International Expansion of Xiaomi

Topic:	Difficulty:	Style:
Entering new market, Growth, Market Sizing	Intermediate	Interviewer Led (McKinsey Style)

By: Vasanth Pragash and Chat GPT - 4

Case Prompt: Xiaomi, a leading Chinese electronics company (revenue of $1 billion), is considering expanding its operations internationally. They have reached out to our consulting firm for assistance in formulating a strategic plan for their global expansion. Xiaomi is well-known for its smartphones, smart home products, and IoT devices, with strong emphasis on an online sales model and does not hold inventory. They do not have a presence outside of China.

Globally the main competition to Xiaomi are Samsung and Apple.

The client seeks insights and a comprehensive strategy for their international expansion.

Exhibits:

Exhibit 1:

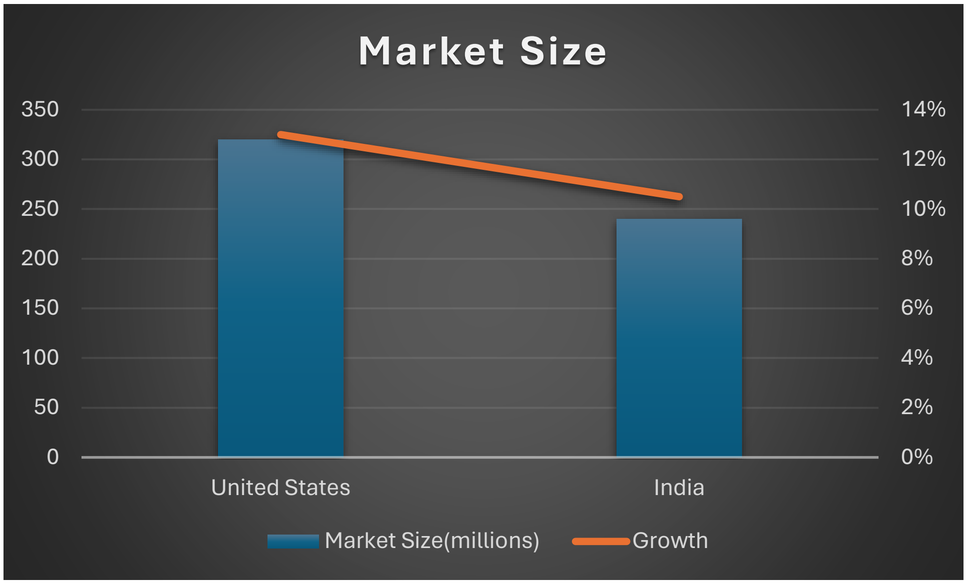
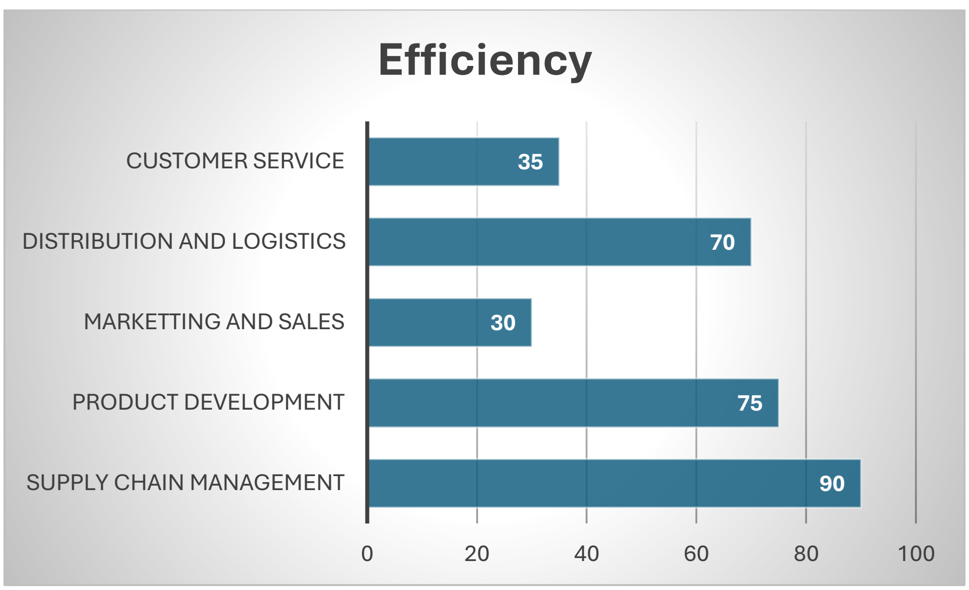


Exhibit 2:



Data:

Xiaomi Product categories:

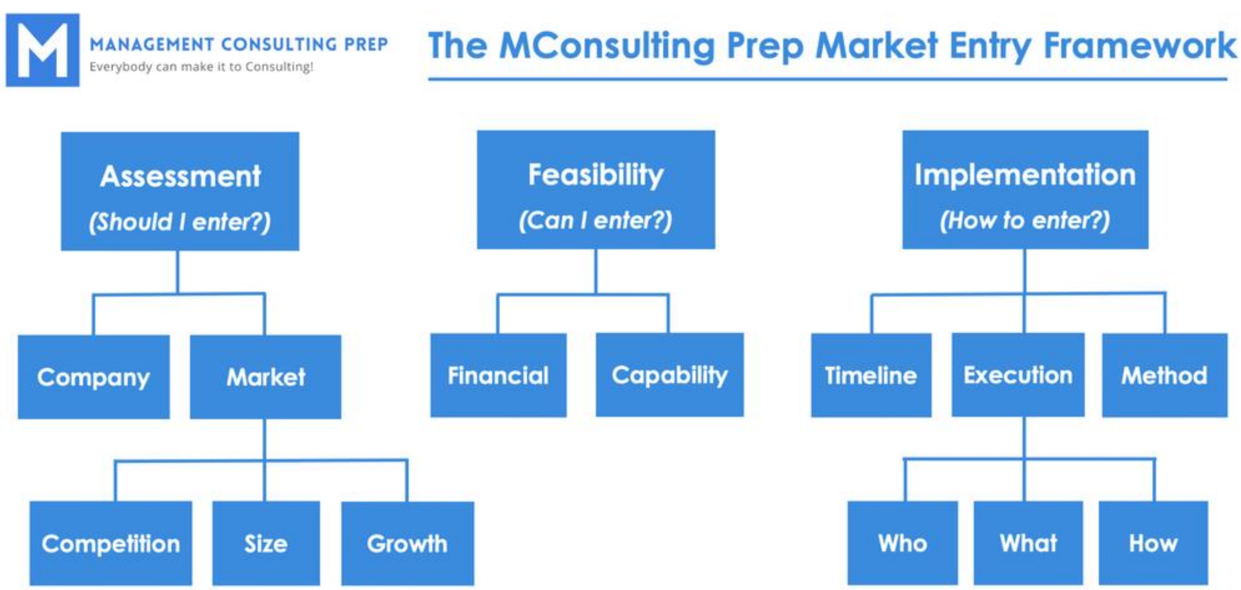
Product categories	Contribution	Average Price per product
Smart phones	60%	280

Smart home products	30%	400
IOT products	10%	80

Competitors:

Company	Country	Revenue (in millions USD)	Marketing Costs (in millions USD)	Working Capital for Operations (in millions USD)
Samsung	USA	55	4	5.5
Samsung	India	35	3	3.5
Apple	USA	80	7	8
Apple	India	40	2	4

Frame work:



Case interview:

Interviewer: How would you proceed?

Candidate: I have a few clarification questions before we proceed.

1) Why does the client want to expand internationally?
2) What would constitute success in the client's eyes?
3) Did the client set aside any funds for the planned expansion?

Interviewer: The client feels that the domestic market is saturated, further growth in the domestic market is limited to a CAGR of 2%, they want to explore a new market, establish their brand, and diversify their income stream. The client wants to increase their revenue by 8%, with a significant amount of the growth coming from abroad. The client has cash on hand but has not stated an amount and would like you to come up with a reasonable estimate.

Candidate: The client's current revenue is 1 billion, assuming the domestic market situation is stable, a 2% growth would yield an additional revenue of 20 million. This would mean 60 million of the revenue would need to be obtained from the newly established international presence. Is this correct?

Interviewer: Yes

Candidate: Ok I have a good understanding of the clients objectives. I would like to consider the scenario under three lenses.

1. Market Assessment: Should the client enter the market? What are the nuances of each market, and can the client leverage its strengths in each market?
2. Market Feasibility: Does it make sense for the client to enter the market? What are the competitors doing?
3. Market Entry: If it makes sense for the client to enter, how should they do so. If it doesn't make sense what can the client do instead.

Part 1: (Market assessment)

Candidate: To proceed with the first part, id like to know about the client:

1. What is the client's current product mix and their respective contributions?
2. What is the market segment that the client is targeting (income, age, etc.).
3. Its production capability, distribution channels and current strategy for acquiring customers.
4. What are the clients' advantages in the domestic value chain?

Interviewer: Sure,

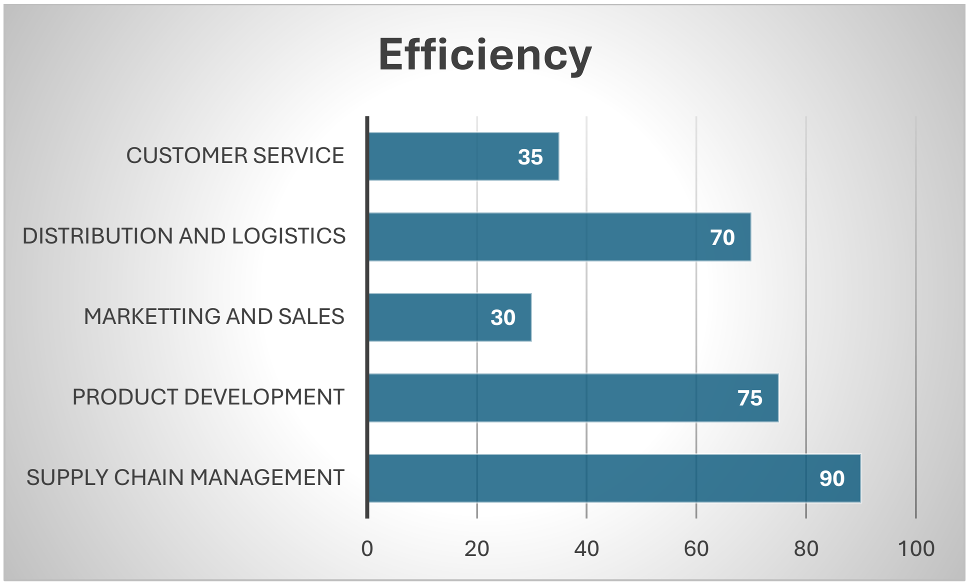
The client has three main product categories:

Product categories	Contribution	Average Price per product
Smart phones	60%	280
Smart home products	30%	400
IOT products	10%	80

The client is currently targeting lower and middle-income segments of the population, they are roughly 99% of the consumer base. Higher income segments are not a focal point of the client, and no other categories such as age or gender are of any concern.

Currently the client does not spend money on advertising and relies exclusively on word of mouth enabling greater focus on features and cost. Production is in-house and not an issue as the client can easily produce more products without any major disruptions.

Our client has to following advantages in the domestic value chain:



Currently they only sell products from their website direct to customers, they don't have any physical presence.

Candidate: I see their focus on lean model means they can reinvest cost savings from marketing into product development.

Interviewer: Exactly!

Candidate: Great to proceed, id like to ask a few questions about the global electronics markets:

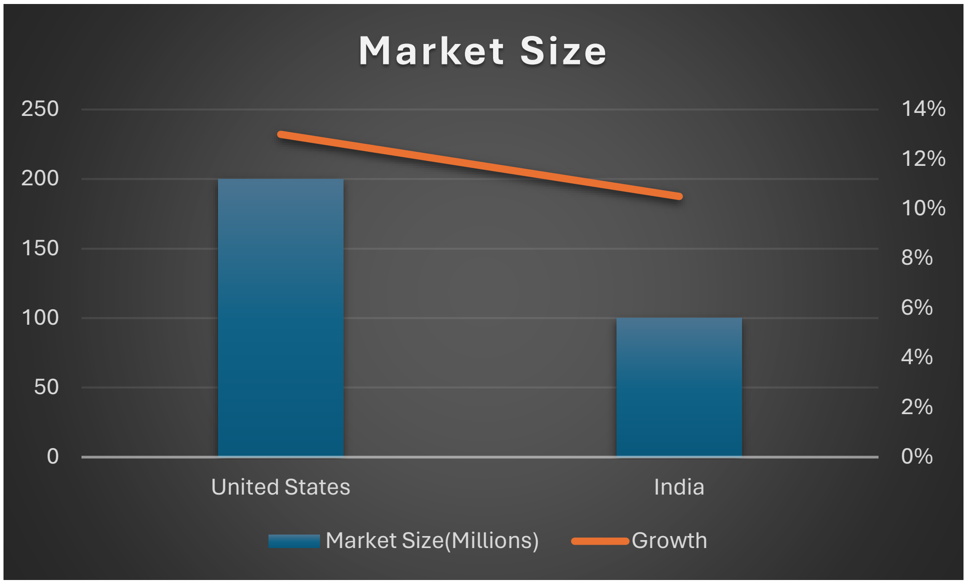
1. What are the market sizes, revenues, and trends in the regions the client is looking to expand to?
2. What are the distribution channels common to the markets?
3. You mentioned that our primary competitors are Samsung and Apple, are there any other competitors to contend with? Do we have more information about them and how our products are different from theirs?

Interviewer: Good list. Answering your questions

1. The client presently is interested in looking at USA, and India for international expansions. They have provided this information for electronics market size and growth, and it's expected that these trends will continue for the next 5 years.
2. Both the Indian and USA markets have products sold via distributors, retail outlets or online ecommerce marketplaces like Amazon. This is what our competitors do, they import the products into the market and sell them to distributors, retailers, or marketplaces. Direct

distribution from manufacturer to consumer is rare, and not a common occurrence in these markets.

3. There are other smaller regional players in each market, but we are not concerned with them. There is a duopoly between Samsung and apple in both USA and India. They sell a wide range of products to our target customer segments but they lack the features we can provide at the price point. We have the following information about our competitors.



Company	Country	Revenue (in millions USD)	Marketing Costs (in millions USD)	Working Capital for Operations (in millions USD)
Samsung	USA	55	4	6
Samsung	India	35	3	4
Apple	USA	80	7	8
Apple	India	40	2	4

Candidate: Ok. Do we have a breakdown of the customer segmentation in each market?

Interviewer: Yes. What will be our serviceable market size in both the countries?

Customer segmentation:

1. Indian population: 5% extreme poverty, 10% lower income, 60% middle income,25% high income
2. USA population: 1% extreme poverty, 9% lower income, 60% middle income, 30% high income

Candidate:

1. For the Indian market, we have a serviceable market size of (10% + 60%) * 100M = 70M
2. For the USA market, we have a serviceable market size of (60% + 9%) * 200M = 138M

Part – 2 (Market Feasibility):

Interviewer: What would be a reasonable amount for the client to spend on advertising?

Candidate: Our competitors are roughly 8% each, we will probably need to match or exceed that amount to enter the market. Say 10%

Marketing expense = Target revenue * 10%

= 60 million * 0.1 = 6 million

So, the client would need to set aside around 6 million for marketing purposes.

Interviewer: Can you think of any other costs involved, to set up operations?

Candidate: Look at the distribution differences between distribution channels in China and the USA/India, the client will need to hold inventory (as they don't manufacture in these markets), and may need to open physical stores. Looking at similar costs for our competitors we can see that they constitute around 10% of their revenue.

However, they may be benefiting from economies of scale, so the client would need to spend more, say 15%.

That would mean an operations cost of:

= 60 million * 0.15

= 9 million

This would bring the total costs to around $15 million for the client

Interviewer: Good, the client is enthusiastic and believes that they can sell at least 100,000 products in each market in our first year. What will be the expected revenue? You can assume the product mix and prices will be the same as the domestic market.

Candidate:

Sure,

60,000 smartphones * $280 = 17 million
30,000 smart home products * $400 = 12 million
10,000 IOT products * $80 = 1M

Rounding the figures, this would entail 31M for each market.

Interviewer: Good anything else?

Candidate: I think that the client's goal would be too ambitious to achieve that volume, especially in our first year for the following reasons.

As our client has no established presence outside of China, this would be the first-time international customers would be exposed to our product. There will be a lot of reluctance even if we can spend heavily on advertising due to lack of brand awareness and limited initial traction.

Traditionally we can expect a market share of 1% under optimal conditions for a first-time market entry. The client expects to obtain a market share of 44% in India and 22% in USA which is just not likely due to fierce competition from existing players.

Part 3: (Market entry, risks and conclusion)

Interviewer: Ok, do you have any recommendations for the client?

Candidate: Yes. While I understand that the client needs to expand its operation internationally for growth and diversification, the target markets of USA and India do not offer an attractive proposition in terms of target revenue for the client. The client would be better off finding larger international markets which are more suitable for its objective.

Interviewer: If the client is willing to revise its target revenue, and decides to proceed with the expansion what would you recommend? What are some of the risks they should anticipate?

Candidate:

Ok, in that scenario I would recommend the following:

1. The client should focus on its strengths in its domestic value chain and should manufacture its products in China. I would not recommend incorporating or manufacturing in the markets of USA/India.
2. Selling directly to the customer is not possible in USA and India. To overcome this impediment the client can consider acquiring a distributor in the local market to use their capabilities to sell Xiaomi products. Alternatively, Xiaomi may want to tie up with major retailers/distributors or negotiate deals with online marketplaces to sell products.
3. Advertising is key for initial penetration into a market, the client should be ready to spend money proportionate to its competitors for its target revenue. This will entail a brief reduction in profits if the costs cannot be passed on to the customer. Gradually advertisement spending can be reduced as word of mouth is established.
4. Localization of content to match regional tastes would be very helpful in encouraging adoption of its product lineup and reduce the friction of trying a new product.

In terms of risks the client could face:

Challenges:

1. **Intense Competition:** In both the markets, Xiaomi will face competition from established brands like Apple and Samsung. Either could undertake predatory strategies to close market access

2. **Regulatory Hurdles:** USA and India have varying regulations on electronics and data privacy, which Xiaomi must navigate.
3. **Cultural and Consumer Differences:** Understanding local consumer preferences and cultural nuances is vital.
4. **Brand Recognition:** Xiaomi's brand recognition outside China may be low initially.

These actions will help the client mitigate these risks:

Mitigation Strategies:

1. **Innovation and Differentiation:** Continuous innovation in products and services can help Xiaomi stand out in competitive markets.
2. **Local Partnerships:** Collaborate with local partners to navigate regulatory and distribution challenges.
3. **Market Research:** Invest in thorough market research to understand consumer preferences.
4. **Brand Building:** Develop marketing campaigns to increase brand recognition and trust.