

[Review]

Emergence and Success of Xiaomi in the Transitional Situation of Chinese Smartphone Industry

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Abstract

Purpose – 2013 to 2014 was a transitional situation in which China's Smartphone industry was fluctuating. So in this paper, we will look at the strategies and achievements of Xiaomi, a company that has emerged in this situation and topped the market share. In particular, the purpose of this paper is to analyze why Xiaomi, which is considered a copycat, was able to succeed in the smartphone market four years after entering the market and analyze its strategy.

Research design and methodology – Various secondary data are to be used for this study. Using various newspaper articles as well as corporate reports, the company analyzes the transitional situation from 2013 to 2014 and the competitors together. Through these analyses, Xiaomi's strengths are selected objectively and analyzed to identify the factors that made Xiaomi successful.

Results – After China's transitional shift in 2014, Xiaomi brought about a 152.3 percent share change over the previous year. In addition, it surpassed Samsung Electronics, which has been the industry's No. 1 player, in 2014, and achieved the No. 1 ranking with a 16 percent share. Xiaomi Mi4's phone had a strong point of maintaining low price while being loaded with high performance.

Conclusions – Xiaomi's success is because its price and performance was excellent. Xiaomi's Mi4's specifications were not far behind its competitors', but it was very cheap compared to its competitors' prices. They also valued software and used talent-oriented human resource strategies. Plus, it created the 'Mifan' culture successfully and benchmarked the strengths of its competitors smartly.

Keywords: Transitional Situation, Xiaomi, Market Share, Chinese Smartphone industry, Mifan

JEL Classification Code: M10, M16, M19.

1. Introduction

The smartphone is a mobile phone that has more advanced capabilities than a general mobile phone and has similar performance to PCs. It is defined as a mobile phone that with a high-performance general-purpose OS. “Global Smartphone Market Analysis and Outlook”, prepared by CCS Insight, forecasts that the smartphone market, which pulls the growth of the global mobile phone market, will show around 13% of annual growth on average until 2018.

In this situation, the size of China’s smartphone market surpassed 100 million units for the first time in the second quarter of 2014. The sales of ultra-low-priced smartphone rise in China, which is the largest global smartphone market. There were many outstanding companies competing in the low-priced smartphone market such as CoolPad, Lenovo, and Huawei, there was a sensational company, which hit the Chinese smartphone industry in 2014. Xiaomi, a successor of Xiaomi Tech, which was established in 2010, recorded a market share of only 1.5% in the third quarter of 2013. However, in the third quarter of 2014, only one year after, Xiaomi products accounted for 5.2% of the global smartphone market, which was 3.7% increase. A company that used to sell 3.6 million smartphones could sell 15.77 million smartphones one year later.

Thomson Reuters reported the share of global smartphone makers for the third quarter of 2014 on December 15, 2014, and the report showed that Xiaomi became a leading company in China and 336% growth with taking the most market share lost by Samsung Electronics. Therefore, it became one of the top five companies in the smartphone industry. This study aimed to analyze the external environment and internal environment and strategies that helped Xiaomi, a new company and considered as “an Apple copycat”, achieve such remarkable advancements just in four years since its establishment only in the smartphone market. This study also will evaluate the analysis and make suggestions.

2. Chinese Smartphone Market in a Transitional State

At the time of 2014, the economy of China was rapidly growing using its abundant labor force. China had sustained a rapid growth of over 7% per year for five consecutive years from 2010 to 2014(World Bank, 2014). Owing to this rapid growth, China's per capita income exceeded \$7,000 in 2017. Consequently, the purchasing power of Chinese consumers was increased and the demand for the smartphone that is more expensive than the feature phone. Moreover, it is expected that it will create the demand for the smartphone consistently in the future. In short, the Chinese market is in a transitional state.

At the same time, unlike South Korea where broadband LTE was nationwide supported, the 3G network was dominant in China and LTE communication network was mainly available around large cities. The data of IDC, a market research agency, revealed that the approximately 95% of mobile phones produced in China in 2013 were 2.5G or 3G mobile phones. However, since the last year, Chinese mobile careers have been expanding their coverage of broadband mobile networks under the support of the Chinese government. As a result, 4G smartphone production, which was only about 5% until 2013, has been increasing rapidly since 2014. The conversion of the mobile communication network created the demand for existing 3G smartphone users for 4G smartphones. Considering the situation, the transition from 3G to 4G has acted as a factor in creating the demand for the smartphone in China continuously (Choi, 2014; Kim, 2014).

The steadily growing Chinese economy and the expanded 4G mobile communication network have created a steady demand for the smartphone in China. However, there are other issues to be considered: such as “how much demand will be generated in the future?” and “how long will the Chinese smartphone market grow in the future?” IDC predicted that the demand of approximately 500 million smartphones will be generated in China every year since 2035, which is more than one-third of global smartphone production in terms of sales volume. It clearly shows that why the Chinese market is the top smartphone market and attractive. At the same time, the prediction indicated that the Chinese smartphone market, which has been growing at double digits every year, was close to saturation. In fact, the growth rate of the Chinese smartphone market, which had exceeded the growth rate of the global smartphone market since 2012, showed a single digit growth (7%) in the third quarter of 2017, falling below the global growth rate for the first time (Kim, 2014; Lee, 2014; Statista, 2014).

Another interesting characteristic was that the importance of female consumers has increased tremendously, among external factors. The number of Chinese male smartphone users increased by 11% per year from 2011 to 2013 on average, while that of Chinese female smartphone users increased by 116% per year during the same period, 10 times higher than the former (Bae & Hong, 2014). More specifically, the number of female smartphone users

increased by 140 million in three years, literally explosive growth. As a result, a segmented market only focusing on female users was created and it was named “a gigantic cake”. Moreover, some brands emerged to solely attract female users or some smartphones were sold with carrying applications exclusively for female uses. In other words, one of the major growth engines of the Chinese smartphone market was female consumers. It meant that if one wanted to succeed in the Chinese smartphone market, the one they had to succeed in capturing women’s hearts.

At the same time, the Chinese government recently ordered China Mobile, China Telecom, and China Unicom, which were three major telecommunication companies in China, to cut the marketing cost (e.g., mobile phone subsidies) by 40 billion CNY (equivalent to 7 trillion KRW) over the next three years. It was because Chinese telecommunication companies were paying too much for mobile phone subsidies every year. In fact, these three companies paid approximately 20 billion CNY (about 3.5 trillion KRW) every year for Apple and Samsung products. The mobile phone subsidies are generally paid when a consumer purchases a mobile phone with a contract from a telecommunication company. A more expensive phone generally has a higher subscription rate so Apple and Samsung phones had relatively more subsidies. Therefore, the order of decreasing subsidies impacted Apple and Samsung relatively more because they targeted a high-priced segment of the market and it became a good opportunity for Chinese companies.

3. Analyzing Competitors in China

In terms of the market share, the main competitors of Xiaomi in the Chinese market are Apple, Samsung, Huawei, and Lenovo. Apple is the leader in the smartphone market and it became an icon of innovation when it launched the iPhone in 2008. When the smartphone business was in its infancy, it increased the demand for smartphones.

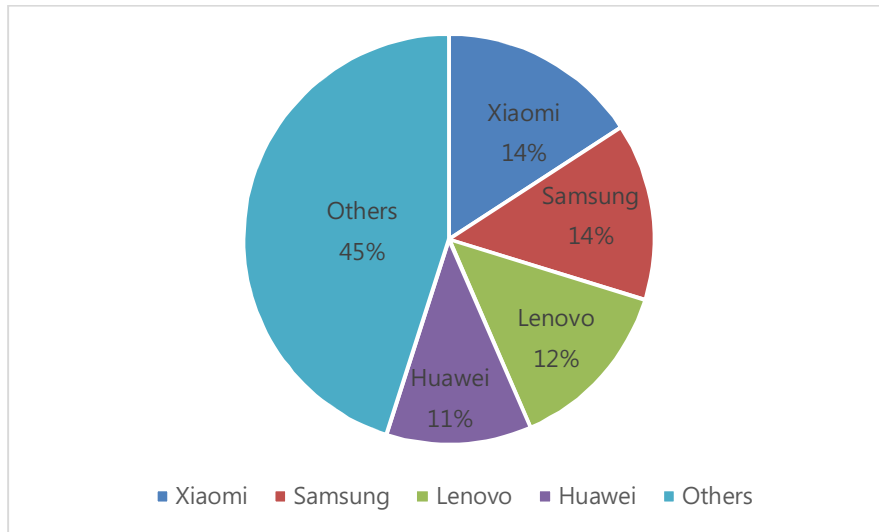
As a result, the position of Apple in the smartphone market is still very strong. Apple is the flagship of the smartphone industry. There were some pessimistic views about whether it could be successful in the smartphone market because Apple does not have good hardware manufacturing capabilities, compared to existing feature phone manufacturers. However, it still has many loyal customers owing to the cost savings through outsourcing and excellent software competitiveness. Apple has launched only two smartphone products per year and both of them are high-end expensive smartphones. Apple has declared that it is not interested in the mid- and low-end smartphone market. Considering that, Apple has not been a direct competitor to Xiaomi until now (Lee, 2014; Lee, 2014a).

Samsung Electronics has strived to surpass Apple, the pioneer of the smartphone market, based on its top global competitiveness in the feature phone industry. Samsung Electronics also target the high-end market with its representative flagship models such as the Galaxy S series and the Galaxy Note series. Although it has surpassed Apple in the global smartphone market share, its weakness is that its profit per unit is much lower than that of Apple. As the mid-low price smartphone market has rapidly grown in the Chinese and Indian markets and the local companies with price competitiveness have emerged in these markets, Samsung has lost market share rapidly. In fact, in the second quarter of 2014, Samsung lost the top market share holder position to Xiaomi in China for the first time in the past eight quarters (Lee, 2014a; Lee, 2014b).

Huawei is the first-generation smartphone company in China and the world's largest communications equipment company. Huawei succeeded in obtaining high market share by extensively focusing on the mid-low price smartphone market ahead of Xiaomi. Nowadays, it is launching premium products as well as mid-low price smartphones. Lastly, Lenovo is also a follower of the smartphone market. It is the first-generation smartphone company in China and the world's No. 1 PC maker. Just like Huawei, Lenovo mainly focuses on the mid-low price smartphone market and has been aggressively pursuing mergers and acquisitions. It recently acquired Motorola from Google. Since both Huawei and Lenovo target the mid-low price smartphone market, they are direct competitors to Xiaomi.

<Figure 1> and <Table 1> shows the changes in market share of these competitors and Xiaomi between the third quarter of 2014. It reveals that the market shares of Apple and Samsung, which focus on the high-end smartphones, decreased compared to the previous year because the importance of the mid-low price smartphone market increased. By contrast, Xiaomi, Lenovo, and Huawei, which focused on the mid-low price smartphone market, increased their market shares.

Unlike Huawei and Lenovo, which increased slightly, Xiaomi showed a three-digit growth rate. It showed well what Xiaomi boom was. These results indicated that, although Lenovo and Huawei are the competitors of Xiaomi, they cannot be a direct threat to Xiaomi if Xiaomi continues the current strategies well.



(Source: Thomson, Canalis, 2014)

Figure 1: Market Share of Chinese Smartphone in 2014

Table 1: Changes in market share of 2014Q4 compared to 2013Q3

Company	Changes in market share
Samsung	-26.7%
Apple	-7%
Xiaomi	152.3%
Lenovo	10.6%
Huawei	2%

(Source : Thomson, Strategy Analysis in 2014)

4. Strengths of Xiaomi

4.1. Human Resources Policy of Xiaomi

Xiaomi is a newly established smartphone company founded by Lei Jun, a CEO of SW development company, in 2010. Naturally, the company has a different perspective for software from the smartphone manufacturers originated from hardware. It uses MIUI, which is a customized UI developed by Xiaomi. Although Xiaomi does not have a long history, the board of directors is comprised of talented people who have gained experience in leading companies such as Microsoft, Google, and Motorola. They are experienced in the localization of Windows Mobile and Google Search, and their services and products in the Chinese market.

Xiaomi has the highest market share for the second and third quarter of 2014 and CEO Lei Jun is at the center of it. "Pigs can fly if it has the right wind." "What I realize at my 40 is that 1% inspiration surpasses 99% sweat. Although diligence is a basic element, a more important element is to understand the trend." These are the famous quotes of Lei Jun. Lei Jun is often mocked by Jobs' followers that he is a "Jobs' imitator" (Lee, 2014b). However, as Lei Jun defeated the original Apple with his so-called "Apple imitators" in China and raised Xiaomi amazingly, people began to consider him differently (Lee, 2014b).

He was deeply shocked by the emergence of the Apple iPhone in 2010. He soon began to dream of founding a smartphone company by himself. He quit his job soon after. As soon as he decided the mainstream of his business, he attracted talented people from all over the world who would lead the smartphone business with him. They first made one hundred smartphone units, which were equipped with their own software (OS), and sold them via the internet. They received an explosive response from smartphone enthusiasts. Xiaomi, with its small success, launched its first own-brand smartphone, Xiaomi 1, in August 2011. Since then, it has launched Xiaomi 1S, Xiaomi 2, Xiaomi 2S, Xiaomi 2A, Xiaomi 3, Xiao Hongmi, and Xiaomi Smart TV consecutively (Kang, 2014).

4.2. Xiaomi’s Corporate Philosophy and Products

Xiaomi means millet and it reflects the Buddhist worldview that "The world is hidden in one millet grain." The name also demonstrates the Xiaomi’s business goal that it will go beyond Apple or Samsung Electronics. Xiaomi is deeply studying fandom culture according to its corporate philosophy “Just for Fans!” and shows the management method to fully utilize it. It tries to realize the Internet psychiatric and method as much as possible. Xiaomi is constantly presenting results that exceed customer expectations through these processes and it actively participates in industries other than the mobile phone business (Lee, 2014a; Lee, 2014b). The smart TV and the fitness smart band are representative examples (Kang, 2014). Both products use their affordable prices as the main competitiveness. Xiaomi also sells routers, set-top boxes, external battery packs, and even Xiaomi mascot stuffed toys.

4.3. Superior Design and Strong Price Competitiveness

The excellent design of Xiaomi is the strength of it. In fact, the designs of smartphones are getting monotonously similar in the current smartphone market. The design of the smartphone is standardized and characterized by a large display on the front, a front camera on the top, a main button at the bottom, and auxiliary buttons on both sides. However, some products obviously have superiority in design even among similar designs. This design superiority is determined by consumers' preference in the market. In the smartphone market, Xiaomi has been favorably received by consumers for its excellent designs (Lee, 2014; Lee, 2014c). In addition to price competitiveness, Xiaomi's superior designs are attracting consumers. Xiaomi is coping with the consumer trend that emphasizes simplicity with a simple design and clean finish.

Another advantage of Xiaomi is its price competitiveness. Products of Xiaomi are sold in the market at less than half the price of a smartphone of the same specification (Michael, 2014). The KT Economic Research Institute reported that the display sizes of Mi4, Galaxy S5, and iPhone 6, which were the 2014 flagship models of Xiaomi, Samsung Electronics, and Apple, respectively, were 5, 5.1, and 4.7 inches, respectively, showing little difference. Moreover, the RAM capacities of them were 3, 2, and 1G, respectively, and Xiaomi had the largest RAM. RAM is a volatile memory device for a smartphone. When a smartphone has a larger RAM capacity, it does not slow down the operation and it has a good performance. Additionally, battery capacity was 3080, 2800, and 1800mAh, respectively, and Xiaomi’s battery capacity was the largest. Xiaomi’s smartphone has good performance and is also superior in design. Nevertheless, the factory price of Xiaomi’s smartphone was approximately 340,000 KRW (1,999 CNY), which was less than half of Samsung's Galaxy S5 (866,000 KRW) and Apple's iPhone 6 (approximately 700,000 KRW (549 USD)). This means that Xiaomi can attract consumers based on its great competitiveness in the smartphone market.

Table 2: Major Smartphone Specifications and prices

	Mi 4	Galaxy S5	i-phone 6
Manufacturer	Xiaomi	Samsung	Apple
Release date	2014. 7.	2014. 3.	2014. 9.
Display	5 inch	5.1inch	4.7 inch

Weight	149g	145g	129g
CPU	Qualcomm snapdragon 801 2.5GHZ Quad Core	Qualcomm 2.5 Quad Core	A8 Dual Core 64bit
Battery Capacity	3080mAh	2800mAh	1800mAh
RAM	3G	2G	1G
Camera Pixel	Rear-13Million Front-8 Million	Rear-16Million Front-2Million	8Million
Price	340,000won (¥ 1,999, 16G)	886,000 won 6,000 원 (32G)	700,000won (\$549, 16G)

(Source: KT Economic and Management Research Institute, 2014)

The excellent price competitiveness of Xiaomi largely owes to its great distribution structure, another advantage of it. Unlike other smartphone manufacturers (Michael, 2014), Xiaomi focuses on the online distribution channel, not the offline distribution channel. Xiaomi sells smartphones directly to customers via Xiaomi's smartphone homepage (mi.com), instead of selling them through offline smartphone sales stores.

The domain address of the homepage was originally "xiaomi.com", but it was moved to "mi.com" in the first half of 2014 for \$ 36 billion. It was the effort of Xiaomi to improve the accessibility of online distribution channels for customers by using an easier domain address. In general, Chinese offline stores demand between 30 and 40% margin to manufacturers. Xiaomi can save the 30-40% cost, which is generally taken by the offline sales stores as a middleman, owing to the utilization of the online distribution channel. In fact, Xiaomi could reduce the distribution costs down to the 1-2% of the sale price using the sales through the online distribution channel.

Moreover, Xiaomi minimizes inventory management costs through a "pre-booking and manufacturing" method, instead of marketing and selling products to customers after mass production (Lee, 2014; Lee, 2014d). The "pre-booking and manufacturing" method manufactures smartphones according to the quantity of pre-orders instead of manufacturing smartphones before sales. This method can minimize the inventory because it produces according to the precise demand. It has an advantage of minimizing the inventory management cost through the minimized the inventory.

4.4. Establishing an Ecosystem with MIUI

Xiaomi can establish its own ecosystem through MIUI, which is its own operating system (OS). Xiaomi also considers it as its ultimate goal. MIUI is an independent OS developed by Xiaomi based on Android. MIUI is named after "XIAOMI User Interface (UI)". It can be considered as a custom ROM with strengthening the necessary parts and eliminating the unnecessary parts. Although a common custom ROM maximizes the performance of OS, MIUI maximizes the emotion. In other words, it emphasizes intuitive and sensual design and convenience (Michael, 2014a; Michael, 2014b).

Even though it cannot use Google's own service because it uses an independent OS, it can use the existing Android infrastructure as it is. It exquisitely combined the strength of Google's Android, which is like a standard of the smartphone OS, and the platform and service of Amazon (Choi, 2014). Additionally, Xiaomi collects user feedbacks directly and updates every Friday to address these feedbacks and add new features. As of October 17, 2014, it had been updated 209 times and these updates always reflected the opinions of users. In fact, for the case of MIUI6, one-third of the features were proposed by users. It contrasts with the delayed updates of the most of Android smartphones due to the interest conflicts between Google, manufacturers, and telecommunication companies. Moreover, although there are more than 200 Android markets across China and Xiaomi runs only independent application stores, Xiaomi could rank fourth in the industry.

4.5. Customer Care Policy

"We deeply study the fandom culture and manage based on it" is Xiaomi's management motto. Xiaomi's second core competency is customer care. Unusual as a smartphone manufacturer, Xiaomi has a fandom. These fans are called 'Mifan' (米粉), which means Xiaomi's fan and, at the same time, it means millet in Chinese. These Mifans are approximately 9 million and they are actively interacting in online forums as well as in offline environments. Currently, approximately 200 Xiaomi fan clubs are operating and they are organized in many countries including China, Singapore, Thailand, Indonesia, Philippines, Malaysia, and Russia. Xiaomi also holds more than 800 offline events annually, enhancing the cohesion of Mifans. Additionally, Xiaomi holds "Mifun Festival" once a year and Xiaomi sells various products at a discount price on this day. Xiaomi has an internal SNS task force (about 100 people) in order to communicate with users directly for enhancing the interaction with customers. The customer management capabilities of Xiaomi allow 'Mifan' to voluntarily advertise products and receive immediate feeds from customers.

5. Conclusion and Suggestion

Xiaomi could be very successful in the market, even though Xiaomi's sales strategy is incredibly inconvenient for most consumers, because Xiaomi's products have excellent performance per price. For example, Xiaomi's Mi4 specification is as good as the competing Galaxy S5's and iPhone 6's specification, yet it is sold at approximately 340,000 KRW, which is very low compared to the competitors <Table 2>.

Many competitors have raised the suspicion that Xiaomi is selling virtually without making margins due to the high-specification and low-price strategy. However, surprisingly, their net profits are increasing every year. Xiaomi predicts that the net profit of it will reach 6 billion CNY in 2014, which is approximately triple of that in 2012 (1.8 billion CNY). They could have a high net profit while selling at low prices because they reduced the distribution costs innovatively. Xiaomi does not do any offline marketing activities at all. They could drastically lower the distribution costs because it fully depends on the direct sales via the internet.

Xiaomi spent 81.5 billion KRW in 2012 and 167.6 billion KRW in 2013 for marketing. Although it doubled in 2013, the actual ratio was 3.9 and 3.2% of the total sales in 2012 and 2013, respectively. Since the ratio decreased, it is hard to say that the marketing cost actually increased.

Xiaomi was able to maintain its high-performance, low-price strategy because it benchmarked various companies. Xiaomi actively imitated the strong points of some companies (i.e., Dell, Apple). First is the internet direct sales model like Dell. Dell assembled and sold personal computers in the way that consumers wanted, unlike conventional personal computer manufacturers. Building personal computers has a weak point of increasing the inventory cost, Dell took care of the cost issue using the direct sales via the internet. Xiaomi was also able to reduce distribution costs significantly by selling goods only through its official homepage, without going through mobile carriers. Secondly, Xiaomi uses various marketing strategies. Through this case, it will be possible to give other companies an idea of how important it is to make decisions that adapt to large changes in the industrial development cycle.

For example, Apple succeeded in drawing the attention of customers drastically by supplying only a limited amount of products from the beginning of sales. Apple can be called as the leader of the hunger marketing among the smartphone companies. Moreover, Apple could reduce the production cost by completely outsourcing the manufacturing part and focus only on software development. Xiaomi absorbed Apple's this strategy in many ways. Xiaomi, like Apple, claimed itself as a software development company and manufactured products by outsourcing and reducing the associated cost. Xiaomi could spur the development of MIUI, which is the core competency of Xiaomi. As Xiaomi defined itself as a software company, Xiaomi took a strategy to sell hardware cheaply to attract more users and to establish an independent ecosystem, called MIUI.

While it was benchmarking Dell and Apple, it has made successful innovations in distribution structure and marketing style. Consequently, it has made great changes in the smartphone industry. However, it has not achieved enough in benchmarking Amazon's cross-subsidization strategy. Xiaomi made a great success in spreading terminals with arising a big echo in the industry. It took the market share of Samsung in the past two years and became the top market share in the second and third quarters. Moreover, it ranks third in the global smartphone market. However, Xiao Mi's profit structure tended to depend too much on equipment. They recorded 5.3 billion USD in sales revenue in 2013 and only 170 million USD was from accessories and application service sales.

A cross-subsidy strategy is to gain a big profit from products derived from a device after spreading the device widely at a low cost. However, Xiaomi currently has low return from the products derived from the devices. In this situation, Xiaomi will need to diversify its profit structure. In the future, it should seek possibilities and plans specifically according to it.

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