

The Business Model Shift of Xiaomi Corporation

Introduction

Competing in the intensively competitive smartphone manufacturing industry, Xiaomi Corporation experienced explosive growth in the first five years since 2011. However, it fell to the bottom with its mobile phone sales being just 41.5 million units in 2016 which is 62.7 percent lower than last year. Many observers said that Xiaomi model was a failure since there was no smartphone maker able to turn around while sales decline. But Xiaomi made it. In 2017, Xiaomi rapidly changed its business model from “Xiaomi Model 1.0” to “Xiaomi Model 2.0”, in order to achieve a steadier development. After that, Xiaomi quickly reversed the decline in sales in just one year. In 2017, it sold 92.4 million units and reached its goal of exceeding 100 billion yuan in sales ahead of schedule. Why can Xiaomi achieve a sales reversal in such a short time and overcome the crisis? To illustrate this interesting issue, this article will include the following parts: a deep analysis of the smartphone manufacturing industry, the key features of Xiaomi and its strategic transformation process, and some brief strategic recommendations.

Smartphone Manufacturing Industry Analysis

To understand the situation that Xiaomi faced, it is important to know the features of the industry it competed in. According to Porter's Five Forces Model, the competition of an industry will be shaped by five factors: the bargaining power of suppliers, the bargaining power of buyers, the rivalry among existing competitors, the threat of new entrants and the threat of substitute products or service (Porter, 2008). As for the smartphone manufacturing industry, the bargaining power of suppliers and buyers are both strong, the threat of substitute and the potential entrants are more benign. And there is a fierce rivalry between dominant producers Apple and Samsung which means that this industry is highly monopolized. (Huang, H et al., 2016).

THE POWER OF SUPPLIERS. The supplier group of smartphone manufacturing industry is strong. Firstly, the smartphone producers highly relies on the supplier group to provide core components of mobile phones, such as chips, LCD/TP and camera. However, the supplier group does not heavily depend on the industry for its revenues since they serve many industries. Secondly, the supplier group is more concentrated. For example, chip suppliers Qualcomm, Samsung and Mediatek together have a combined market share of more than 89 percent. Due to the excellent performance of Qualcomm Snapdragon, almost all the Chinese smartphone producers use Qualcomm's products. Therefore, Qualcomm is nearly monopoly in chips. Thirdly, producing core components of smartphones requires a huge amount of capital and high technology, it is hard for producers to produce themselves. As a result, the suppliers can charge higher prices, limit quality and shift costs to industry participants.

THE POWER OF BUYERS. The customer group is also strong. There are lots of mobile phone products on the market and most of them are quite similar. For customers, it is quite easy to find an equivalent product. Plus, they face few switching costs in changing vendors.

THE THREAT OF SUBSTITUTE. The substitute of the smartphone is mainly the tablet computer. To some extent, the tablet computer meets the needs of people to surf the Internet and communicate online. But tablets are yet not so convenient to make telephone calls or send messages. Therefore, the threat of the tablet computer is small now. If technology develops further, it may pose a bigger threat to phones.

THREAT OF ENTRY. The entry barrier of this industry is very high. First, it needs large finance capital to invest in research and development. The huge capital requirements limit the pool of likely entrants. Second, having the scale economies effect, the incumbents have cost advantage not available to potential entrants. What's more, they possess high brand recognition, a stable supply chain, and mature distribution channels. For new entrants, it is difficult to compete with them and gain market shares.

RIVALRY AMONG EXISTING COMPETITORS. Smartphone manufacturing industry exists a fierce rivalry which limits the profitability of the industry. The competition in mainland China is cruel, with nearly hundreds of brands disappearing within five years. What's more, this industry is nearly monopolized. In mainland China, Huawei, OPPO, VIVO, and Xiaomi together account for 74.5 percent of the market share. In the global market, Samsung, Apple, Huawei and Xiaomi accounted for 59.4 percent of the market share. With such a high market concentration, it is hard for a company to win some market shares.

Xiaomi's Business Strategy and Its Transition

As is said above, the smartphone market is hard to enter and survive. Xiaomi entered it in 2010 and stood out in 5 years. The secret of its success is cost leadership strategy. Lei Jun, the CEO of Xiaomi, concludes it as "Xiaomi Model 1.0" which refers to "no factories, no offline channels and advertising, light assets and high cost-performance" (Wallstreetcn.com, 2018).

Under this model, Xiaomi simplified its value chain activities. Its value chain activities were divided into three parts: technology development, marketing and sales, and after-sales service. Xiaomi adopted network direct sales model and outsourced mobile phone manufacturing to original equipment manufacturers such as Foxconn to reduce production costs. It carried out marketing through almost zero costs, such as hunger marketing and microblog marketing. Cost saving ensured that Xiaomi could provide consumers with cost-effective products and implement a cost leadership strategy successfully.

"Xiaomi Model 1.0" enables it to grow extremely fast. However, there were many potential risks. As there was no foundry for Xiaomi, it lacked mastery of the supply chain. With the rapid expansion of Xiaomi, its supplier system was increasingly large. Due to the lack of control over the supply chain, there were no alternative suppliers in the initial stage. Xiaomi products had problems such as delayed listing and goods shortage.

In 2016, the external market environment became worse. Many traditional mobile phone producers also used online sales channels to sell products, which reduced the advantages of Xiaomi. Furthermore, from 2015 to 2016, the competition in China's smartphone market intensified. The capacity of domestic first-tier and second-tier markets were gradually saturated, with third-tier and lower-tier cities becoming the main consumer market. This kind of market is dominated by offline channels. However, Xiaomi only has online sales channels. As a result, Xiaomi experienced sales reduction in 2016.

The CEO of Xiaomi quickly adjusted the business strategy. He first identified three strategic objectives: innovation, quality, and delivery. In terms of value chain activities, Xiaomi's strategy also changed from three aspects: technology development, marketing and sales, supply chain management. The company created a triathlon business model integrating hardware, new retail and Internet services, called "Xiaomi Model 2.0".

TECHNOLOGY DEVELOPMENT. Xiaomi constantly increased investment in research and development. Xiaomi's R&D (Research and Development, R&D) spending rose from 2.1 billion yuan in 2016 to 3.2 billion yuan in 2017, an increase of 49.8 percent. Plus, Xiaomi's R&D staff increased from 3441 in 2016 to 5,247 in 2017. In 2017, Xiaomi has become one of the four smartphone manufacturers that have independently developed the chip of the mobile phone (Zhou,2018). As of March 31, 2018, its patent portfolio includes more than 16,000 pending patent applications and more than 7,000 licensed patents. (Xiaomi Corporation's Prospectus,2018)

MARKETING AND SALES. Xiaomi has changed from a 100% focus on e-commerce to a new retail model, paying more attention to offline channels, including direct stores, franchised stores, and cooperative retail stores. Since 2017, Xiaomi's offline channel layout has entered a period of expansion. By the end of 2017, Xiaomi had opened 22 stores across the country and planned to increase the number of stores to 1,000 by 2019. At the same time, it no longer relied solely on new media marketing. It launched advertisements in buildings, outdoors, transportation hubs, variety shows, and other channels in 2016. The advertising expenditure increased by 99.5% in 2017 (Xiaomi Corporation's Prospectus,2018). Xiaomi comprehensively strengthened the publicity and advertising activities of launching products and brands.

SUPPLY CHAIN MANAGEMENT. Xiaomi replaced the person in charge of the supply chain, and the CEO Lei Jun personally took charge of the supply chain management. Xiaomi also introduced talents with relevant experience and made efforts to improve the relationship with suppliers. It also carried out the integration construction of production, supply and marketing, and set up special staff planning and coordination departments respectively in the mobile phone department, supply chain and Xiaomi online sales team.

Briefly speaking, Xiaomi changed the business model from light assets to appreciating supply chain management, from no offline advertising to employing spokesmen to advertise, from only online sales to building offline sales channels.

Recommendation for Future Development

With Xiaomi's strong cost control ability, it is expected to maintain competitive advantage of high cost-performance. With the improvement of supply chain management, the development of offline channels and the strong capital strength after its listing, Xiaomi is likely to develop into high-end smartphones and continuously expand the market while maintaining its advantages. In Q4 2017 and Q1 2018, Xiaomi's smartphone market share reached 31%, which has surpassed Samsung to become the number one smartphone supplier in India. With the success of the Indian market, Xiaomi's phone sales in overseas markets may continue to expand. However, the smartphone manufacturing industry now has a relatively flat growth rate. To get more profits, Xiaomi can try to expand their products to some areas with higher profit rate. As for the corporate strategy, I argue that cost leadership strategy can still help Xiaomi to achieve a great success in the future, at least in the emerging market.

Conclusion

The reason why Xiaomi reversed the decline is quite clear now. First, the cost leadership strategy they adopted was quite effective excepts the flaws of supply chain and marketing. The rapid expansion caused the crashing of their supply chain. And the increasingly competitive environment makes their online marketing less effective. These factors resulted in the sales crisis. Plus, the core competitive advantage did not change, just the value chain activities hinder the company to maximize their core competitiveness. Furthermore, the rapid and precise decision of the CEO also contribute to their success. The change of business model solves the underlying problems effectively. Once again, Xiaomi was back to the market as a winner.

References

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