



# IS XIAOMI A GAME CHANGER?

Anita Kumari Yadav<sup>1</sup>

## ABSTRACT

Mobile phones have become ubiquitous today. As they evolve, they are packing more and more functionality. The feature phone to Smartphone transition marks a major leap. As with every technological change, new companies are emerging to take advantage of the changes in market. Some of them may simply be imitating what others before them have done. Once in a while, emerges a company that seeks to change the very fundamentals of a market. It may be in terms of innovating new products, like Apple did by introducing iPhone a few years ago. It may also be in terms of offering value at a price point which may have been considered impossible so far. Xiaomi is one such company that has come up in the last four years. It has offered features to customers at less than half the price that its competitors are offering. To make it possible, it has utilized hitherto unheard business models that are made possible by emerging technology. By eliminating entire heads from its cost structure, it is able to offer smartphones at unbelievably low prices. Xiaomi was initially considered to be pursuing a non-scalable and non-sustainable business model and its critics were waiting for the forces of gravity to catch up with the company. However Xiaomi has defied expectations by capturing the numero uno slot in world's biggest Smartphone market – China. As it expands its footprint to more countries, including India, it will be more closely examined. This case study is an attempt to understand the things that make Xiaomi distinct and potentially a game changer.

**Keywords:** Game changer, mobile, smartphone, business strategy, marketing, sales, Feature phone



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<sup>1</sup> Assistant Professor, DIAS, India

## INTRODUCTION

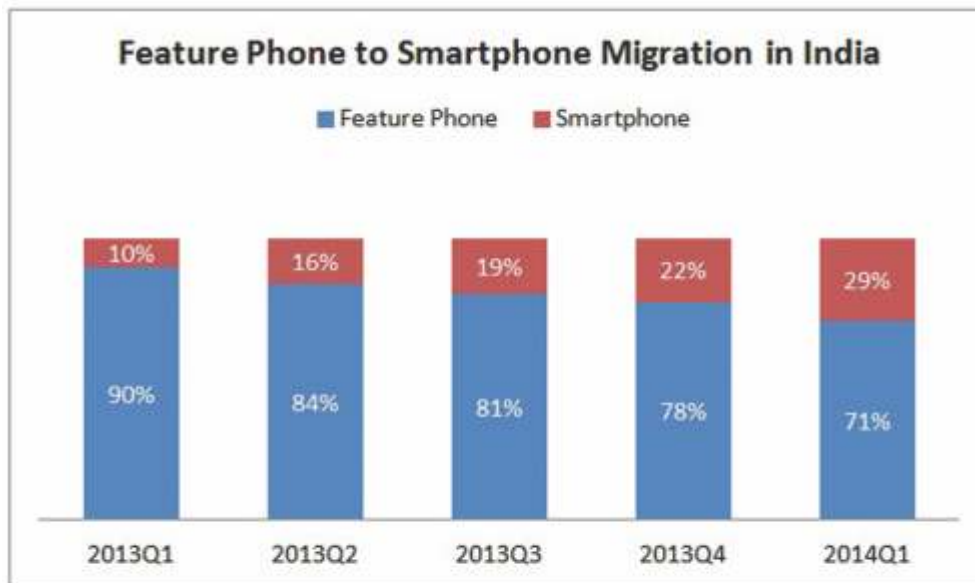
In today's digital age, smartphones have become an integral part of our life. These devices have many built-in functions and features which make our life easier. They are not only used to make and receive calls but one can send and receive mails, click photos, read data, play games, see reports, watch videos, transfer money, make all kinds of reservations whether it is railways or air-lines or hotels, use maps while driving, do e-shopping, listen to music etc.

Smartphone is defined as “a mobile phone with more advanced computing capability and connectivity than basic feature phones” [1].

“In 1994, IBM and BellSouth introduced a combination phone and PDA called the Simon Personal Communicator. Simon, the first smartphone was heavy and costly [2]. After many

years of research and development, the size was reduced and many features were added. BlackBerry introduced its first corporate smartphone in 2002. Its main focus was e-mail and due to this it got huge positive response. In 2007, iPhone gave a new direction to smartphone market. Over time, feature phones are getting replaced by smartphones. The overall market share of feature phones in India reduced from 90% in 1Q 2013 to 71% in 1Q 2014. The feature phone to smartphone migration in India [3] is shown below

At present there are many players in the smartphone market like Samsung, Apple, Huawei, Lenovo, LG Electronics, Sony, Xiaomi, Karbonn, Micromax, Nokia and others. The world smartphone market is showing tremendous growth. It grew 25.3% in the second quarter of 2014. This is new single quarter record of 301.3 million shipments which crossed the 300 million unit mark in a single quarter. The world smartphone market share[4] is shown below:

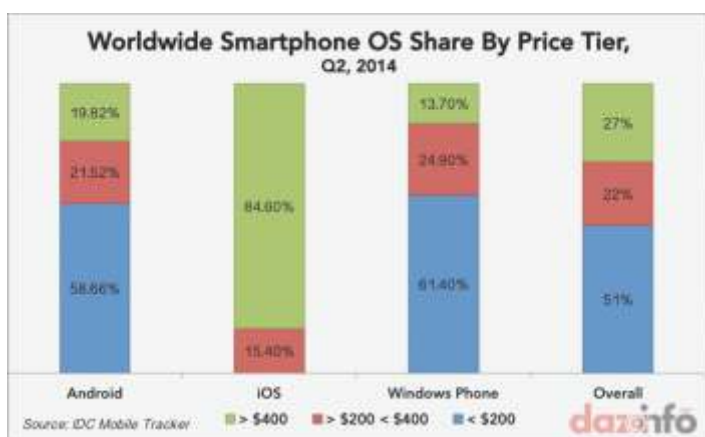


Source: IDC Asia Pacific Quarterly Mobile Phone Tracker, 1Q 2014



The various smartphone operating systems (OS) are Android, iOS, Windows Phone, Blackberry OS, Bada, Firefox OS, Tizen and others. Android is leading with market share of 84.7 in Q2 2014 followed by iOS which is having market share of 11.7%.

India is emerging as fastest growing market in smartphones. In the last quarter of 2013, Smartphone sales in India increased by 166.8%. Now India has become third largest smartphone market. China and the United States are at first and second position in terms of smartphone shipments. The report of Q2 2014 shows growth of smartphone is driven by low-end and mid-range smartphones [5]. This range controls 73% of the shipments. 216.25 million units of smartphone that were shipped during Q2 2014 were price tagged with \$400 or less. In the same quarter, major market share was captured by smartphones which were priced below \$200.



For the past several years, the smartphone market has been dominated by Samsung and Apple. Their current market share stands at 31% and 15%. However, a new wave of companies is rising which is threatening to disrupt the market. These companies offer smartphones that have comparable features to Samsung and Apple phones but at half or less of their price. The most notable example of this new wave of companies is China's Xiaomi which has zoomed to the top in the China market in just three years and has made waves with its recent entry into India.



### BOUT XIAOMI

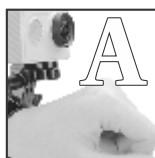
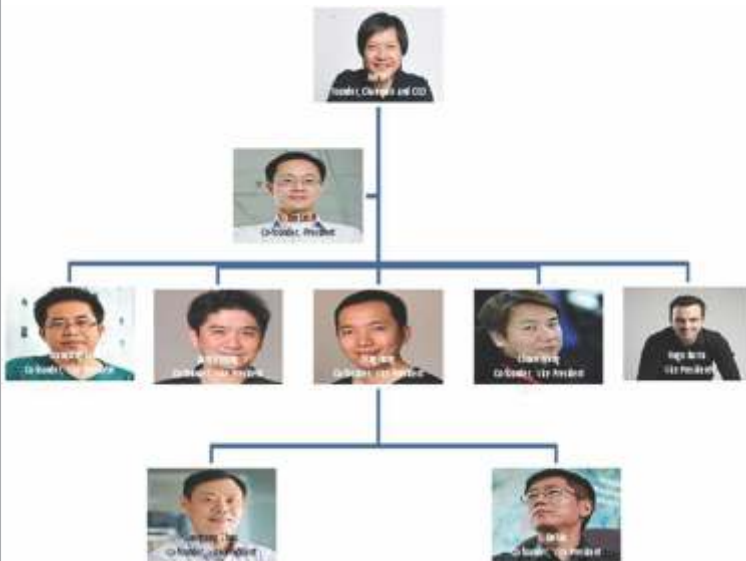
Xiaomi (pronounced SHAO-mee) is a mobile internet company founded in 2010. Its name literally means "little rice". It is privately owned with its headquarters in Beijing [6]. It has had a meteoric rise and is currently valued at over 10 billion USD and has over 3000 employees [7]. Xiaomi's main portfolio of products includes:

- Mobile Phones: Android based
- MIUI ROM: for use across multiple Android devices
- MiTalk: a messaging application
- MiBox: A set-top box for TV

Xiaomi is based in China which led the worldwide mobile

phone market with sales of 108.5 million smartphones in April-June 2014 out of which Xiaomi accounted for 15 million devices [8]. At the time of preparing this study, Xiaomi sells in only a limited numbers of countries besides China viz. Indonesia, Brazil, Mexico, Malaysia, Philippines, Taiwan, Thailand, Vietnam, Russia, Turkey, Hong Kong, Singapore and recently India.

Xiaomi has made its name by designing phones with high end specs and selling them at mid range prices. In some cases Xiaomi phones are less than half the price of competitor phones with comparable specs.



### BOUT LEI JUN

Lei Jun is considered one of the reasons behind the success of Xiaomi. His personality is said to have driven Xiaomi's success. Lei was born in 1969 and received a B.A. in computer science from Wuhan University in 1991. Before founding Xiaomi, Lei spent 6 years at Kingsoft, working his way up to CEO. "He also started an e-commerce site, Joyo.com, which he sold to Amazon for \$75 million, and become one of the country's leading angel investors, with stakes in online clothing retailer Vancle, shoe retailer Letao, mobile browser maker UCWeb, and communications portal YY, all of which have valuations in the hundreds of millions of dollars" [9]. In 2010 Lei got together with a few other founders and started Xiaomi. Lei is currently ranked 377 in the Forbes 500 list and is valued at \$4.1 billion.

Lei Jun says that he modeled Xiaomi after two distinct sources of inspiration: a hot pot chain called Hai Di Lao and a more than three hundred year old traditional Chinese medicine manufacturer, Tongrentang. Hai Di Lao, taught him the importance of customer service. Tongrentang taught him two things — never manufacture low-quality products for lowering cost and put all possible effort in producing the best quality products.

Lei has nearly 4 million followers on China's popular micro blogging platform, Weibo and feeds the buzz about Xiaomi by dangling teasers about new products and launch dates. Lei



once read a book on Steve Jobs and is highly inspired by him. He even copies some of Jobs' mannerisms like dressing up mostly in black T shirt and blue jeans; using keynote for presentations; building up excitement and launching products in a big way. Chinese media calls him "Steve Jobs of China". While some criticize Lei for it; his fans like his style and enthusiastically cheer his presentations and launches.



#### IAOMITIMELINE

Xiaomi has become the number one in sales in China in second (April-June) quarter of 2014. "Xiaomi's app store sees 3.5 million app downloads a day, 3.5 million photos uploaded to its cloud service a day and has seen 2 billion messages uploaded cumulatively" [10]. The fast growth of the company can be understood by just one piece of statistics – no company in China has reached one billion dollars in yearly revenue, faster than Xiaomi.



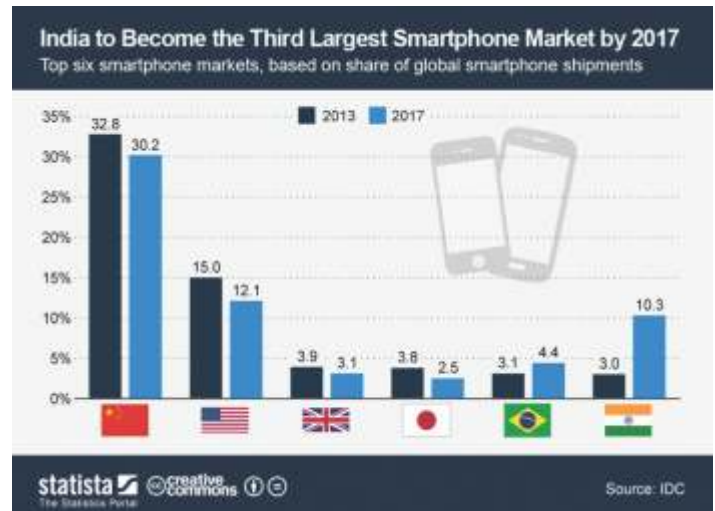
#### Performance in China



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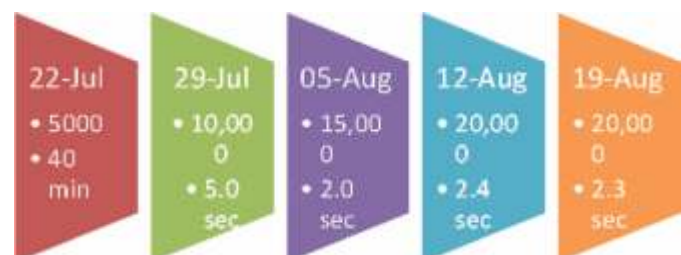
#### Entry into India

Xiaomi is entering India at a time when the India Smartphone market is poised for rapid growth. The graph below shows that among the six major Smartphone markets in the world, India is expected to have the largest growth, by a big margin, between 2013 and 2017. It is well known that India is a highly price sensitive market. This large growth is expected to be largely driven by companies that offer good features at low price. Xiaomi seems to be looking to corner a big chunk of the increased volumes.



#### The Stay so far ...

As of writing of this case study, five flash sales for Xiaomi's Smartphone Mi3 have been held by e-retailer Flipkart. Following diagram shows the dates, number of units offered and time to sell out for the flash sales.



#### Analysis

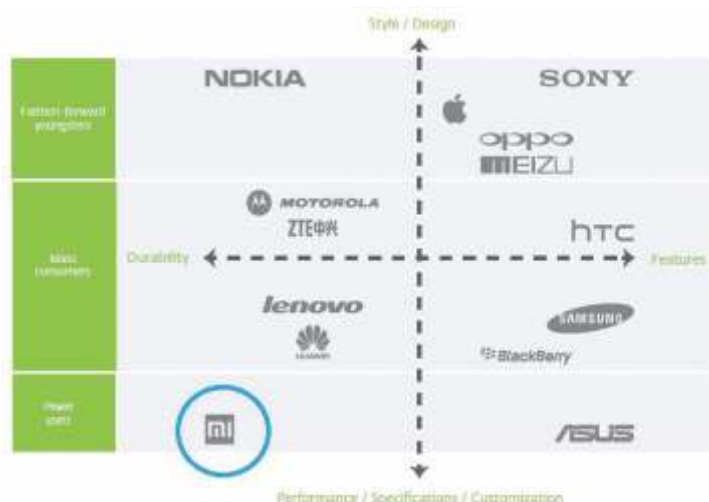
##### Consumer behavior Analysis

"Leading global smartphone brands offer distinguished hardware and interface design as well as strong features. On the other hand, Xiaomi mostly concentrates on building durable and high customization phones. Xiaomi gained popularity by identifying a niche group of smartphone power-users. These consumers are constantly tweaking their phones for richer features and the newest experience. Xiaomi phones are tailored for this particular group of consumers" [11]. This unique positioning is achieved by Xiaomi's Android ROM MIUI

## Competitor Analysis

### Samsung

Samsung is the global market leader in handsets. Samsung has been locked in a bitter patent-infringement battle with Apple. A few Samsung devices have even been banned in the US. If Samsung loses the battle, it may be forced into new innovation cycles which may negatively impact it in the short term but may be beneficial in the long run.



### Apple

Apple is the number two in global sales. Apple had redefined the smartphone market with iPhone and its strategy is to further refine the iconic phone. Recently Apple has faced criticism that new versions of its devices have offered only incremental changes. It will be a big challenge for Apple to sustain its innovation after Steve Jobs' demise.

### Microsoft and Nokia

Nokia used to be the number one phone maker in the world but could not face iPhone's onslaught. Most of it has now been acquired by Microsoft which has provided its Windows OS for the popular Lumia series. Historically Windows OS has never achieved much popularity in mobile space so it remains to be seen whether acquisition of Nokia turns things around.

### Google

Google is the undisputed leader on the OS front with Android. On the handset side, its Nexus series has been quite popular. Nexus offered value for money to its customers. If Google can expand its product line, it can present a stiff challenge to the market leaders.

### Research in Motion

BlackBerry has seen a steep fall from grace due to lack of innovation, unpopular designs, poor app ecosystem and outdated user interface. On the business side, however, BlackBerry continues to have pockets of strong influence. RIM is trying to build on that to make a comeback into mass markets.

## Demand Analysis

Global Smartphone sales grew 27.2% year on year in the second quarter of 2014. The projection is that 2014 is likely to end with 1.3 billion shipments.

OS wise analysis: Android is expected to corner the biggest market share among various OS options with a market share in excess of 80%. iOS continues its slow slide down and currently stands at below 12%. Windows phone has seen a fluctuating market share and currently stands at just below 3%. BlackBerry has been a big loser over the past few years and currently stands below 1%.

Smartphone Vendor wise Analysis: Samsung continues its global leadership backed by high end smartphones within mature markets and wide range of entry and mid range phones in emerging markets. Apple had some year on year sales growth mainly coming from emerging markets. Apple's larger screen models are expected to revive sluggish sales. Huawei maintained third position just ahead of Lenovo. Huawei has been emphasizing large screen smartphones like its latest addition which has a 6.1 inch screen, one of the largest on offer. Lenovo has been increasing market share fast with its main presence in Asia Pacific. Once the acquisition of Motorola is completed, the company will acquire footprint in North America and Western Europe. LG continues as the fifth vendor but it is coming under increasing danger from Chinese Vendors like Xiaomi.



## HAT MAKES XIAOMI A GAME CHANGER?

### Cost leadership strategy

Xiaomi has adopted business strategies that are radically different from other mobile phone manufacturers like Samsung or Apple. "While Apple ran iTunes for years at little or no profit — using its music, movies and apps as a way to sell higher-margin devices — Xiaomi's approach is similar to Amazon. Amazon sells its Kindle devices at or below cost to expand market share, using apps and content revenue to shore up slim margins" [12].

At a Mobile phone conference in April 2013, Xiaomi co-founder and president Bin Lin stated the company's driving philosophy as "Building a business on services by selling mid-to high-end smartphones at cost" [13]. What this means is that Xiaomi expects its revenues to come largely from services rather than by selling mobile phones. In the company's view, the days of large profit margins on making and selling mobile phones are gone.

Xiaomi offers high end specifications at mid level prices. Its first offering in India, Mi3, is compared below to three popular flagship models in the Indian market. Fifteen most useful parameters have been considered. On 12 out of 15 parameters, Mi3 is better or equivalent while on three parameters it is worse. This is fantastic value for money considering that Mi3 is priced at half or less of the other three phones. (The data has been sourced from India's leading e-commerce vendor Flipkart)

Table 6: Cross tabulation for department and skills present in employees (as per their perception)

| Model                    | Xiaomi Mi3  | Google Nexus 5                  | Samsung Galaxy S4                       | Apple iPhone 5S   |
|--------------------------|---|---------------------------------|---|---|
| <b>Price</b><br>(approx) | Rs. 13999   | Rs. 28449                       | Rs. 27899                               | Rs. 44100   |
| OS                       | Android v4.4.2 (Kitkat)                           | Android v4.4 (KitKat)           | Android v4.2.2 (Jelly Bean)             | iOS v7  |
| Processor                | 2.3 GHz Qualcomm Snapdragon 800 8974AB, Quad Core | 2.3 GHz Qualcomm Snapdragon 800 | Quad-core 1.6 Ghz Cortex-A15            | A7 Chip with 64-bit Architecture and M7 Motion Coprocessor  |
| Size                     | 5 Inches  | 4.95 Inches                     | 5 Inches                                | 4 Inches  |
| Resolution               | Full HD, 1920 × 1080 Pixels                       | Full HD, 1920 × 1080 Pixels     | Full HD, 1920 × 1080 Pixels             | 1136 × 640 Pixels   |
| Primary Camera           | 13 Megapixel                                      | 8 Megapixel                     | 13 Megapixel                            | 8 Megapixel   |
| Secondary Camera         | 2 Megapixel                                       | 1.3 Megapixel                   | 2 Megapixel                             | 1.2 Megapixel   |
| Flash                    | Dual LED  |                                 | LED                                     | Dual LED  |
| Video Recording          | 1920 × 1080                                       |                                 | 1920 × 1080                             | 1920 × 1080   |
| HD Recording             | HD, Full HD                                       |                                 | HD, Full HD                             | HD, Full HD   |
| Size                     | 73.6x144 × 8.1 mm                                 | 69.17 × 137.84 × 8.59 mm        | 69.8 × 136.6 × 7.9 mm                   | 58.6 × 123.8 × 7.6 mm   |
| Weight                   | 145 g   | 130 g                           | 130 g                                   | 112 g   |
| Battery                  | Li-Ion, 3050 mAh                                  | 2300 mAh                        | 2600 mAh                                | Li-Ion  |
| Internal Memory          | 16 GB   | 16 GB                           | 16 GB                                   | 16 GB   |
| RAM                      | 2 GB  | 2 GB                            | 2 GB                                    |   |
| Business Features        |   |                                 | Document Viewer, Pushmail (Active Sync) | Document Viewer, Microsoft Excel, Microsoft PowerPoint, PDF, PPT, PPTX, XLS, XLSX, TXT, DOC, DOCX |

### Operational effectiveness strategy

Xiaomi does not own any factories. Its phones are manufactured by companies like Foxconn. This means it can utilize world's best factories. It has no sales channels or physical retail outlets. It is able to utilize its capital more efficiently since none of it is blocked in sales or stores. This give an edge to Xiaomi in global competitiveness.

Till now, all of their directors were Chinese but to mark their presence in the global market, they have hired Hugo Barra. He was earlier handling the Android division at Google. He is very much familiar with worldwide smartphone market [19]. He can set up Xiaomi's worldwide marketing strategy.

### Differentiation strategy

Despite being called “Counterfeit Apple”, one of the ways Xiaomi differs from Apple is [14] “that it allows users to help design their operating systems. Every Friday at 5 in the evening local time, Xiaomi releases a new round of software updates for its own Android-based operating system — MIUI — to users in China and in other countries. Within hours, thousands of fans are on Xiaomi forums to describe bugs and give feedback. Of their millions of customers, there are a few hundred thousand hardcore fans that do the teardowns, scrutinize every spec and offer suggestions on how to change the phone”.

### Innovation Strategy

Xiaomi does not own even a single physical store and sells each of its phones through its own online store or through tie up with online sellers. It does not do traditional marketing. In late 2012, Xiaomi decided to sell phones directly from Sina Weibo which proved successful when it was able to sell 50,000 units in 5 minutes besides a huge backlog of more than a million.

### Its phones' performance beats costlier phones

Shown below are the results of some of the most popular Android phone benchmark tests. These results have been shared by Xiaomi on their Google+ page. They compare





performance of Mi3 with other flagship phones which are priced more than double of Mi3.

*It is crowd sourcing mobile phone development*

Some companies like Apple are famously secretive about their development plans, so with their phones people don't know what to expect till they are released. Xiaomi gives users an opportunity to participate in designing their phones. "In the past, fans have weighed in on how much memory they want in their phones, how thick the next generation model should be and whether there should be a flashlight on the back of the phone" [14]. This offers a fundamentally different and potentially better way to design phones.

*It is trying to take mobile phones the PC way*

Personal computers were a hot tech item twenty years ago; just like mobile phones are today. In an exploding market, leading manufacturers made huge profits by making and selling PCs. Similarly, in recent years companies like Apple and Samsung have generated record profits on the back of increasing mobile phone sales with healthy profit margins. However if we look at the progression of the PC market in the last twenty years, we see that they were increasingly commoditized. As a result profit margins kept on decreasing. This even led to some marquee names totally exiting the PC business. Xiaomi believes that mobile phones are in a similar situation now. In India we can see some evidence of this. India is a price sensitive market and local sellers like Micromax are gaining market share with their low priced phones. In fact, as of writing of this study, it has been reported that [15] "Micromax has ousted Samsung as the leading brand in all types of mobile phones in the April-June 2014 quarter". In the same quarter Samsung has been ousted by Xiaomi as the largest smartphone vendor in China.

*It wants to earn money not from phones but from services*

While the mobile phone hardware shows all signs of leading towards commoditization, mobile internet services are exploding. "The rise of smartphones, apps and mobile internet access has made the mobile phone a key battleground in the fight for new business and customers' attention. One of the main attractions of mobile marketing is that mobile phones are almost always switched on and people usually have them to hand. What's more, the mobile phone has become the first place many people turn in all kinds of situations: to check for directions or to look up the price of a product, indeed, to find any information online" [16].

*It is totally user and product focused*

Out of Xiaomi's 4000 employees, 2500 are communicating with customers and 1400 are doing research. Since a number of functions like sales and marketing are absent or severely curtailed, Xiaomi can focus all of its energy on developing its product and serving the users.

*It utilizes Flash Sales to excite the market*

One reason for the high demand for Xiaomi phones is the factor of scarcity attached with them. They are not available all

the time at the regular mobile phone selling outlets. Instead buyers need to keep track of the flash sales that happen periodically and only if they are able to beat the rush that usually happens, can they buy a phone. This strategy creates a strong excitement among prospective buyers. The company has been criticized by some people for their sales strategy. However, Xiaomi insists that flash sales enable it to estimate demand before producing more handsets and reduce its inventory carrying costs.

*It successfully elicits Word of Mouth Publicity*

Xiaomi's approach of involving users in "co-developing" phones has an additional benefit. If a person contributed to developing some feature in a Xiaomi phone, he/she is likely to tell everyone around him/her about it. This translates into free publicity for Xiaomi and it can afford to spend significantly less than its peers in advertising. "Their approach also ties into a big trend that is fueling a hardware Renaissance globally: the ability to feel out product-market fit through social media before a capital-intensive manufacturing process — be it through Twitter, Weibo or a Kickstarter campaign. Through that feedback and Xiaomi's own in-house engineers and designers, miUI includes improvements over the standard flavor of Android" [17].

*They are successfully building a cult*

Fans of Apple are known to be fierce in their loyalty to the company. Xiaomi has built up a fan base that is equally energetic and loyal. They call themselves "mi fen" in Chinese. "The phrase is a pun that is shorthand for "Xiaomi fan" and also means "rice flour", a clever play off Xiaomi's name, which means millet or "little rice" [18]. They turn up in large numbers for Xiaomi events. After Apple, Xiaomi is the only company capable of producing huge queues to buy their phones.

Xiaomi has a toy rabbit as its icon. In 2012, the company reported selling 180,000 units of the icon.



Xiaomi gives out T shirts to fans at events. “It also sells other accessories like dolls and dongles that promote the “mi fen” culture” [18].



## **UTURE CHALLENGES**

### *Global Markets*

Xiaomi needs to overcome a lot of challenges to move into Global markets.

- In some of the developed markets like the US, initial handset costs are heavily subsidized by carriers and then offset by post paid plans that the subscribers are locked into. This makes top-of-the-line phones more affordable and reduces the advantage that Xiaomi can offer in countries like China and India where their handsets are sometimes priced half of their competitors.
- The carriers are reluctant to sell fully branded handsets produced by newbies.
- Developed markets are already saturated with a large number of mobile devices, making penetration more difficult.

### *Diversification*

Xiaomi's continued success will also depend on whether it can replicate its success with mobile phones in other areas of consumer electronics. Xiaomi is already looking at Television.

### *Monetization*

Xiaomi's business strategy, though innovative, is still unproven. It has notched up the sales figures to establish its consumer presence but it is yet to show how it will monetize software services. This is an area where companies like Alibaba and Tencent have established themselves and will give stiff competition to Xiaomi.

### *Product Differentiation*

While Xiaomi is still a relatively new entrant, it can get away with simply offering same specifications as its rivals phones at lower prices. However as it gains market leader position, it needs to differentiate its products through innovation and research.

### *Expected Retaliation*

As Xiaomi eats into its rivals' market share, they can be expected to come out with lower priced products to wrest back lost market share. This may reduce the price advantage Xiaomi enjoys today.



## **ONCLUSION**

Launching a new phone is not something that a startup will normally attempt. However Xiaomi has successfully done it. One of the critical factors that helped the company in the initial stage was that unlike the US market which is totally

dominated by carriers, the Chinese market is more open. Consumers can buy and use the phone they want. So a new company can directly sell phones to customers without having to first build relationships with carriers which can be difficult.

Now that Xiaomi has established a base for itself in the Chinese market, it is looking to replicate its success globally. It has generated phenomenal buzz with its launch of the Mi3 in India through flipkart. It's first three flash sales have been sold out in mere minutes; some even in seconds. More than a hundred thousand customers are still waiting for future sales. If Xiaomi can replicate such success in more markets while keeping its business model profitable, it can be a true game changer in the mobile phone industry.

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CEO Lei Jun had once told the New York Times, “We're not just some cheap Chinese company making a cheap phone. We're going to be a Fortune 500 company.” So far it looks like they are on track.

## **Questions**

1. Xiaomi has made a great start but can they achieve economies of scale as they become a top five company?
2. Being a Chinese company, can they successfully market their brand outside China?
3. As their competitors copy their successful strategies like online marketing and flash sales, can Xiaomi innovate?
4. Can Xiaomi make the transition from “follow the leader” to “being the leader”?
5. Can Xiaomi replicate its success with mobile phones in other areas of electronics like TV etc.?



## **PPENDIX: LITERATURE REVIEW**

Downes and Nunes[20] discuss how silicon valley innovators are launching new products very fast to see which ones take hold. The ones that do, often result in “big bang disruption” - a phenomenon where products don't follow the usual pattern of customer adoption famously described by Everett Rogers. Instead they are perfected with a few trial users and then are embraced quickly by the vast majority of the market. Downes and Nunes also offer a few strategy for companies to survive big bang disruption.

Liu and Buck[21] consider examples from Chinese hi-tech industries and provide empirical data to investigate the impact of international technology spillover. They have analysed the impact of R&D activities done by multinational companies on innovation done by domestic Chinese firms.

Clark et. al.[22] discussed about how usage of Smartphone in the workplace impact an executive productivity and



efficiency. This technology helps the executive to find certain information accidentally which can be very helpful in strategic decision making in business.

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## TEACHING NOTES:

### Case Synopsis:

This case is about Xiaomi, a Chinese Smartphone company that has become number one in China in just four years. The company has become famous for its unique business model and marketing strategy which has enabled it to sell smartphone at unbelievably low prices. Now the company is entering global markets. It has made a sensational debut in India in 2014.

### Target Audience:

This case can be useful for the students and practitioners of Marketing and Sales/ Strategic Management/ Business Research.

### Learning Objectives:

This case would help the students to understand the strategies a new company can use to challenge well entrenched leaders in a highly competitive market. The students can also learn how cutting edge technology can be leveraged to gain a business advantage. This case could be a good example to understand how building a strong connect with the customers can help a company's brand.

### A Detailed Teaching Plan:

Suggested time for this case study would be around 50-60 minutes.

Suggested student assignment related to this case could be to identify management theories that help to best explain the factors responsible for Xiaomi's success.

Teachers should support this case with other relevant cases from the industry that illustrate penetration of a market by a new company, innovative use of emerging technology and building strong customer connect with company brand.