to the firm. The basic question from this analysis is "What would the dollar impact to the firm be if you improve (increase) new hire on-the-job performance?"

Here is the scenario: (Note: This scenario omits all impacts except individual performance improvement.)

- The firm has 40,000 employees.
- It hires 6,000 people per year (to replace turnover of 10 percent as well as new positions created by 5 percent growth).
- The current "revenue per employee" at this firm is \$250,000 (total firm revenue divided by the number of employees).
- If you shifted all hires to referrals, you could expect to hire people with a 14.36 percent better on-the-job performance than an average employee.

That would result in an increased revenue of \$35,900 per hire (14.36 percent of \$250,000).

Advantages of Employee Referral Programs, cont'd

That adds up to:

- Added revenue of \$215.5 million in just one year. (Because the new hires would also stay longer, the savings would continue over multiple years.)

Even if it was applied only to two-thirds of the hires, the added revenue would be more than \$140 million.

Similar business impacts can be demonstrated by using split samples (treating two similar sample populations differently, such as making the referral program available to only one of two manufacturing plants) and/or by showing the correlation between usage and business results.

The conclusion is that measuring source impact and changing sources so that you use the ones that produce the best on-the-job performers (quality of hire) can result in millions of dollars in business impacts that clearly exceed your entire recruiting budget!

The Dark Side

It's important to note that even though many referral programs produce very good to stunning results, when auditing referral programs I have found that a majority (yes, more than half) of referral programs are either stagnant or so poorly designed that they are an embarrassment to the referral program's name. A few of the many reasons for those failures include:

- Assigning management of the program as a part-time responsibility (a number of organizations have even assigned it to interns.)
- No rewards or delayed rewards.
- Marketing and PR collateral crafted from the companies' perspective and rarely updated.
- Slow response time and poor treatment of referrals and "referrers."
- Burdensome administrative rules and processes.

Lack of metrics (or only cost metrics) to enable and drive continuous improvement efforts.

It turns out that referral programs are a lot like marriages; when they work, they provide exceptional happiness and results for all involved, but once one party gets let down, they fast deteriorate to a shell of their potential. While the concept behind employee referral programs is a simple one, the programs themselves must be well managed if the goal is to produce anything more than mediocre results.

If you believe in making "fact-based" recruiting decisions (most don't), referrals should be your number one source (followed by recruiting at professional events). If you also gathered data on source effectiveness (beyond just costs or volume) of your corporate recruiting function, I would love [to see your results](#).

**author unknown