



Don't Get Eaten!

Understanding and Handling Cannibalization Risk

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*Cannibalization,
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Fighting Brand*



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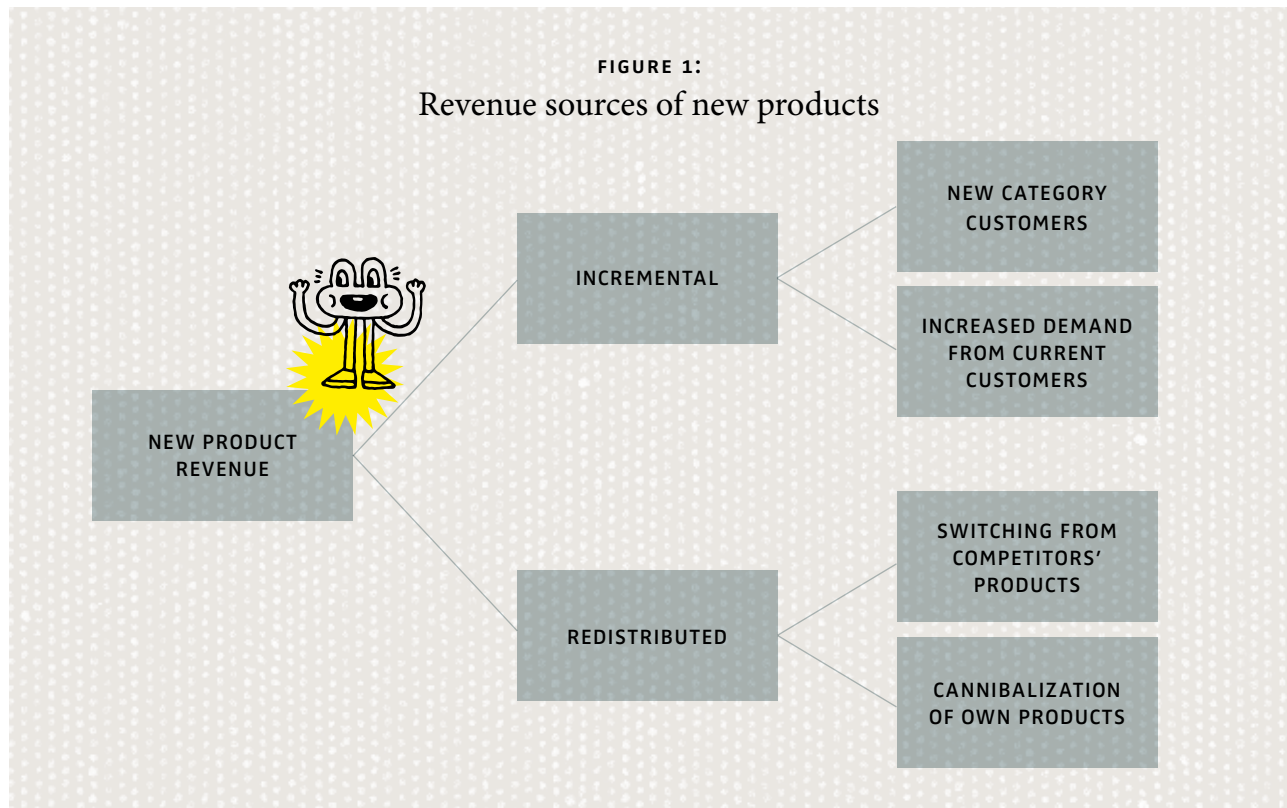
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Cannibalization – a necessary evil /// With businesses under pressure to demonstrate growth in sales and profits and to target new customers, companies introduce new products frequently. The market research company Mintel reported that the annual number of new product introductions of consumer goods in the U.S. has ranged between 30,000 and 45,000 over the past decade. When so many new products are launched, they risk taking sales from a company's other products. This is known as cannibalization and can eat away at profits and destroy company value.

Conventional wisdom characterizes cannibalization as a risk associated with introducing new products and something to be avoided. However, many leaders recognize cannibalization as a necessary evil. Companies expect some cannibalization, as illustrated by Krispy Kreme's recent attribution of their international franchise same-store sales decline to "normal cannibalization." There are advocates for pre-emptive cannibalization as well. Steve Jobs famously said, "If you don't cannibalize yourself, someone else will." To that point, with 2006 iPod sales still growing and accounting for 50 % of Apple's revenue, Apple launched the iPhone knowing it would severely cannibalize and ultimately replace, the iPod. Ultimately, the critical issue is cannibalization's impact on profits. New products are introduced to attract new consumers to the category, encourage consumers to replace products with a newer model, switch consumers to a higher margin option, and as a defensive response to competitors. Figure 1 shows that new product revenue may be incremental to the category or redistributed revenue, including cannibalization of the company's other products.



Most commonly, cannibalization occurs when a new product draws customers from that company's existing products. Retail cannibalization occurs when a retailer such as Starbucks opens sites close to each other, drawing customers from existing sites. Channel cannibalization can occur when companies expand into a new channel, e.g., when brick-and-mortar office supply retailer Staples made a major push to move online. Finally, consumer or trade promotions in one period can cannibalize future sales.

To minimize the potential loss of market share and profits, it is important to understand factors that drive cannibalization. It is also important to estimate and measure the cannibalization effect on existing products and consider additional organizational implications.

Brand factors and their impact on cannibalization

/// Key brand variables for cannibalization risk concern how the new product compares in price and quality to existing products. Many new products, particularly in consumer packaged goods, are line extensions at similar price and quality levels. Examples include new flavors of sparkling water or scents in laundry detergent. Because of similarity, these line

extensions pose a high risk of cannibalization. Price and quality variations should differentiate existing products from new introductions. Lower priced offerings are typically introduced as "fighting brands" and intended to combat low price competitors while maintaining the more premium product's position. In direct contrast to fighting brands, a premium super brand is higher priced and positioned as higher quality vis-à-vis the base brand.

Fighting brands /// A fighting brand should have lower perceived quality or fewer features to match the lower price to minimize cannibalization with the core brand, and therein lies the risk. A classic example is Kodak's launch of the Funtime brand to compete with the lower priced Fiji film. While Funtime was lower quality, the difference was not apparent or important to most consumers, resulting in major cannibalization of Kodak's flagship Gold Plus Brand.

Super brands /// Consumers trading up to a premium product cannibalize sales of the core brand, but the higher price yields higher profits. Examples include Land O'Lakes European Style Super Premium Butter and the new iPhone X.

Product, category and company factors and their impact on cannibalization risk /// Other factors have shown to impact the likelihood and extent of cannibalization. The category plays a role as well as the type of product and a company's distribution system. Another managerial question to consider is whether a new product will coexist with or replace the existing product.

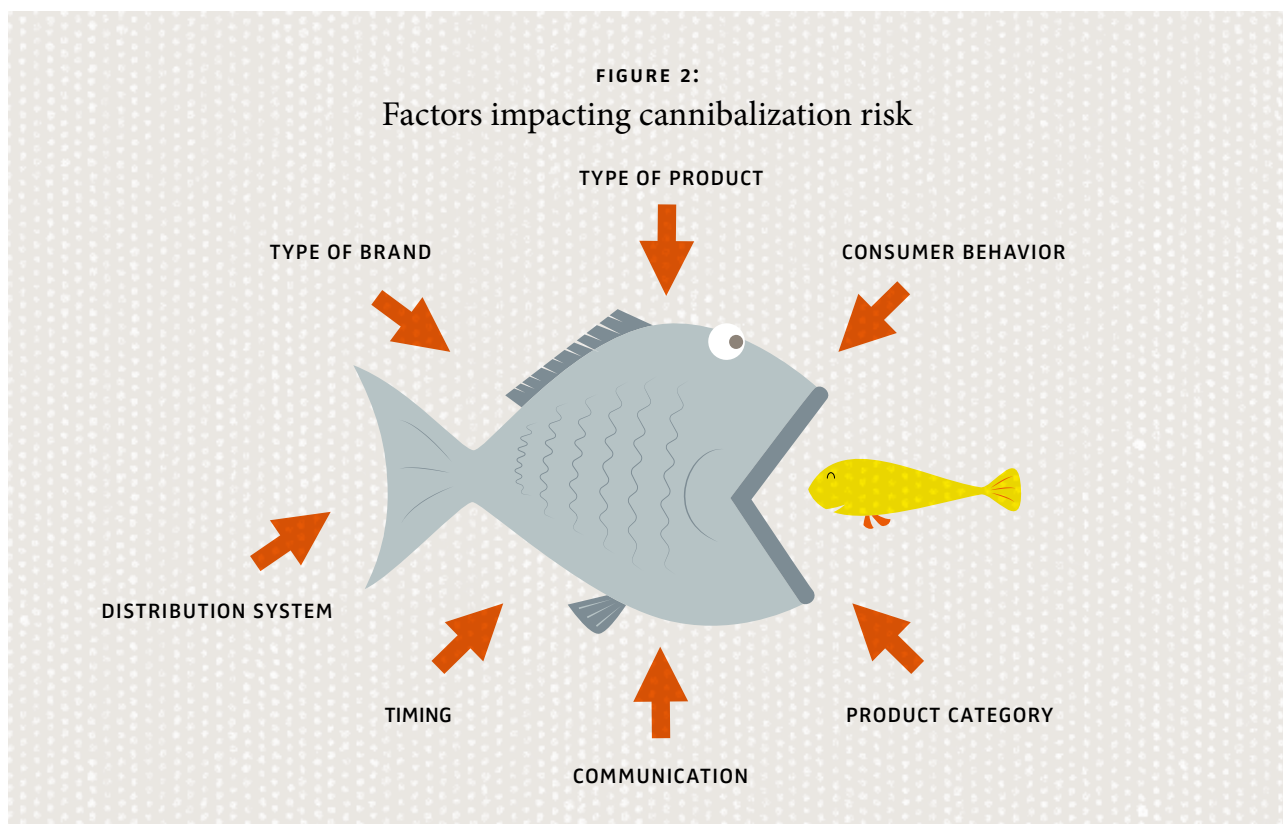
Is demand expandable? /// Product categories such as diapers and toothpaste offer limited possibilities for increased consumption, thus increasing the cannibalization risk of new product launches. In contrast, consumers can increase consumption of yogurt or bottled waters. For durable products, consumers are unlikely to buy multiple blenders but may readily purchase another television or different eyeglasses to match their mood.

Replacement or coexistence? /// In some industries like automobiles, new models routinely replace existing models. In other industries, new products co-exist with existing products but with clear differentiation of price and quality. For example, when Apple launches a new iPhone, it usually maintains

or raises pricing for the top models, and previous generation models get price reductions, which may draw in new buyers and thus offset some of the cannibalization risk.

Is the product pleasure oriented or functional? /// Products such as designer lipsticks or sports cars involve a more sensory experience compared with the functional, practical nature of other products such as microwaves or paper towels. For consumers who value the experience of owning and using televisions or cellphones, new models with added features may result in lower prices for earlier models and increase cannibalization. However, this may also accelerate the replacement cycle compared with functional products such as refrigerators or vacuums.

How prevalent is variety-seeking? /// Since consumers exhibit variety-seeking in many food and beverage categories, a deeper product line may cannibalize other items in the line, but also keep consumers loyal to the brand. Thus, to control cannibalization, companies need to find the optimal product line depth and avoid too few or too many variants.



{Box 1}

ESTIMATING CANNIBALIZATION RATES WITH FAIR SHARE DRAW CONSIDERATIONS

A new brand is launched into a market with three existing brands totaling \$1000K in sales. The new brand's expected sales are \$150K with no market expansion. The upper table shows the expected Fair Share Draw sales. The actual draw in the lower table reveals that the new brand drew disproportionately from A and C. As A and the new brand are marketed by the same company, the new brand shows high cannibalization of A's sales – more than expected based on Fair Share Draw.

BRAND	SALES – BEFORE	SHARE – BEFORE	FAIR SHARE DRAW PROJECTIONS FOR NEW BRAND
A	\$ 500,000	50 %	$\$150,000 * .5 = \$75,000$
B	\$ 300,000	30 %	$\$150,000 * .3 = \$45,000$
C	\$ 200,000	20 %	$\$150,000 * .3 = \$35,000$
Total	\$1,000,000	100 %	\$150,000

BRAND	SALES – AFTER	SHARE – AFTER	ACTUAL DRAW INCLUDING NEW BRAND
A	\$ 400,000	40 %	\$100,000
B	\$ 300,000	30 %	\$ 0
C	\$ 150,000	15 %	\$ 50,000
New (A's sister brand)	\$ 150,000	15 %	
Total	\$1,000,000	100 %	\$150,000

Is it an inexpensive, low-risk product? /// Low-risk products are more likely to suffer cannibalization from lower-priced entrants, as consumers have little to lose from trying the cheaper option.

Is consumption private or public? /// Whether consumption or choice decisions are seen by others or not is known to impact consumer decision-making. This may also impact cannibalization. A new fighting brand may have greater cannibalization if privately consumed than publicly consumed where consumers want the brand to reflect a certain image. A fighting brand of cooking oil that is consumed privately may cannibalize the core brand more than a "second label" from a winery that is publicly shared with friends.

Can the new product achieve distribution goals? /// If the company has control over distribution through company-owned retail outlets, franchises or direct online sales, it can assure distribution of the full product line. More common are channels with intermediaries who ultimately decide the extent of distribution for a given offering. In such arrangements, new products may likely cannibalize the distribution of existing ones.

Estimating cannibalization effects /// The first step in managing cannibalization risk is to measure it. Often, Fair Share Draw is used to calculate potential cannibalization effects. The Fair Share Draw represents the loss in share of products to a new entrant, assuming that the new entrant will

draw share proportionately from existing products. The Fair Share Draw may be compared with the actual share change to gauge the amount of cannibalization (see Box 1). Alternatively, prior to the new product introduction, estimated sales and shares are often measured via real or simulated test markets or Source of Volume Analysis (SOVA) using a conjoint-based market simulator.

Manufacturing and operations implications of extending product lines ///

Estimating cannibalization risk should assess possible effects on company operations. A deeper product line offers consumers more choices, but potential inefficiencies in manufacturing can result from smaller batch sizes or increased changeover costs, destroying profits. More products will likely involve more parts and raw materials which add costs to the supply chain. Other costs are increased inventory cost and greater warehousing space needs. Estimates of the costs of cannibalization need to consider total company costs.

Marketing strategies to limit cannibalization risk

- > **Carefully plan and communicate the positioning of new products** /// Beyond potentially negative effects of cannibalization on sales, there are other downsides that must be managed. One is consumer confusion, especially if the products are insufficiently differentiated and/or the positioning is not well communicated. Whether glues, shampoos or televisions, too many options may confuse the consumer. In addition, the introduction of economy or fighting brands by a company traditionally offering premium products may dilute the brand image. Marketing communications must mitigate both cannibalization and damage to the brand image through clear and consistent messaging about the brand's positioning. For example, explicit messaging that the economy product is suitable for, say, light-duty usage and the premium product for heavy-duty contexts can help minimize cannibalization and maintain brand image.
- > **Investigate timing options** /// If cannibalization is inevitable, timing is important. An example is the release of a hardback book followed by the paperback edition. The margins on the hardback are typically high, but generally associated with a small sales potential compared to the larger sales potential for the lower-margin paperback. In this situation, despite the high cannibalization risk, releasing the paperback shortly after the hardback is optimal.

- > **Focus on profit impact** /// While cannibalization is an inherent risk of new product introductions, careful consideration of brand and category factors as well as the consumption context can help managers mitigate its extent. More importantly, although cannibalization is measured by sales lost to the company's other products, the real measure is the impact on profits. A lower-margin product cannibalizing a higher-margin product eats away at profits, but a higher-margin product cannibalizing a lower-margin one is potentially worth the cannibalization risk.

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FURTHER READING

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