

# A Smartphone Challenger's Competitive Strategy: The Case of Xiaomi

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## Abstract

For many years, China's mobile phone market had been dominated by foreign companies such as Nokia, Motorola, Apple, and Samsung. But the situation suddenly changed with the arrival of smartphones. Nokia quickly disappeared from the market. Motorola was sold to Google and sold again to Lenovo in 2014. Although Samsung still has the largest share of the Chinese market, its performance has lagged, with not only revenue but also profit showing negative growth. Apple is still growing, although the pace of growth has slowed. In contrast to this is the leap of Chinese businesses, with Xiaomi making especially impressive gains. According to data from IDC for worldwide smartphone shipments in the third quarter of 2014, Xiaomi made the top five list for the first time, coming in at number three behind Samsung and Apple.

Xiaomi has a presence in six countries and regions but has not yet entered the Japanese market, so few people [in Japan] know the brand. This paper gives the background of the founder of Xiaomi and its history and describes the competitive strategy supporting Xiaomi's rapid growth.

**Keywords:** *Lei Jun, Chinese enterprise, Xiaomi, smartphone, competitive strategy*

## INTRODUCTION

According to newspaper, Sharp [Japanese electronics company] reported a final profit of 4.7 billion yen for the April-September 2014 period, its first surplus in four years. The driving force behind this has been Sharp's sales of LCD displays to Xiaomi, a smartphone maker in China. According to IDC, the top three companies for worldwide smartphone shipments in the third quarter in 2014 were Samsung (78.1 million units), Apple (39.3 million units) and Xiaomi (17.3 million units). What these two facts have in common is Xiaomi. What is Xiaomi? Xiaomi has not yet entered the Japanese market, so few Japanese know the company. This paper will describe Xiaomi's history and competitive strategy.

## ABOUT XIAOMI'S FOUNDER

### *Professional Programmer*

Lei Jun was born in Zhaowan Village, Mianyang County (now Xiantao City) in China's Hubei Province in 1969. As a middle school student, he liked literature. He was good at Go [a traditional board game] and won a Go championship while in high school. At age 18, Lei Jun passed the National College Entrance Examination and began studying at the Department of Computer Science at Wuhan University.

Since there were few universities with computer science departments in China at the time, the number of applicants was large and the competition was fierce. Lei Jun's major was software. Thanks to the logical thinking ability he had cultivated through playing Go, Lei Jun learned the essentials of pro-

programming faster than the others and developed his programming skills. Sometimes, his knowledge and ability in the software exceeded those of his lecturers in the department. Two facts illustrate this point. One, a program written as homework by Lei Jun in his first year was included in a text edited by the lecturers in the next year. Two, Hubei Province police invited Lei Jun to lecture as an expert on antivirus software, although he was still a sophomore.

Wuhan University is one of the universities where the credit system was introduced in China, so students with ability and a strong desire to learn have a high degree of freedom in course selection. Lei Jun earned all the credits required for graduation in just two years. However, since it was not possible to be immediately graduate from the university, Lei Jun began to look for opportunities to use his software knowledge.

Just like Beijing's Zhongguancun area, an electronics district around Wuhan University sprang up early. All manner of things related to computer equipment and parts, whether hardware or software, can be found there. Lei Jun went to the electronics district every day in order to work on software-related tasks related to his part-time job or volunteering, which he then developed at the student dormitory.

He had the ability to develop software faster than others could come up with ideas, and he developed very effective software. For example, he developed software to prevent illegal downloads, antivirus software, financial software, CAD systems, Chinese language system and others. He was also involved in designing and building motherboards and even had experience as a hacker unlocking software developed by others. The bosses of the electronics street noted his skills, and he soon became a software celebrity. During this period, Lei Jun found that existing software development texts were not easy to use, so he edited a book with a colleague. After the book was published, it became very popular with readers. Therefore, he was able to achieve economic independence based on royalties and wage income from the time he was a sophomore.

Lei Jun met Wang Quanguo in 1989. Wang was the electronic district's technical authority, working

in a university venture business (a computer sales company) after graduating from Wuhan University, and who later became a vice president of Kingsoft. At the time, Wang Quanguo was developing software to prevent illegal copying. Because Lei Jun previously developed similar software, they decided to work on it together. The result was BITLOK0.99, which Wang and Lei upgraded 20 times in response to attacks from hackers. Because this software attracted much attention and orders from leading software companies such as Yonyou, Kingsoft, Wang and Lei earned 1 million yuan (about US\$161,300) from it.

Two years later, BITLOK1.0 had been successfully developed and was used in more than one million personal computers. But since BITLOK 1.0 is software for professional software developers, the market for it was small. Nevertheless, as long as there were users, Lei Jun kept improving the product up to version BITLOK3.0.

In summer 1990, Lei Jun founded a venture business called "Three Colors" with two classmates. They tried to imitate software to convert the Chinese language to English developed by others, but failed after six months. This failure proved to be a useful lesson for Lei Jun later in life.

### *Hired CEO*

In July 1991, Lei Jun graduated from Wuhan University and was assigned to a National Institute in Beijing. He had a stable job, but he did not find the work stimulating. In November the same year, Lei Jun met Qiu Bojun at a computer exhibition. Qiu Bojun, the founder of Kingsoft, was Lei Jun's idol. At that time, Kingsoft had already become famous for developing Chinese word processing software known as WPS, and Qiu Bojun wanted to further his company's expansion by recruiting personnel. Qiu Bojun had heard that Lei Jun was a software expert and offered him a job at Kingsoft. Needless to say, Lei Jun jumped at the chance, becoming the sixth employee of Kingsoft, and started working as the company's manager of its Beijing R&D Department.

In order to write programs, Lei Jun had been studying MASM, PASCAL, C++, VBA, DELPHI and JAVA intensively and began to use these programming languages freely.

WPS was born from 100,000 lines of code written by Qiu Bojun. It was further developed under Lei Jun and won a large share of the Chinese word processing software market.

However, Microsoft began to attack the Chinese market with Word 4.0 in 1994. Because of the dominance of WPS, Microsoft wanted to avoid a head-on collision and suggested that Kingsoft combine WPS with Word 4.0. Lei Jun considered this is a good opportunity to learn from global giants and accepted the suggestion, but fell into the trap set by Microsoft.

In the face of the Windows whirlwind, WPS was rapidly losing market share. Taking responsibility for this, Lei Jun submitted his resignation to the company in April 1994. Qiu Bojun refused to accept his resignation and gave Lei Jun a six month-long vacation. During his time off, Lei Jun focused on reading, especially books by Mao Zedong. Why did Lei Jun read Mao Zedong's books? I thought that might be related to other business leaders' reading. For example, Zhan Ruimin (CEO of Haier), Liu Chuanzhi (former chairman of Lenovo), and Ren Zhengfei (founder and CEO of Huawei) all like to read Mao Zedong's books. They received a lot of inspiration from Mao's books. Lei Jun also wanted to learn more about Mao's military theories, especially the David and Goliath theory of guerrilla warfare.

To compensate for the loss of its flagship software, Kingsoft continued developing other software, such as computer game software, application software and antivirus software, and expanded its market share in these areas. For example, "Zhongguancun Revelation," released in January 1996, became the first personal computer game. The "Swordsman's Love Story" series released in April 1997 was also very popular. But the acceleration of software development led to a shortage of operating funds. Receiving an investment of US\$4.5 million from Lenovo, Kingsoft also made personnel changes: Yang Yuanqin, who was vice president, Qiu Bojun and Lei Jun were appointed chairman, president and CEO, respectively. Lei Jun was 29 at the time.

After obtaining operating funds, Kingsoft began to counterattack. In October 1997, the company successfully developed WPS97 for the Windows

platform. The launch of this product, sold at the low price of 28 yuan (US\$4.50), was reported as an important event in the computer industry by the Chinese media. In October 1999, "Kingsoft Chinese Dictionary 2000" was released, achieving sales of 1 million units in one month. Because it was the first domestic software product to achieve sales in excess of 1 million units, the National Library of China decided to save one copy of "Kingsoft Chinese Dictionary 2000" permanently.

Kingsoft cooperated with Legend Investment to establish Zhuoyue, a company focused on e-commerce (B2C) in May 2000. Kingsoft invested management resources equivalent to a 70% shareholding, with Legend Investment holding the remaining 30% of the company's shares by investing US\$4.5 million. Lei Jun was appointed chairman of the company.

Zhuoyue set up an audio division, a book division and a software division. Next, Zhuoyue launched a web site and started online sales. A year later, Zhuoyue.com had become one of the top two online bookstores in China. However, in 2004 Amazon tried to acquire Zhuoyue in order to expand its business in China. Lei Jun had no intention of selling Zhuoyue that he and others had founded, but believing that Zhuoyue would be crushed someday by Amazon, he decided to sell the company for US\$75 million. After the completion of this transaction, Kingsoft got US\$52.5 million, but the management team, including Lei Jun, all left Zhuoyue. Legend Investment received US\$22.5 million from the sale, earning a high return on its investment of US\$4.5 million.

### *Angel Investor*

After selling Zhuoyue, Lei Jun's personal assets also increased, so, beside engaging in management as Kingsoft CEO, he decided to focus on and provide support for youth entrepreneurship.

In 2005, Sun Taoran founded Lakala, a third-party payment platform venture in which Lei Jun invested US\$2 million with Legend Holdings. Today, Lakala has become a leading Chinese internet finance and community e-commerce company.

When Li Xueling founded Duowan.com, an electronic game venture, in 2005, Lei Jun personally invested US\$1 million. Seven years later, YY

Customer, a division of Duowan, was listed on NASDAQ in the United States with a market value of US\$600 million.

Again in 2005, Chen Nian established Woyou.com and asked Lei Jun to invest. Lei Jun did so, but the venture soon failed. In 2007, Chen Nian founded Vencle.com and asked Lei Jun to invest again. Lei Jun readily agreed and invested 2 million yuan, equivalent to 28.5% of the company's total capital. Since then, Vencle.com has been expanding and has accepted US\$522 million in investments from venture capital and funds including IDG, Softbank, Tiger Fund, Temasek and others.

In 2006, Lei Jun invested 4 million yuan in UCWeb, which has become a leading provider of mobile internet software technology and services in China.

On October 6, 2007, Kingsoft was listed on Hong Kong Stock Exchange with a market value of HK\$602 million. This became an opportunity, Lei Jun quit the CEO that has served nine years, and left the company where has been working for sixteen years.

Up to 2010, Lei Jun had invested in a total of about 20 companies in the mobile network, e-commerce and SNS areas. Not only that, but these companies directly or indirectly supported the development of Xiaomi.

Because Lei Jun had been much more successful with his investments than professional venture capitalists, he was sometimes asked by reporters about his investment know-how. To which Lei Jun answered that "I started in business earlier and experienced many mistakes and failures. Therefore, I can tell entrepreneurs which roads lead nowhere and help them make fewer mistakes."<sup>1)</sup> As an angel investor, Lei Jun had his own investment criterion which was: "If you do not know me or are not an acquaintance of my acquaintance, please do not come, since I will not invest."<sup>2)</sup> From this criterion we can see that Lei Jun attaches great importance to trusting relationships with key people. On the other hand, he never reads any business plans.

### *A True Entrepreneur*

So far, Lei Jun had been successful as an engineer (programmer), a hired CEO and an angel investor. However, he was still not satisfied. Why? It's true

that under Lei Jun's leadership, Kingsoft attained a certain level of market share and obtained a listing, but the company did not become the industry leader. He put his dreams into Zhuoyue.com, but it was acquired by Amazon. Lei Jun once said that selling Zhuoyue felt as painful as if he had been selling his children. And although he earned vast sums of money as an angel investor, that was not what he really wanted to do. Well, what did he really want to do? His dream was to establish a firm which would become the industry leader. That was the motivation for Lei Jun to start a venture for the second time in his life.

## **XIAOMI**

### *Entrepreneurship*

In December 2009, 40 year-old Lei Jun decided to become an entrepreneur again and immediately began looking for partners. He found six, whose former positions had been vice president at the Google China Research Institute, senior product manager at Google (China), development commissioner at the Microsoft China Research Institute, design commissioner at Kingsoft, dean of the Industrial Design Faculty at Beijing University of Technology, and senior commissioner at the Motorola Beijing Research and Development Center. Among them, some were Lei Jun's subordinates who responded immediately after just one call from him, while others made him wait several days before a final decision despite Lei having spent over 12 hours to try and persuade them.

The first product these people developed was a smartphone open platform based on Android. The result was the birth of the MIUI smartphone operating system. Its development philosophy highlights the minimalist aesthetic: refining the essence, focusing on content and achieving the ideal situation.

Lei Jun formally established Xiaomi in April 2010. Part of the company's name, "xiao," is a humble word meaning small in Chinese. "Mi" stands for mobile internet in English. Xiaomi's logo is also a modification of MI (Figure 1).

### *The Xiaomi Smartphone*

Lei Jun wanted to produce a smartphone, but al-



**Figure 1. Xiaomi's Logo**

Source: Xiaomi's website.

most no one in the industry was supportive, given that Apple and Samsung occupied the world market due to their overwhelming superiority and would not tolerate any challenge. However, Lei Jun said, "Xiaomi is a dreamer. Whether you think it is sick or not, I want just to do it."<sup>3)</sup> Needless to say, no matter how strong his willpower, the man would be a Don Quixote tilting at windmills if he was unable to do it.

Apple plans and designs its smartphones, but manufacturing is outsourced to Taiwanese manufacturers on an OEM basis. Xiaomi also tried to adopt the same business model, but no manufacturer was interested in accepting orders from Xiaomi, because they had never heard of the company. Smartphone production is very specialized, and having accepted to take on production, a manufacturer would have to spend money to purchase the necessary equipment. So, unless the order is large, it is difficult to recoup the expense. Because Xiaomi was just starting to produce smartphones and was unable to offer a large order like Apple, they either had to give up or accept paying much more for manufacturing.

Even so, Xiaomi placed an order, because it wanted to make smartphones as well as Apple. Xiaomi procured parts the same way as Apple. For example, Apple purchased LCD panels from Sharp, and so did Xiaomi. After the earthquake of March 11, 2011, many foreign customers left Japan, but Lei Jun went there with his procurement staff and signed a supply contract with Sharp. That contract was one reason why Sharp was able to improve its performance, as mentioned earlier in this paper.

But even though Xiaomi had been able to find

the same suppliers and plants to produce smartphones, due to lack of brand name, they have little presence in sales. This was not the result that Xiaomi had expected. Lei Jun's goal was to develop a product with the same quality as Apple at less than half the price, that is, a high-quality, low-priced smartphone.

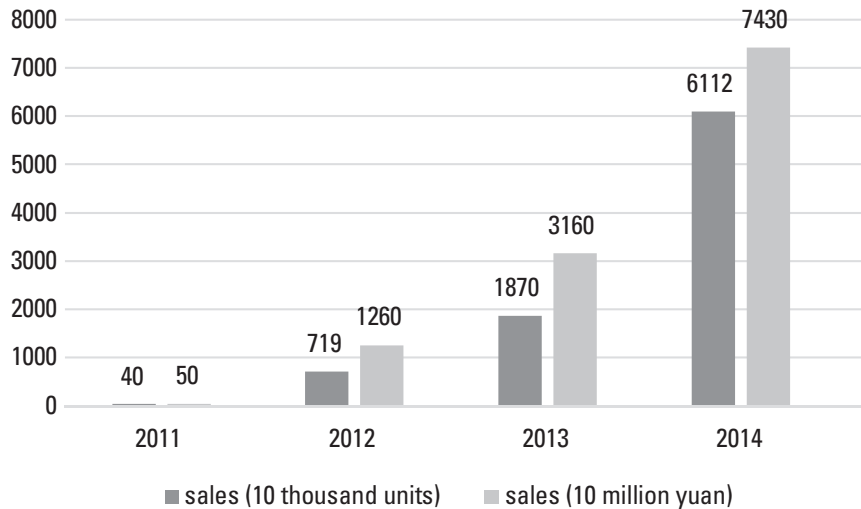
At the same time as it was developing suppliers and OEM manufacturers, Xiaomi developed "MiChat," an SNS tool for smartphones. Thus, the developers can always open their ideas and asked users to assess whether the product was good or not. Users understood the developers' intentions and responded with a variety of comments and suggestions. As a result, Xiaomi already had 500,000 fans before the birth of its smartphone. In addition, Lei Jun not only started a blog initially but also required each employee to transmit information outside the company through social networks, and acquired 10 million members that way<sup>4)</sup>. These members were called "MiFans," and they later became the first users of the Xiaomi Smartphone.

In September 2011, Xiaomi began selling its M1 smartphone at 1,999 yuan (US\$322) and sold 300,000 units within 34 hours. All was surprised at the price, because Apple smartphones sold for more than 5,000 yuan (US\$806), which was expensive for most Chinese consumers. Could Xiaomi gain profit at this selling price? The answer is no. Lei Jun knew this but still chose to compete on price. After some research, I discovered why he did this.

First, because a new entrant has no brand power, if the functions of the product are the same, price will be the only factor that will attract customers. But it's not enough to be only 5 percent or 10 percent cheaper than the competition, so Xiaomi simply priced its product at less than half the price of a comparable Apple product. Many rebellious people will accept the price. Even if the product sells at a loss at the beginning, if more units are sold the cost will drop, and once the breakeven point is reached, the company can turn a profit. In other words, Xiaomi's breakeven point was high, but it could achieve the same effect by accelerating the pace of sales.

A second reason was that Xiaomi derived profits from hardware as well as from software. Apple turned a high profit because they kept the cost of



**Figure 2. Xiaomi Sales Data**

Source: A variety of materials drawn on by the author.

the hardware as low as possible. By contrast, Xiaomi's competitive strategy was to earn profits not only from hardware but also from software and services.

In order to achieve this competitive strategy, Xiaomi made operating system upgrades available for free to users. Up to January 19, 2015, this service had continued for 220 weeks. Moreover, Xiaomi developed a new bracelet with a variety of functions such as pedometer, calorie counter, alarm clock, caller ID, and others.

In May 2012, Xiaomi started sales of the "Xiaomi Youth Version" for college students: 150,000 units of this smartphone sold out in just 10 minutes and 52 seconds, meaning that an average of 230 units were sold per second.

In October 2012, Xiaomi began selling M2, a new version of its smartphone. The first batch of 50,000 units sold out in 2 minutes and 51 seconds. The second batch of 100,000 units, released for sale the next month, also sold out in 2 minutes and 29 seconds.

In October 2013, Xiaomi launched its M3 phone. Although this model featured upgraded main components, the price stayed at 1,999 yuan. For example, the CPU was NVIDIA's Tegra4, the display panel was Sharp or LG's 5-inch 1080P, the camera was Sony's 1300-pixel camera, and the battery was made by Samsung, LG or Sony. In other

words, the M3 was the most sophisticated smartphone in the world. Lei Jun once commented about the M3 that "I will always pursue the goal of making the fastest smartphone in the world. This is what I have dreamed of since founding Xiaomi."<sup>5)</sup> Today, Xiaomi is selling the latest version of its smartphone, the M4, for 1,999 yuan (US\$322), the price of the M3 model was reduced to 1,499 yuan (US\$241).

Compared to Apple smartphones, Xiaomi's smartphone is very moderate, but even so, many young people in China are unable to afford even 1,999 yuan. Thus, Xiaomi began selling the Redmi smartphone to China Mobile customers in July 2013. Redmi has the basic functions of a smartphone, but the minimum price is 699 yuan (US\$112). Thanks to Redmi, the population of smartphone users has rapidly increased in China.

Looking back, in only three years and four months from the launch of M1 to the end of 2014, Xiaomi had sold a total of 87.41 million smartphone units, and sales is growing rapidly. Because Xiaomi is not yet listed on the stock market, detailed financial data is not available, although some data for sales can be extracted from media reports (Figure 2). According to those reports, we know that sales of 500 million yuan to 74.3 billion yuan was a 148-fold increase, and that sales of smartphones from 400,000 units to 61.12 million units was a 152-fold

**Table 1. Xiaomi's funding list**

Implementation date	Amount of funding (US\$)	Valuation (US\$)	Main investors
December 2010	41 million	250 million	Morningside, IDG, Qiming, Xiaomi employees
December 2011	90 million	1 billion	Morningside, Shunwei, Qiming, IDG, Temasek, Qualcomm
June 2012	216 million	4 billion	Not disclosed
August 2013	2 billion	10 billion	DST
December 2014	1.1 billion	45 billion	All-Stars Investment, DST, GIC, Houpu, Yunfeng

Source: A variety of materials drawn on by the author.

increase. In addition, IDC reported that Xiaomi jumped into the top three in worldwide smartphone shipments for the first time in the third quarter of 2014. Compared to the same quarter of the previous year, Samsung shipments decreased by 8.2 percent, and Apple shipments were up by 16.1 percent. In contrast to this, Xiaomi achieved an increase of 211.3 percent.<sup>6)</sup>

#### *Financing for Xiaomi*

Given that Xiaomi was set up less than five years ago and has developed so fast, what about operating funds? Needless to say, the faster the development, the greater are the financial needs. Does Xiaomi have a funding problem? This is the issue I will look into next.

In December 2010, the first time of funding, Xiaomi raised a total of US\$41 million, and its valuation was US\$250 million. Three investment companies, Morningside, IDG and Qiming Venture Partners, invested US\$30 million. Morningside is a Hong Kong venture capital firm mainly for high-tech ventures. IDG is a famous American company in IT research services and is also involved in venture capital. Qiming is an investment company located in Shanghai, and invests mainly in Chinese enterprises in their early stages and growth phases. The remaining US\$11 million was collected from Xiaomi's 56 employees, including the management team. Everyone invested an average of US\$200,000.

In February 2011, Xiaomi held a second round of funding, raising US\$90 million. Its valuation was also evaluated at US\$1 billion. In addition to the previous three investors, Shunwei, Temasek and Qualcomm joined as investors. Shunwei is an investment fund focusing on network-oriented venture; Lei Jun is its co-founder and chairman.

Temasek is an investment company owned by the Singapore government that has been ranked one of the best investment companies in the world. Qualcomm is an American company that designs and develops communications technology and semiconductors; it is also a CPU supplier for Xiaomi.

Six months later, Xiaomi started its third round of funding, raising US\$216 million. The company's valuation climbed to US\$4 billion. Due to a confidentiality agreement, Xiaomi did not disclose the name of the investors.

In August 2013, Xiaomi canvassed for its largest funding until then. Xiaomi asked one company to invest US\$2 billion, and its valuation was evaluated at US\$10 billion. The investor was DST (Digital Sky Technologies), a Russian investment company. DST is not well-known, but it is a large shareholder of Facebook, an indicator of its strength.

The most recent round of funding for Xiaomi was held in December 2014. Xiaomi raised US\$1.1 billion from five investment companies: All-Stars, DST, GIC, Houpu and Yunfeng. The company's valuation was estimated at a whopping US\$45 billion. This made Xiaomi the unlisted ICT enterprise with the highest valuation in the world. All-Stars is an investment company established by five former employees (including the director and general manager) of Morgan Stanley. The company invests mainly in ventures related to the internet in China. GIC, an investment company owned by the Singapore government, is also the largest international investment company in that country. Houpu is an investment company launched by Fang Fenglei, who is a Goldman Sachs partner in China and is supported by Goldman Sachs and Temasek. Yunfeng is an investment company established by Jack Ma, founder of the Alibaba Group and the

richest man in China.

Table 1 lists the details of the five funding rounds so far. From this we know that venture capital firms and investment funds in China and abroad have been focusing on Xiaomi from its birth.

### ***Xiaomi's Competitive Strategy***

The outline of Xiaomi's competitive strategy is clear. Using Apple as a benchmark, it has identified its weaknesses and given full play to its strengths, as follows.

#### 1) Providing a high-quality, high-function product at a low price

Generally speaking, there is a contradictory relationship between high quality, high function and low price. To achieve high quality and high function, a company needs to invest more, so selling for a lower price is impossible. As mentioned earlier, the main components for Xiaomi's products are from Samsung, Sharp, Sony, LG and others, and the OEM are also the same Taiwanese companies' factories in China (for example, IAC and Hon Hai) used by Apple. But since the volume of procurement and contract manufacturing is lower than for Apple, the total cost is higher. Nevertheless, Xiaomi would rather cut profits and set its prices lower than Apple. After all, high quality and high function are compatible. Also, Xiaomi's high-function aspect is not synonymous with multi-function. Rather, it means eliminating unnecessary functions and providing the functions that consumers really want. For example, the remote control function for using Xiaomi's smart TV and the electronic ticket function for subway turnstiles (like SUICA in Japan) are very popular with consumers.

#### 2) Ensuring benefits from non-hardware elements

Apple earned a large part of its profits from its hardware, but Xiaomi cannot do that, so it needs to earn profits from software and services. This is related to Xiaomi's nature of specializing in software. For example, some mobile games developed by Xiaomi became best-sellers and contributed greatly to profit. Xiaomi is also well-regarded for its good service to users.

#### 3) Giving full play to the role of SNS

Before launching a smartphone, Xiaomi developed MiChat, which is similar to Facebook, and attracted many members (Mi fans). Blogs written by Xiaomi's management team, including Lei Jun, also played a major role in expanding the number of Mi fans. Making full use of SNS created an environment that supported the launch of Xiaomi's smartphone. Moreover, even after launching its smartphone, Xiaomi keeps track of users' reviews, communicates with consumers in real-time, and continues improving its product.

#### 4) Online sales

As a latecomer in the smartphone market compared to the pioneers, Xiaomi faced several disadvantages. From the perspective of management resources (human, technology, capital, information and brand), Xiaomi lacks all. Therefore, Xiaomi does not use any traditional marketing methods such as stores, advertising or TV commercials. It concentrated its resources in online sales, thus achieving significant cost savings. Today, 70 percent of Xiaomi's products are sold online and the remaining 30 percent through China Unicom, China Mobile and other sales partners.

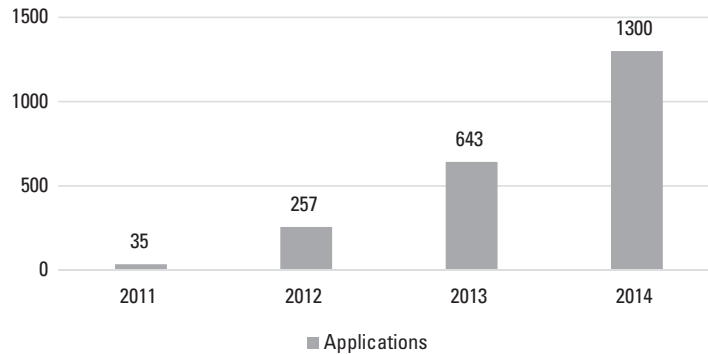
#### 5) Xiaomi's Achilles heel

Although Xiaomi is less than five years old, it has grown very rapidly. However, is Xiaomi's business model sustainable? I have some doubts in this regard, for two reasons.

One is the barrier of patents. Although Xiaomi is very good at developing software, its lack of smartphone design and manufacturing know-how is also very obvious. Therefore, to produce and sell smartphones, Xiaomi had to sign license agreements with the companies owning the related patents. Lei Jun published Xiaomi's cost list on June 26, 2012. According to this list, the royalties for CPU technology paid by Xiaomi to Qualcomm are linked with selling prices and percentages. Because the royalty payment was 110 yuan per product priced at 1,999 yuan, we know that the percentage for royalties is 5.5 percent.

However, a single smartphone uses a multitude of technologies. I believe that Xiaomi does not have a clear map of other companies patent protection in





**Figure 3. Xiaomi Patent Applications for Inventions**

Source: <http://www.ebrun.com/20141222/119003.shtml>. The figure for 2014 is estimated value.

their phones. Therefore, they have carried the potential lawsuit of patent infringement.

For example, in June 2014, Xiaomi entered the Indian market, but after it began to sell its Red Mi smartphone, Ericsson requested that Xiaomi immediately stop infringing on its patents and pay royalties. After fruitless negotiations, Ericsson filed a suit in India. On December 11, 2014, the Delhi High Court ruled that Xiaomi had infringed on Ericsson's patents and ordered it to stop importing and selling its smartphone.

Xiaomi later resumed sales in India by introducing a smartphone that did not use technology patented by Ericsson, but Xiaomi was severely affected by this ruling. Likewise Microsoft and Nokia may also bring charges, relying on the results of Ericsson's action. If Xiaomi signed a license agreement with Ericsson and every potential litigation opponent, would it be possible for Xiaomi to still keep selling its smartphone for 1,999 yuan? I believe that would probably be impossible. If Xiaomi had to raise prices, it would gradually lose customers.

In response to losing in India, Xiaomi quickly disclosed patent application data for inventions. According to this, we know that Xiaomi's patent applications have been increasing rapidly. Figure 3 shows the details. These data show that Xiaomi is indeed making progress, but a total of 2,235 patent applications is not enough in order to compete with the giants in the industry. Thus if Xiaomi is unable to overcome the barrier of patents, it may suffer a sudden setback. At present, there is a real possibility.

The other is the fact that Xiaomi is also chal-

lenged by rivals.

In the computer industry, modular parts mean that anyone can easily assemble a PC. With the competition becoming more intense, restructuring has taken place in the industry. For example, Dell once occupied the first place in global share, but in now, their production is disappeared. HP was also once at the top but lost its place and was overtaken by Lenovo. It's the same in the mobile phone industry. Nokia was once the world leader, but it was too slow to develop smartphones. Consumers abandoned it, and it was sold to Microsoft.

In other words, life cycles in the ICT-related business are short and the risks are big. No one can forecast even when, where or which competitor will appear or if a company will get stuck in a price competition or be overwhelmed by a new competitor with an innovative business model. There is always a risk. In China, known as the world's factory, the potential of such a competitor emerging is greater than in other countries. In fact, there are several enterprises in China that consider Xiaomi a rival. Therefore if Xiaomi fail to build a new business model protecting imitation, they are attacked by rivals.

## CONCLUSIONS

This paper focuses on Xiaomi, which is a challenger in the global smartphone industry. After giving an overview of the history of Xiaomi's development, I focused on its competitive strategy. Although Xiaomi has only a short history, its performance has been outstanding and we will never see the same case again. According to Lei Jun, "2014 was

an important milestone in the history of Xiaomi's development. We changed our position in the industry from a challenger to one of defenders being chased by the entire industry.”<sup>7)</sup>

However, it is not correct to think of Xiaomi as simply a mobile phone company. Xiaomi is doing its best in software, hardware and networks, seeking perfection by synchronizing those elements. Xiaomi has caught up with Apple, which it viewed as a benchmark, and would like to go beyond Apple. Lei Jun has great respect for Steve Jobs, even imitating how Steve Jobs dressed. For example, he wore a black T-shirt and jeans when appearing at new product launches, so he has been called the “Chinese Jobs” by the Chinese media. But he undoubtedly has a huge dream of outreaching Apple.

The combination of software, hardware and networks may be a weapon for catching up to Apple. In Lei Jun's view, “Xiaomi is a national consumer electronics brand, the founder of smart home ecology, and a platform for mobile internet content and services.”<sup>8)</sup> Needless to say, these are Xiaomi's goals, although they have not yet been fully realized.

Recently, the Internet of Things (IoT) has become a buzzword. What is IoT? It means connecting all sorts of things, not just computers and mobile phones, but also eyeglasses, beauty equipment and fitness equipment around us to the internet. Xiaomi Bracelet already offers this function, and the smart TV developed by Xiaomi uses a smartphone instead of a remote control to control the TV. Thus Xiaomi can be called a leading IoT company.

## NOTES

- 1) Run Chen (2014), *Lei Jun*. Huazhong University of Science and Technology Press, p.12.
- 2) Ibid, p.158.
- 3) Run Chen (2014), *Lei Jun*. Huazhong University of Science and Technology Press, p.3.
- 4) As of January 10, 2015, Lei Jun's blog had 11,542,379 registered followers.
- 5) Lei Jun's presentation at the “Xiaomi New Product Recital 2013”, on September 5, 2013.
- 6) Source: IDC.
- 7) Lei Jun's blog, January 4, 2015.
- 8) Ibid.

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