EFFECTIVE VIRAL MARKETING: ADVERTISING WITH A KICKER

Break even cash flow is the point at which your cash balance levels out and stops its gut-wrenching plunge towards zero. Break even occurs when your cash receipts rate is equal to your cash disbursements rate. In this example, the break even sales rate is 200 units per month or, alternatively, a cash receipts rate of $2,000 per month.

The sales rate at which break even occurs is determined by your rate of fixed expenditures per month divided by your profit contribution per unit, which is equal to your price per unit minus your variable expenditures per unit. To break even, you need to sell Q units per month.

Once you know what the goal looks like, the question becomes how do you get there as quickly as possible in order to reduce the amount of cash your business needs to get going? To reach your units sold per month goal, you need to decrease the time it takes to increase your rate of customer conversion - your buying rate, in other words.

An increase in your buying rate can be due to an increase in your advertising effectiveness or by making your word of mouth marketing message more likely to spread. Pure word of mouth marketing is exciting, because it seems to offer a free lunch. That is, all you need to do is seed your product with a few people, and your marketing message will spread throughout your target market with nothing more than a shoestring budget.

Except there are no free lunches. Pure word of mouth success is exceedingly rare. Conditions have to be just right for a word of mouth campaign to work. And we can't often see, much less control, those conditions. A pure advertising strategy can more predictably yield an increased buying rate. But advertising is expensive.

The more you increase your fixed and variable expenditures, the higher your break even sales rate. If you aren't careful, you can end up chasing rainbows as your break even point recedes into the distance. Of course, I've been presenting a false choice. It's not really a matter of advertising or word of mouth. Smart marketers use both strategies in order to accelerate buying in a cost effective manner.

If you want your product to spread like a wildfire, you don't want to rely on your ability to miraculously place a single match in just the right spot. A disciplined advertising campaign is like lighting several matches and dropping them throughout your target audience. Advertising can stimulate adoption more or less randomly throughout your total market population, and word of mouth techniques can provide a kicker that helps those little fires of customer adoption spread.

Let's start our model with an advertising effectiveness fraction of zero and a contact rate of zero. In other words, advertising has no effect on the buying rate, and because nobody in the total market population actually talks to each other, neither does word of mouth. So, nothing happens.

Say you were to invest in advertising effectiveness so that 0.5% of potential customers become customers every month. After 12 months, you would have roughly 6,000 customers. Now let's activate word of mouth by moving the contact rate slider from zero to seven. Another look at the customers graph shows that effective word of mouth adds about 45% to the customer count by the end of month 12 and doubles the number of customers by the end of month 24 when compared to the advertising only curve. Of course, results will vary.

Nevertheless, real world experiments suggests that these kinds of gains are plausible. In any case, advertising provides a degree of predictability to your buying rate, while word of mouth offers the potential for an inexpensive boost to growth. Look on the Human Scale Business website for opportunities to join the conversation about how to apply these ideas to your world. Until then, this is Dave Bayless for Human Scale Business.