

“New Retail” in Action – Issue 16

Xiaomi: From a mobile and technology company to a lifestyle and retail company

– with special focus on its evolving business model and New Retail strategies

Asia Distribution and Retail

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KEY HIGHLIGHTS

- With the best-in-class design, high performance and much lower pricing than other smartphones in the market, Xiaomi's smartphones were considered groundbreaking smartphones in the budget segment since the launch of its first smartphone in 2011. Xiaomi has grown very fast in the first few years and became China's top smartphone companies in 2014 and 2015. Yet, there were headwinds for the company thereafter. Its sales for smartphones dropped massively in 2016. The major reason of the slump was attributable to the company's over-reliance on online sales.
- In 2017, Xiaomi has incorporated New Retail strategies to its "Triathlon business model", which Xiaomi started to place great emphasis on interconnecting its online and offline channels. Since then, the company has enjoyed an unprecedented turnaround. In May 2018, Xiaomi submitted an IPO application to the Hong Kong Stock Exchange, aiming to raise US\$10 billion.
- The success factors of Xiaomi include its powerful ecosystem, "killer products" and strong "Mi Fans" culture.
- Part 1 of this paper discusses Xiaomi's new business model and its New Retail strategies. Part 2 covers the observations of our site visit to Xiaomi's New Retail flagship store in MixC World, Shenzhen.



Photo source: Fung Business Intelligence

Part I. Xiaomi's evolving business model and New Retail strategies

BACKGROUND

Xiaomi Inc., headquartered in Beijing, China, is a privately owned innovative technology and electronics company that designs, develops, and sells smart phones, mobile apps, and other technology products. It was co-founded by eight partners (Lei Jun (CEO), Lin Bin, Li Wanqiang, Zhou Guangping, Huang Jiangji, Hong Feng, Wang Chuan, and Liu De) on June 6, 2010. Since Xiaomi Co., Ltd. was established, it has maintained a surprising growth rate. Xiaomi released its first smartphone in August 2011 and has rapidly gained market share in China to become the country's largest smartphone company in 2014. Over 61 million of Xiaomi's smartphones were sold that year. The company was within the top three smartphone companies in China in 2014 and 2015. Xiaomi announced its expansion outside China in the same year, with their first international headquarters in Singapore. Thereafter, the company has expanded into Asia, Africa and parts of Europe.

However, after Xiaomi has enjoyed a rapid rise, it has then gone through a dramatic fall and suffered a massive decline in sales in the second half of 2015. Its sales dropped 30% further in 2016, and in 1Q16, it was kicked out of International Data Corporation (IDC)'s list of the top-five smartphone vendors in the world¹. As claimed by the company, the sales plunge crisis was due to the fierce market competition, supply-chain problems associated with the company's rapid growth, and its heavy reliance on e-commerce.

The slump on sales has forced Xiaomi to revamp its business model, revitalize its supply-chain systems and restructure its organizational and management structure, etc. In 2017, it has incorporated New Retail strategies to its "Triathlon business model", which Xiaomi started to place great emphasis on interconnecting its online and offline channels. Since then, the company has enjoyed an unprecedented turnaround. Xiaomi replaced domestic rival Vivo to occupy the spot of the world's fifth-largest smartphone maker after its smartphone shipment rocketed 74.5% to 92.4 million units². As claimed by Lei Jun, Xiaomi's CEO, "*Xiaomi is a new brand that was born in the process of China's economic transformation and upgrading. It is a mobile phone company, mobile Internet company and a New Retail company. And in the strict sense, Xiaomi is a retail company*³."

Currently, Xiaomi is the world's fourth-largest smartphone company, achieving over 100 billion yuan in annual revenue and has nearly 20,000 employees⁴. On 3 May, 2018, Xiaomi Group officially submitted an IPO application to the Hong Kong Stock Exchange, aiming to raise US\$10 billion.

Xiaomi is a mobile phone company, mobile Internet company and a New Retail company. And in the strict sense, Xiaomi is a retail company.

XIAOMI'S ECOSYSTEM STRATEGY

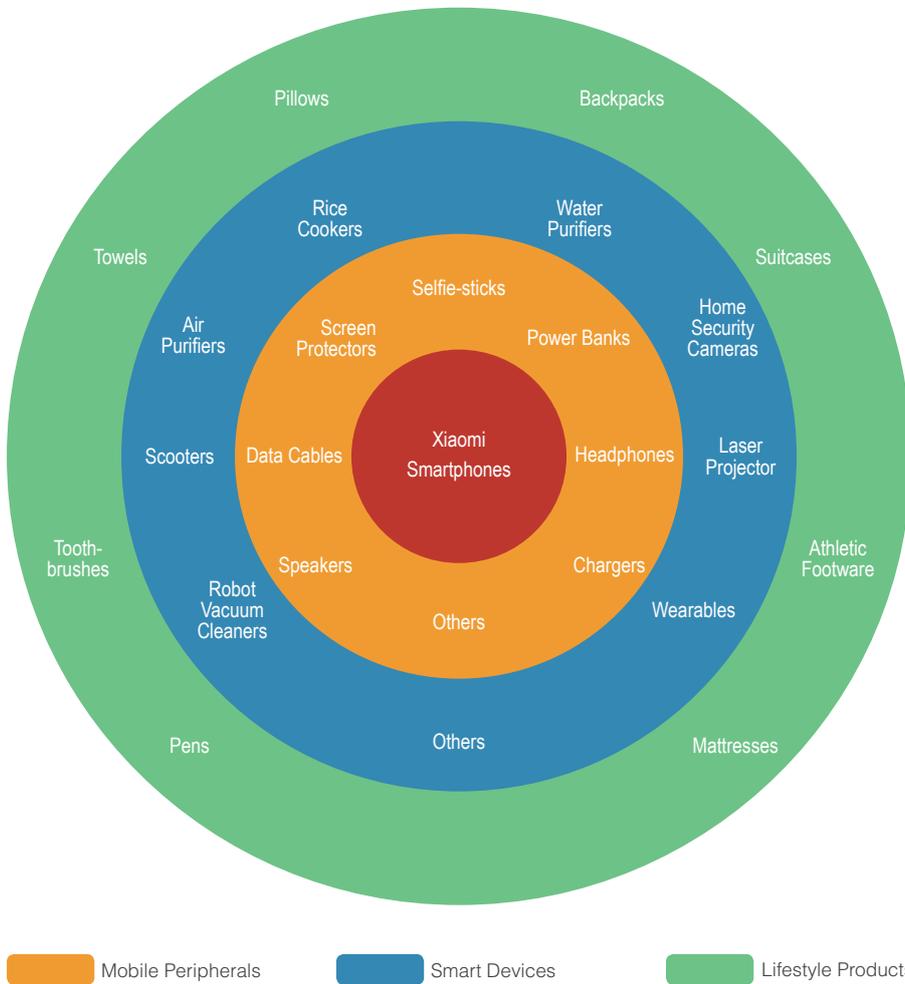
Xiaomi started to create a “one-of-a-kind” ecosystem back in 2013 with a five-year plan to invest in 100 hardware startups. They would feed Xiaomi with an ecosystem of products surrounding smartphones, such as power banks and internet-connected devices like air purifiers; and would draw customers to Xiaomi’s stores. Over the years, the ecosystem has expanded rapidly and become increasingly complex that other market players find it hard to replicate. In March, 2016, the company strategically upgraded Xiaomi's ecosystem and launched a new brand, MIJIA, with a Chinese name of "Mi." By March 2018, Xiaomi has 210 companies within its ecosystem, including ZMI, Huami Technology, Zhimi Technology, 1More, etc.

As of March 31, 2018, Xiaomi has established an ecosystem of more than 210 companies through investment and management, of which more than 90 companies are focused on research and development of smart hardware and consumer lifestyle products⁵. These startups have received support from Xiaomi in areas of branding, capital, supply chain, product design and management, as well as access to Xiaomi’s online and offline retail network. A number of them have flourished – such as Huami, Smart Mi, ZMI and NINEBOT. These companies reached unicorn status with billion-dollar valuations by the end of 2015⁶. According to iResearch, as of December 2017, Xiaomi has built the largest consumer IoT platform globally in terms of the number of connected devices (excluding smartphone and laptops)⁷.

Xiaomi’s ecosystem is centered on Xiaomi’s core products – smartphones including peripheral products such as chargers, earphones and power banks; smart hardware including robots, rice cookers, televisions and air purifiers; and lifestyle products including backpacks, suitcases, toothbrushes, pillows and other daily necessities (Exhibit 1). Xiaomi’s gigantic ecosystem offers a wide range of new and interesting products that customers anticipate. This helps attract customers to visit Xiaomi’s physical store – Mi Home from time to time to see what they offer. This also makes Xiaomi nothing like a smartphone company, but a lifestyle and retail company that offers a large array of lifestyle products to customers.

Xiaomi started to create a “one-of-a-kind” ecosystem back in 2013. Over the years, the ecosystem has expanded rapidly and become increasingly complex that other market players find it hard to replicate.

Exhibit 1: Xiaomi's ecosystem with over 90 companies focused on the development of smart hardware and lifestyle products

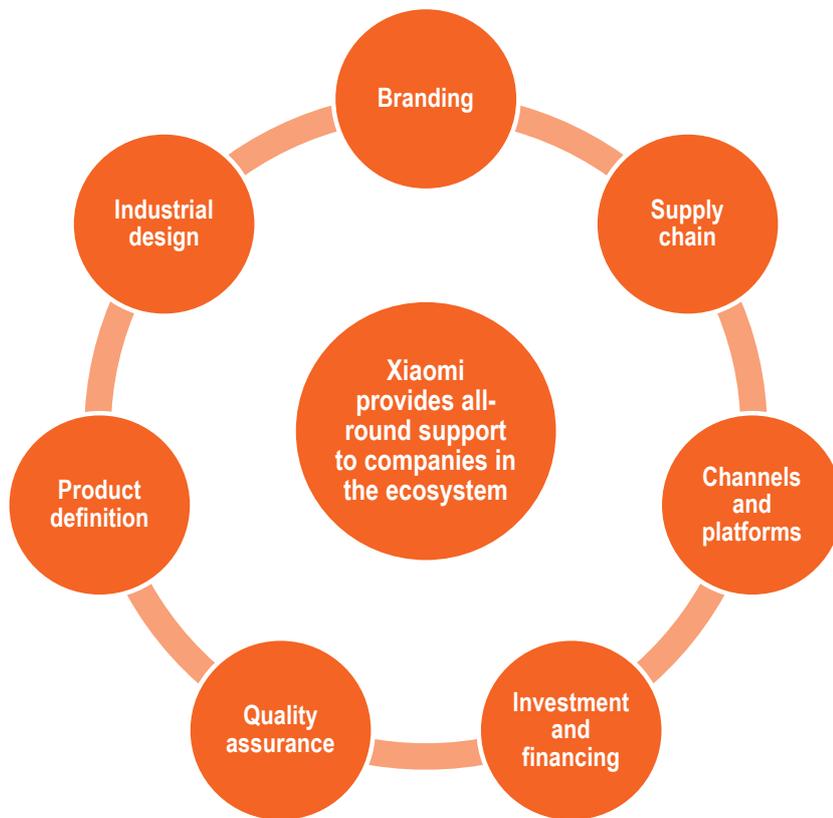


Source: Xiaomi's prospectus

Xiaomi's ecosystem adopts an "investment + incubation" strategy. Xiaomi would provide resource support to companies it has invested in, especially in their early stages of entering the market; these include branding, supply chain, channels & platforms, investment and financing, quality assurance, product definition, and industrial design (Exhibit 2). Xiaomi will continue to invest in and incubate companies with good potential for development, primarily in the fields of IoT and mobile Internet services.

Xiaomi's ecosystem adopts an "investment + incubation" strategy.

Exhibit 2. Xiaomi provides all-round support to companies within its ecosystem



Source: CMS Research[®]; compiled by Fung Business Intelligence

XIAOMI TO GO OFFLINE; OMNI-CHANNEL IS THE KEY

Having experienced the sales plunge since 2015, Xiaomi realized the drawbacks of being a pure-play e-commerce player. Thereafter, Xiaomi has started to push forward its brick-and-mortar strategies. In September 2015, Xiaomi opened its first physical store Mi Home in Beijing, which marked Xiaomi's official debut in the offline retail market. As of May 2018, there are more than 400 Mi Home stores, covering more than 50 cities in China; the number of Mi Home stores is expected to reach 1,000 by 2019 and achieve total revenue of 70 billion yuan in five years⁹.

Currently, omni-channel is Xiaomi's critical driver of growth. Exhibit 3 shows the major online and offline sales channels of Xiaomi.

Xiaomi realized the drawbacks of being a pure-play e-commerce player; it has started to push forward its brick-and-mortar strategies since 2015.

Exhibit 3. Major sales channels of Xiaomi

Online channels

Platform/format	Launch date	Purpose/nature	Current situation
Mi Store (available in mobile app and Mi.com)	January 2011	Provide the official Xiaomi products to customers; offer customer service and after-sales support	Mi Store was the third-largest 3C and home appliances direct sales online retail platform in China by GMV in 2017. As of March 2018, 300 SKUs of 194 categories of products are launched on the platform
Xiaomi Tmall Store	July 2013	Third-party e-commerce platform	Selling full product lines of Xiaomi
Xiaomi Wechat store	November 2013	Third-party s-commerce platform	Selling full product lines of Xiaomi
“Mi Jia” app	January 2014	Self-operated m-commerce platform	Selling full product lines of Xiaomi
Xiaomi Taobao Store	December 2014	Third-party e-commerce platform	Selling full product lines of Xiaomi
Xiaomi JD.com store	May 2015	Third-party e-commerce platform	Selling full product lines of Xiaomi
Xiaomi Suning.com store	April 2016	Third-party e-commerce platform	Selling full product lines of Xiaomi
Xiaomi Youpin	April 2017	An e-commerce marketplace that sells Mi-branded products as well as high-quality products that are not associated with Xiaomi but curated and sourced by the company.	Changed its name from Youpin to Xiaomi Youpin in May 2018

Offline channels

Platform/format	Launch date	Purpose/nature	Current situation
Mi Home	November 2011	Xiaomi’s self-operated B2C stores, with store size around 200-400 sqm. Mi Home provide sales, technical support and after-sales services to customers	As of May 2018, there are more than 400 Mi Home stores across China, with sales reaching over 10 billion yuan in February 2018
Xiaomi Suning stores	November 2015	Chained electronics stores	Selling mainly Xiaomi’s smartphones and other hardware products
Xiaomi specialty stores	July 2016	JV stores	Selling mainly Xiaomi’s smartphones and other hardware products
Xiaomi authorized dealers/ cellular network carriers	NA	Local authorized stores (“Mi Preferred Partners”), consumer electronics retail chains and telecommunications companies in China including China Mobile, China Unicom and China Telecom	Selling mainly Xiaomi’s smartphones and other hardware products
Xiaomi Xiaodian	March 2017	Xiaomi’s local authorized stores; Xiaomi provides merchandise, support and trainings to authorized retailers	The sales network has reached 22 cities with 8,726 touch points
Xiaomi Youpin physical stores	May 2018	Xiaomi’s self-operated B2C stores, with store size around 600 sqm. It provides more than 1,000 SKUs	The first store was opened on 25 May, 2018 in Nanjing. Various “black technologies” such as unmanned vending machine and facial recognition are introduced in the store

Source: Xiaomi’s Prospectus; Xiaomi’s website; various Internet sources; compiled by Fung Business Intelligence

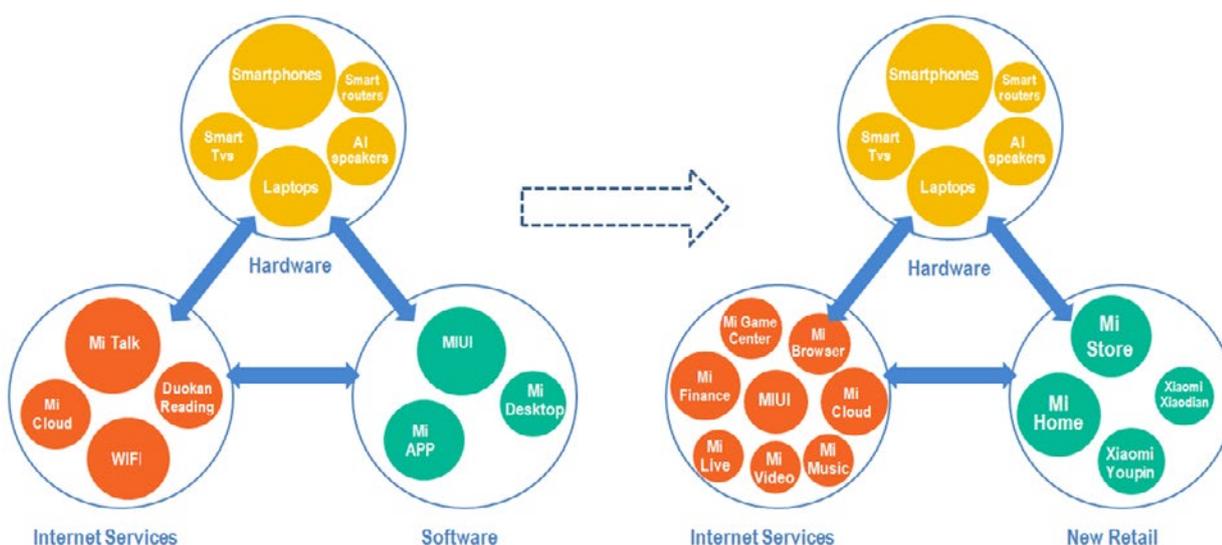
EVOLVING BUSINESS MODEL

Xiaomi named its unique business model as "The triathlon model". Originally, the triathlon model was comprised of three modules namely, "Hardware", "Software" and "Internet Services". In 2017, Xiaomi upgraded its business model to incorporate the "Software" section to the "Internet Services" section, and added the "New Retail" section. The triathlon model now entails three components – the "Hardware", "Internet Services" and "New Retail" (Exhibit 4).

- **Hardware** – innovative, high quality and well-designed hardware focused on exceptional user experience. These include mobile phones, TVs, routers, AI speakers, etc.;
- **Internet Services** – provide Internet services and give users a complete mobile Internet experience. These include MIUI, Mi Live, Mi Cloud, Mi Finance, Mi Music, Mi Video, Mi Game Center, etc.
- **New Retail** – the integration of online and offline channels. Major online channels include Xiaomi's direct online retail store Mi Store (available in mobile app and Mi.com), Xiaomi's self-operated boutique-style e-commerce marketplace "Xiaomi Youpin", and its flagship store on Tmall. Key offline channels include Mi Home, and local authorized stores in China "Xiaomi Xiaodian". New Retail is a core component of Xiaomi's growth strategy, allowing the company to operate efficiently while simultaneously extending the customer reach and enhancing customer experience.

Xiaomi named its unique business model as "The triathlon model". The triathlon model now entails three components – the "Hardware", "Internet Services" and "New Retail".

Exhibit 4. Xiaomi's Evolving Triathlon Business Model



Note: The above graph shows selected key features, products or services of each component only.

Source: Various Internet sources; compiled by Fung Business Intelligence

ESSENCE OF XIAOMI'S NEW RETAIL STRATEGIES

To put its New Retail strategies into action, in September 2017, Xiaomi launched its first New Retail flagship store, Mi Home, in Shenzhen to demonstrate Xiaomi's New Retail strategies. The essence of Xiaomi's New Retail strategies is to provide users with omni-channel shopping experience and through highly efficient store operations, with optimal rent-to-revenue ratio. As shown in Exhibit 5, the strategies highlight eight tactics under four areas:

- **Increase traffic flow** – Locate Mi Home stores near fast fashion brands; offer products with higher repurchase rates
- **Drive up conversion rates** – offer a number of “killer products” for each product category; leverage big data analytics
- **Increase sales** – increase the purchase rate for inter-related products; provide better shopping experience
- **Encourage repeat purchase** – strengthen brand awareness; enhance seamless integration of all channels

The essence of Xiaomi's New Retail strategies is to provide users with omni-channel shopping experience and through highly efficient store operations, with optimal rent-to-revenue ratio.

Through its New Retail strategies, Xiaomi aims to achieve greater efficiency and provide the same products at the same accessible price points to consumers.

Exhibit 5. Xiaomi's New Retail strategies and tactics



Source: ChinaLabs¹⁰; compiled by Fung Business Intelligence

Xiaomi's New Retail Tactics

Increase traffic flow	
Locate Mi Home stores near fast fashion brands	Most of Mi Home stores are opened in the shopping centers in prime or community shopping districts of tier-1 and 2 cities. Many of them are located near fast fashion brands such as Uniqlo, ZARA, H&M, and casual lifestyle brands such as Starbucks and Muji to boost traffic flow.
Offer "fast-moving products"; quick introduction of new products	All products of Mi Home are updated frequently. New products are introduced from time to time to encourage customers to revisit the shop frequently.
Drive up conversion rates	
Offer a number of "killer products" for each product category	Focused on producing "killer products" with exquisite designs and quality which can generate tremendous sales.
Leverage big data analytics	Leverage online sales data to select which SKU to display in the stores. Select 200-300 SKUs out of 20,000 SKUs from Xiaomi Youpin.
Increase sales	
Increase the purchase rate for inter-related products	The design of Xiaomi's products is consistent in terms of appearance and value, and the technical functions are related and interoperable within Xiaomi's ecosystem (which can be uniformly controlled through Mi App or Mi AI network speaker).
Provide better shopping experience	Offline channels provide touch points for customers to enjoy exceptional shopping experience. Sales associates will not promote the products too aggressively but will let customers explore the products themselves. They will answer customers' enquires and provide technical support if needed.
Encourage repeat purchase	
Strengthen brand recognition	One of Xiaomi's important growth strategies is to attract new users through enhancing brand recognition, particularly for its self-branded products. Xiaomi's tactics to enhance brand recognition is through offering "amazing products" at "honest prices". At its physical stores, customers can understand more about Xiaomi's products.
Enhance seamless integration of all channels	Xiaomi ensures price consistency across its online and offline channels, and devotes great efforts to achieving seamless integration of all channels. For instance, sales associates at the store will guide customers to place order online and download Xiaomi's app; this helps drive customer traffic from offline to online.

Source: ChinaLabs; compiled by Fung Business Intelligence

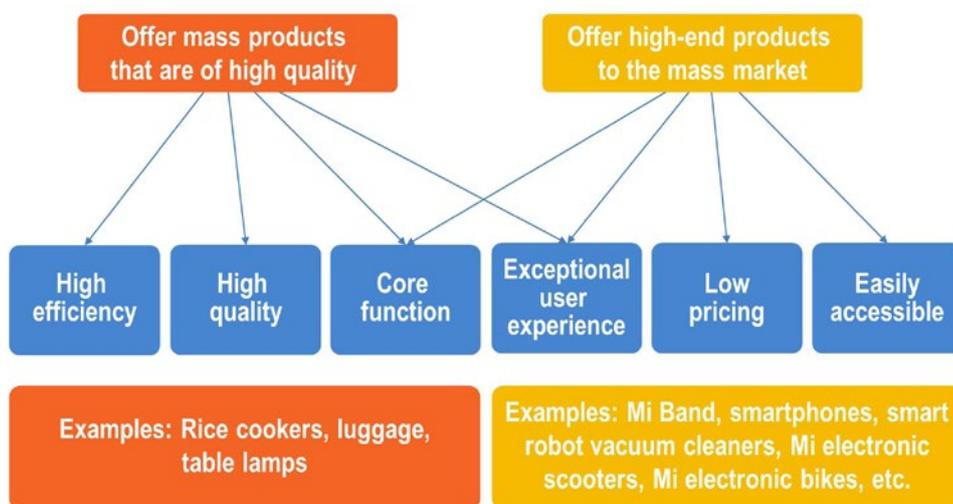
XIAOMI'S SUCCESS FACTORS

Killer products

Xiaomi has strived to offer “killer products” that are of high quality, high performance, well-designed and honestly priced. The company has advocated a unique principle of “satisfying 80% needs of 80% of the market” – to offer products that target the mass market (cover 80% of users in the market) and provide products that can satisfy most (80%) of their daily needs. Xiaomi aims to: 1) offer mass products that are of high quality – in order to meet the needs of the post-80s and post-90s generations who want a higher quality of life; 2) offer high-end products to the mass market – allow high-tech, trendy, and well-designed products at price points that are accessible to the widest and largest user base (Exhibit 6).

Xiaomi has strived to offer “killer products” that are of high quality, high performance, well-designed and honestly priced. The company has advocated a unique principle of “satisfying 80% needs of 80% of the market”.

Exhibit 6. Satisfying 80% needs of 80% of the market



Source: ChinaLabs; compiled by Fung Business Intelligence

Mi Fans

Xiaomi’s success is also largely built upon its strong fans culture. The company has cultivated close interactions and direct relationships with its fans. Xiaomi’s relatively inexpensive products with good design or intelligent functions have continued to win and accumulate massive global community of “Mi Fans”, passionate users who are intensely loyal to Xiaomi brand. There are “Mi Fans Clubs” in different parts of the world and there are active interactions within Xiaomi’s platform for fans to provide feedback and ideas on product development, product testing, advertising and marketing. Xiaomi has regularly launched a number of promotional campaigns such as “Mi Fans Festival”, “Mi Pop” events, games, and contests to boost sales and engage with their fans.

Xiaomi’s success is also largely built upon its strong fans culture.

Many Mi Fans are passionate and keen to exchange product ideas, co-create new features of the smartphones and operating systems through Xiaomi's online forum, Xiaomi BBS and MIUI forum. In turn, Xiaomi's engineers have constantly improved the MIUI platform by incorporating direct feedback from Mi Fans. As of March 2018, Xiaomi has a large and highly engaged global user base with approximately 190 million monthly active MIUI users; over 1.4 million users have more than five connected Xiaomi products (excluding smartphones and laptops); and Xiaomi's users had collectively generated over 250 million posts on MIUI forum since it was launched in August 2010¹¹.

COMMENTS FROM FUNG BUSINESS INTELLIGENCE

Against the backdrop of the consumption upgrading trend in China, Fung Business Intelligence believes that Xiaomi's successful formula of high quality and low pricing strategy will render ample room for the company to seize more market shares ahead. Xiaomi's relatively inexpensive yet high quality and well-designed products will continue to win and accumulate massive number of loyal Mi Fans (de facto customers). The "fans community" will co-design the products with the company or even sell and promote their products to boost sales.

The company's vast ecosystem, together with its new business model and New Retail strategies are set to transform and reshape the traditional consumer electronics and home products sectors. Xiaomi's wide range of high-functional products such as smartphones, smart watches, Internet TV boxes, and smart TVs are well-liked by customers. Its "smart living" product lines, particularly travel suitcases, travel pillows, table lamps, etc. are also gaining increasing attention from consumers.

Going forward, we expect Xiaomi's New Retail strategies will continue to flourish, with stronger physical presence and higher penetration across China and in the rest of the world. Xiaomi will truly transform from a Chinese smartphone brand into an international lifestyle and retail brand. Xiaomi's upcoming IPO, which is expected to be the world's largest IPO since 2014, is expected to bolster its position as one of the leading retail brands in China, and even in the world.

Part II. Site Visit and Observations from Fung Business Intelligence

Fung Business Intelligence conducted a site visit at Xiaomi's New Retail flagship store in MixC World, Shenzhen on 23 May, 2018. Designed by New York-based famous designer Tim Kobe, the same designer of Apple flagship at 5th Avenue of New York City, this Xiaomi flagship is a standalone duplex store located along the shopping avenue "High Street" of MixC World. The store has a floor area of around 650 sqm.

We visited the store on a weekday afternoon; foot traffic was considered quite high at the time we visited. As observed, there were local customers and tourists, students, office workers and different types of people choosing and trying the products.



Photo source: Fung Business Intelligence

The shop is bright with high ceilings and glass facades across two storeys. The interior design is hip and simple with Xiaomi's corporate colors – white and orange as the store colors. Xiaomi's flagship store sells more than 400 SKUs and allows customers to try and experience the products. All products sold in the shop are available in Xiaomi's e-commerce platform Xiaomi Youpin and each of them is attached with a QR code. After scanning the code through Xiaomi's app, customers can place order online by Wechat Pay or Alipay and enjoy speedy delivery to home. Customers can also buy the products and take away with them when they leave the shop.

Xiaomi has incorporated various "black technologies" in its flagship store, including a large interactive shopping wall which comprises five LED screens sizing 80" each. The screens can track user's hand motion and movement. Customers can point to the products that are shown on the screen to browse the product information and place order.

On the ground level, the major "killer products" of Xiaomi are displayed, including smartphones, smart watches, smart music boxes, headphones, portable power banks, etc. The second level mainly displays products of "smart living", including travel suitcases, travel pillows, bicycles, table lamps, coffee machine, etc.

In terms of customer service, Xiaomi's flagship store houses large amount of staff to assist customers. They are mostly young people with a smart and energetic appearance. They attentively answered enquiries from customers and offered advice to them.

Overall, the shopping ambiance is robust and vibrant as the shop displays a large array of Xiaomi's products and allows customers to try and touch them freely. Some customers were trying the electronic scooter on the pedestrian pavement outside the store, which gave them an experience of using the products.



Ground level of the store



Second level of the store



The shopping wall with interactive screens



Technology products

Photo source: Fung Business Intelligence

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