

LEVEL 7 ASSESSMENT SPECIFICATION

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Memorandum

To : Mr. Jun Lei (Chairman and Chief Executive Officer)

From : Patrick Lau - Consultant UWTSD-HKMA

cc : Professor Peter Fong

Subject : Strategy Proposal for Expanding Xiaomi's Business in Indonesia

Dear Mr Lei,

As Xiaomi is entering a phase of rapid overseas expansion, the selection of markets and relevant strategies are certainly critical for the success of such endeavours. Indonesia, the largest market in South East Asia and an important country in the Belt and Road Initiatives, offers an attractive market for Xiaomi's expansion.

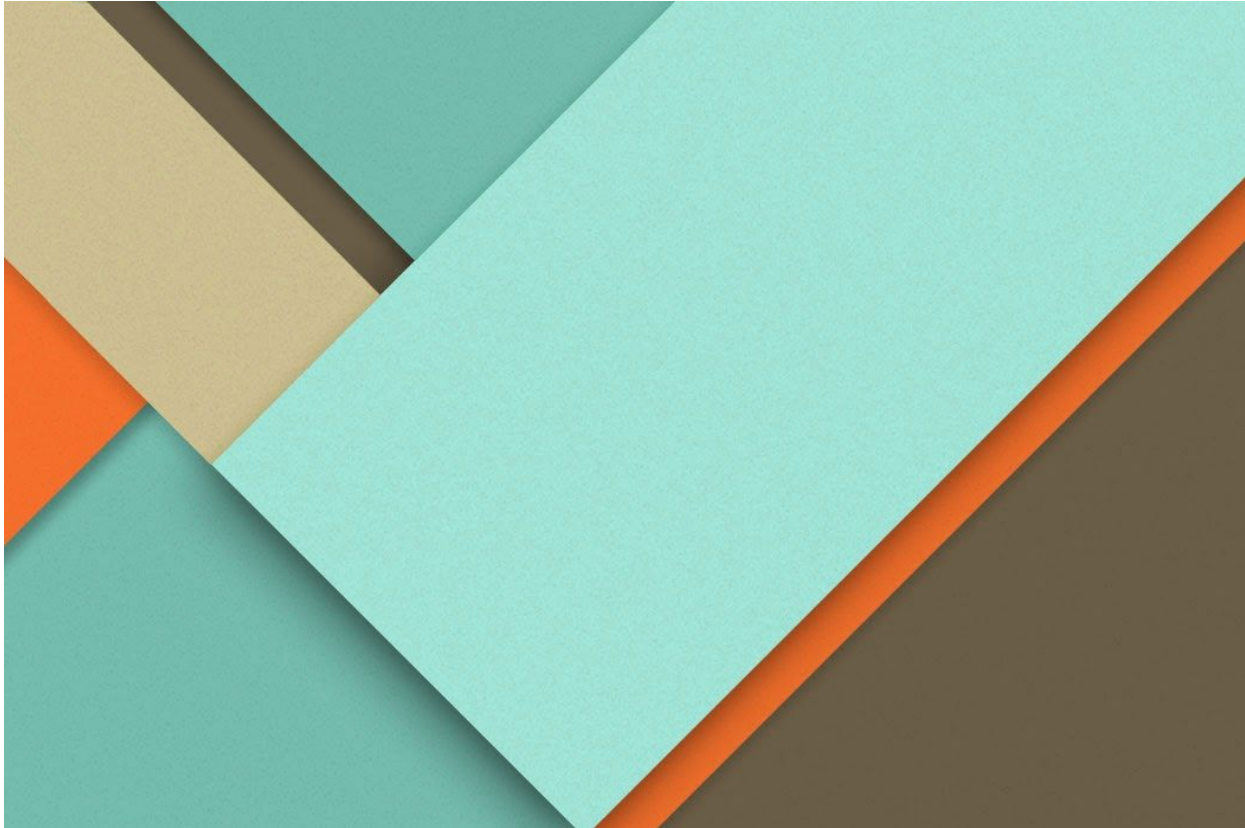
With its well established market share in the Indonesian smartphone market, the opportunity to enter into other higher margin segments is always going to be an attractive proposition for Xiaomi. As such, we performed a detailed study of Xiaomi's competences and the relevant strategies to expand its business in Indonesia is carried out and attached for your review.

Performance tracking methodologies and related recommendations are also included in this report to ensure the proposed strategies can be implemented successfully in Indonesia.

Please review this report and let us know if you have further comments.

Regards,

Patrick Lau



Expanding Xiaomi Business in Indonesia - Southeast Asia's Largest Economy

26.04.2020

Lau Ching Hoi Patrick

UWTSD HKMA

Student ID 1916324

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1) Executive Summary

In rising from a startup founded in 2010 into a Global Fortune 500 company in 2019, Xiaomi utilized its ability to innovate, produce, market, sell and distribute products that customers want to become the 4th largest smartphone brand in 3Q19 (IDC Corporate USA, 2019)^[1]. With a steadily rising GDP per capita of \$3,932 in 2018, a population of 267 million and an economy growing at 5% in 2019, (The World Bank Group, 2020)^[2] Indonesia offers a significant opportunity for many companies to do business. Moreover, with its median age of 31, (CIA, 2020)^[3] the market demand for smartphones, which has reached 11.5 million units in Q3 2019, (Canalys 2019)^[4] and other technology products and services offers an ideal opportunity for a diversified internet services company like Xiaomi. Its Indonesian operation has two essential attributes required to be successful in emerging markets, "business innovation requires attention to distribution and logistics networks as well as to designing products and services" and "anticipate changes in regulation and rules." Sako, M (2015)^[5] An analysis of Xiaomi's core competences against the market situation was summarized in Sections 2 & 3 and strategies for expanding its leadership, profitability and market share in Indonesia is listed in Section 4.

1.1) Summary of Competences

In summary, Xiaomi can leverage the following competences for market expansion in Indonesia

Marketing

A) Identify and refine successful sales, marketing and product strategies from lessons learned in pioneering markets, such as China, before selling into a follower market like Indonesia.

B) Online and social media experience in advertising, marketing, e-commerce and gaming business from China can be used to support Indonesian expansion by adopting more local contents.

Innovation

A) Experienced product development teams in China can support local development teams and partners to enhance user experience specific to Indonesian customers. For example, tailoring of local user interface (MIUI) and the development of Indonesian focused IoT and lifestyle products.

B) Online financial and e-commerce experience such as Mi Pay, Mi Credit and XW Bank and Mi Credit obtained elsewhere can help business diversification.

Production

Xiaomi's existing manufacturing partnerships in Indonesia enable its compliance with local content regulations, indirectly blocking Apple and Huawei from entering the Indonesian market.

Sales and Distribution

A) Xiaomi has established an extensive network of physical stores to showcase its products in Indonesia, composing of 30+ Mi Stores and 200+ Erafone stores. This network is further supported by another 2000+ cellular phone sales shops.

B) Sales to the entire Indonesian archipelago is already supported by online sales partners such as Shopee and Lazada, which are the 1st and 4th ranked e-commerce websites. (iPrice 2020)^[6]

1.2) Summary of Strategies for Indonesia

The following strategies can capitalize on Xiaomi's competences to enhance its leadership.

Production

A) Leverage its relationship with local officials and manufacturing partners to lobby Indonesian government to extend the local content regulations to include smart TV, smart home and IoT products.

B) Work with Erajaya and other partners to upgrade and expand local manufacturing capacities as well as capabilities specific for Xiaomi in Indonesia to meet with rising demands. Identify local partners capable of manufacturing other Xiaomi electronics products for suppliers diversification.

Sales and Distribution

A) Offer Erajaya's retail stores the opportunity to carry the full range of Xiaomi products to strengthen existing relationships and obtain more favorable terms and commitment from Erajaya.

B) Continue to expand its online sales partnership with Shopee, the top online e-commerce websites in Indonesia (iPrice 2020)^[6], to sell more products through more incentive programmes. Also try to establish partnership with local Indonesian owned e-commerce sites, Tokopedia and Bukalapak, which may offer better access to customers outside major urban markets.

Marketing

Xiaomi should leverage its strong brand in Indonesia to promote other smart home, smart TV, laptop and smart wrist band products to increase sales and diversify its customer offerings to create differentiation against competitors like Oppo, Huawei and Vivo.

Innovation

Explore potential partnerships with local banks and financial institutions to increase internet services revenue by utilizing Xiaomi's experience from its online bank, mobile payment application and credit matching platform to serve the 180m unbanked Indonesians. (Nugroho Y, Ilham Samudera I 2018)^[7]

2) Internal Audit Findings

Xiaomi's mission to relentlessly build amazing products with honest prices through innovative technology (Xiaomi Corp. 2019)^[8] is highly dependent on its ability to combine multiple core competences in the fast changing consumer technology industry. Its capability to innovate products that consumers want, successful management of its supply chain and distribution channels, and its marketing strength through social media are all important core competences. However, these core competencies can only stay relevant to the future of Xiaomi with the support of appropriate strategies.

2.1) Internal Audit Findings Summary

The internal strength, weakness, threat and opportunities analysis is summarised as below.

Strengths	Weaknesses	Threats	Opportunities
i) Innovation Focused Leadership Supported by Flat Management Structure	i) Dependence on External Manufacturing Partners and External Component Suppliers	i) Operating Cost Increase due to Direct Competition	i) Early Mover in 5G, Artificial Intelligence, Internet of Things (IoT), Big Data & Internet Financial Technologies
ii) Marketing and Brand Building Ability in the Online Era		ii) Customer Retention to Avoid Churn	
iii) Deliver Innovative Products Through Partnership, Alliance and Technological Acquisition	ii) Low Profit Margin Increase Exposure to Foreign Exchanges Fluctuation	iii) Staff Retention Efforts Increase Company Running Cost	
iv) Focus on customer experience	iii) Litigation Exposure Due to Limited Intellectual Property Portfolio	iv) Data Security	ii) Use of Xiaomi's Shares and Public Listing of Subsidiaries
v) Early Mover in Internet Services and Online Financial Services.			

2.2) Internal Strengths of Xiaomi

2.2.1) Innovation Focused Leadership Supported by Flat Management Structure

Xiaomi was founded with only 3 layers of management – the core founders, the department leaders and the employees. As its business expanded into other areas such as Smart TV, e-Commerce and Internet of Things, CEO Lei Jun did a major corporate wide re-organization in September 2018 to create the new organization structure it has today. With more than 18,000 employees and 10 business divisions, the hierarchical structure remains relatively flat with only 4 management layers starting from experts, managers, directors to divisionals VP. (Huazhang 2019)^[9] This structure enables Xiaomi to grow from a pure smartphone producer in 2010 into a diverse product supplier that responds quickly to customers' feedback and market requirements. McKinsey also recommended organizations to have "a flat structure with fluid roles that combine oversight with execution".(McKinsey&Co. 2017)^[10]

Xiaomi's top management also understands different aspects of technology business, enabling it to respond, innovate and deliver quickly. CEO Lei Jun was the CEO of Kingsoft Corporation, one of the leading security software, online gaming and enterprise software companies in China. He also

invests in YY.com, a real-time video app, and sold his online retailer Joyo.com to Amazon in 2004 for \$75 million. Co-founder Lin Bin worked in both Google and Microsoft engineering, Cui Baoqiu, Head of technology development and research worked in LinkedIn, Yahoo Search and IBM, and Wang Xiang, Head of Group's global business, intellectual property rights and legal affairs worked in chipset companies Qualcomm and Motorola.

2.2.2) Marketing and Brand Building Ability in the Online Era

Xiaomi has created a powerful "value for money" image by publicly pledging that "the overall net profit margin of Xiaomi's hardware business will never exceed 5%." (Xiaomi Corp. 2019)^[8] This is in stark contrast to premium brands like Apple, Samsung and Sony and has won many customers in the mass market segment, especially in price-quality conscious markets like China, India and Indonesia.

Social Media has been successfully used by Xiaomi especially for its customers, developer and fans' community. For example, Mi Community, with more than 130 million users, is the main online channel for communication and key to obtain feedback, views, and ideas from users on Xiaomi's products while building loyalty. With its strong marketing ability, especially in the online realm, Xiaomi also pioneered internet flash sales campaigns through social media and sold new products in limited batches. Xiaomi has since become a recognized brand with a brand value of \$19.8 billion when entered BrandZ™ Top 100 Most Valuable Global Brands for the first time at 74th in 2019. (Schept, K 2019)^[11]

Xiaomi has also used multiple brands strategy within its product line to enhance product differentiation for better margin. In 2013, a sub-brand, Redmi was created for its price-performance tier. In 2018, Xiaomi further introduced two new brands, Pocophone, for the upper portion of the mid tier market, and Blackshark, a gaming focus brand. Mi remains a brand focused on advanced technologies for the premium market. Mi brand has since successfully established a solid foothold in the premium smartphones segment to compete against Samsung S20 Ultra and Huawei P40 Pro to drive the increase in average sales price in 2019.(Sin, B 2020) ^[12]

2.2.3) Deliver Innovative Products Through Partnerships, Alliance & Technological Acquisition

Xiaomi's ability to innovate and develop products quickly to address multiple market segments ensures it becomes the fourth largest smartphone brand globally, resulting in the demise of established brands like LG, HTC, Lenovo and Sony. Speed of innovation is shown by launching 10 models of Mi,

12 models of Redmi and 2 models of Black Shark branded devices in 2019. (GSMArena 2020)^[13] Xiaomi's 5G product innovation capability enables it to win market share globally in the absence of 5G products from Apple. This is the result of heavy investment in R&D, which has over 7,000 engineers. (Xiaomi Corp. 2019)^[8] Long term alliance and technology acquisition program with leading chipset suppliers like Qualcomm and MediaTek as well as display vendors like Samsung and LG has also created a strong foundation for Xiaomi's technological innovation like surround display, wireless charging, camera and 5G.

Investing in partners to secure its supply chain is another important means of technology acquisition, Xiaomi has invested in more than 290 companies with an aggregated book value of approximately RMB30.0 billion.(Xiaomi Corp. 2019)^[14] Xiaomi, as one the the world's largest IoT product suppliers, offers a large variety of gadgets ranging from Smart TV, Smart wristband, Security cameras, Connected air purifiers, Smart wireless headphones, Smart kettle, Smart electric scooter, Smart weight scale, Smart speakers, Vacuum Robots as well as Smart light bulb. Many of these are produced externally by partners and Xiaomi integrates these products into its platform to expand its customer footprint. For example, in December 2018, Xiaomi cooperated with IKEA and connect IKEA's smart light products into Xiaomi IoT platform

With more devices connecting to Xiaomi's IoT platform, its Artificial Intelligent platform could serve a broader group with more application scenarios to acquire better quality data. To enhance development on its IoT platform, Xiaomi established a fund worth CNY 100 million to welcome developers to join this platform besides opening it to a large number of external partners. Xiaomi also cooperates with other cloud platform providers to build a larger AIoT platform. Partnership models have facilitated the rapid and successful ramp up of customer devices. Excluding smartphones and laptops, Xiaomi's IoT platform now reaches 234.8 million smart devices, making it one the world's largest consumer IoT platforms and becoming a big revenue driver. (Xiaomi Corp. 2019)^[14]

2.2.4) Focus on Customer Experience

Xiaomi employed its "Just for fans" approach to collect feedback from customers to drive the product development process. Its user friendly interface, MIUI, is the heart of its interaction with smartphone customers. MIUI is the direct creation of developer and user communities based on Xiaomi's vision of being the "coolest company" in the hearts of its users. For instance, the new MIUI

version in 2019 will get an earthquake warning function that sends alerts to phones running MIUI 11 and Mi TVs before an earthquake arrives by prioritizing the warning messages and reducing latency.

Xiaomi has also developed a highly efficient retail distribution platform as a core component of its customer services strategy to support its rapid expansion. By boosting supply chain and distribution efficiencies simultaneously, it can sell and commercialize products based on customer preferences at lowest cost possible which is similar to Apple's Quantum Strategy. (Heracleous, L 2013)^[15]

2.2.5) Early Mover in Internet Services and Online Financial Services

Xiaomi has been actively expanding its internet services beyond gaming and advertising to Chinese smartphone users in recent years. It is also an e-commerce player in China with its online product sales platforms, Mi Mall and Youpin, and is now trying the same in Indonesia via ShareSave.

Xiaomi also entered the Chinese FinTech market back in 2016 with its Mi Pay payment solution by partnering with UnionPay. Now it also operates a credit and financing platform called Mi Credit, which matches buyers, who require a loan, with financial institutions. Furthermore, it has also invested in a virtual bank, XW Bank, since December 2016 and just launched an online bank in Hong Kong called Airstar. (Fintech News HK 2020)^[16] One major advantage for Xiaomi to enter FinTech is the opportunity to sell both hardware and services to customers instead of just acting as a sourcing portal like Alibaba and Amazon. The information provided by users on its platform can assist Xiaomi to identify new opportunities and optimize existing hardware, internet services and financial services based on customer's preferences to achieve better monetization.

2.3) Internal Weaknesses of Xiaomi

2.3.1) Low Profit Margin Increase Exposure to Foreign Exchanges Fluctuation

In committing to selling hardware at low margin, Xiaomi is always exposed to loss due to unforeseen market situations such as currency fluctuation, market disruption (such as factory shutdown in India due to COVID-19), suppliers' price adjustment. Currency hedging is required to partially mitigate pricing fluctuation. Xiaomi has also been investing in some of its suppliers to lock in long term supply and pricing commitments.

2.3.2) Dependence on External Manufacturing Partners and External Component Suppliers

Xiaomi's entire hardware business depends on external suppliers ranging from Samsung and LG for TV display, Qualcomm and MediaTek for smartphone chipset as well as outsource manufacturing partners and logistic services suppliers such as SF Express to deliver its product. Although Xiaomi carries out some level of supply chain control such as running its own warehouses, it is still subjected to such disruptions as production capacity bottleneck and shutdown of its outsourced manufacturers.

Xiaomi has invested in its key suppliers to strengthen existing partnerships and to reduce operational risk. These investments are aimed at advanced technologies to facilitate the development of strategic industries, in particular around 5G, IoT, AI, integrated circuits, advanced manufacturing and industrial internet. This is similar to what Apple has been doing and Xiaomi is also trying to "balance intense efficiency in operations with outstanding serial innovation and addictive product design, both of which command premium pricing and redefine markets." (Heracleous, L 2013)^[15]

2.3.3) Litigation Exposure Due to Limited Intellectual Property Portfolio

As a technology startup in 2010, Xiaomi neither owns enough patents nor has established a program to protect its business against litigation. When it expanded into India, it was sued by Ericsson for not paying royalties for the relevant patents on products that connect to 2G (GSM), EDGE, and 3G networks due to the use of certain MediaTek processors. Xiaomi had since engaged Qualcomm as a major chipset partner and used its licensing program to gain better protection against litigation.

This infringement litigation exposed weakness in Xiaomi's patent portfolio and the company has since ramp up its patent through in-house invention, direct patent acquisition, signing cross licensing agreements with companies like Qualcomm and Nokia as well as buying into tech companies to protect itself. (Lunden I, Russell J 2017)^[17]. According to WIPO, the total number of patent families owned by Xiaomi has risen from 637 in 2013 to 3137 in 2015 and it is now one of the top 50 patent applicants worldwide, based on the total number of patent families, 2013–2015. (WIPO 2018)^[18]

2.4) Threats

2.4.1) Operating Costs Increase due to Direct Competition

Competitors in similar market segments like OPPO, VIVO, Huawei, Samsung remain strong in many of Xiaomi's markets. They have also copied Xiaomi's online-only model and raced to launch better devices to increase their market share. Under such intense competition, Xiaomi spent more on

elevated marketing campaigns and more physical stores to improve brand awareness in overseas markets, incurring increased overheads to its business operations. In particular, strategically located flagship stores are in higher cost locations. Hence, selling and marketing expenses increased by 45.9% in the third quarter of 2019 compared to the fourth quarter of 2019 while promotion and advertising expenses increased 79.7% in the same period. (Xiaomi Corp. 2019)^[14]

Moreover, due to the impact of the US-China trade war, Huawei has adopted a more China market centric approach for its smartphone business in 2019, increasing its market share from 28% (Q4 2018) to 34% (Q4 2019) (Team Counterpoint 2020)^[19]. Xiaomi needs to lift its pace of overseas expansion even at higher cost to compensate for the intense competition from Huawei in China.

2.4.2) Customer Retention to Avoid Churn

Since most of its hardware is sold at very low margin (<1% in 2019), Xiaomi is in fact making an investment in the customer, hoping to monetize later when customers decide to buy internet services and other products. Unfortunately, retention is more difficult for low price products with shorter life cycle (e.g. smartphone lifecycle is around 2-3 years only) and Xiaomi may lose the customer without making any significant return.

2.4.3) Staff Retention Efforts Increase Company Running Cost

To avoid suffering from similar fate to Blackberry and Nokia, Xiaomi needs to innovate continuously and rapidly to survive in the fast changing consumer technology business. As a result, its research and development expenses increased by 10.8% in the fourth quarter of 2019 when compared to the third quarter of 2019, primarily due to the increase in compensation for research and development personnel. The continuous rising cost of labour and the demand for skilled engineers in China will present an ongoing challenge for Xiaomi's cost control efforts.

2.4.4) Data Security

As an internet technology company, data security is always high on Xiaomi's agenda. Any loss or mis-use of user data will lead to significant impacts on users and Xiaomi's reputation. Furthermore, any leakage of sensitive business data to its competitors may damage Xiaomi's competitive advantages. Formulation of business information policies, implementation of procedures to protect data security throughout the entire data life cycle as well as deployment of systems to effectively monitor any

possible data leakage are all critical components in protecting Xiaomi from any security breaches. For example, Xiaomi has acted upon data security concerns by moving data of people outside China to Amazon web servers in Singapore and Oregon in 2014.(Yu, P.K. 2014)^[20]

2.5) Internal Opportunity

2.5.1) Early Mover in 5G, AI, Internet of Things (IoT), Big Data & Internet Financial Technologies

As Apple is absent from the 5G market, Xiaomi has strengthened itself as a technology leader in this premium smartphone segment to enjoy a higher profit margin by launching three 5G enabled smartphones in 2019 and another 10 5G enabled smartphone in 2020, covering both mid and high tier markets. (Lee, C. 2019)^[21] Moving quickly to 5G resulted in an improved gross margin of the smartphone business which increased to 7.2% in 2019 from 6.2% in 2018. Xiaomi is also augmenting its 5G strategy with IoT offerings and has a total of 238.4 million IoT devices (excluding smartphones and laptops) connected to its IoT platform by the end of 2019, an increase of 55.6% year-over-year.

Although monthly active users of Mi Home reached 36.8 million, about two thirds were non-Xiaomi smartphones users, offering a big cross selling opportunity between Mi Home users and Xiaomi smartphones. Application scenarios using AI and Big data will increase significantly in 2020 as smartphone and IoT devices are getting more intelligent, enabling the collection of more meaningful customer data for Xiaomi analytic platform. Alongside e-commerce, financial and MIUI user behavior data, Mi Home user data can help Xiaomi to refine its internet service offering to individual customers.

2.5.2) Use of Xiaomi's Shares and Public Listing of Subsidiaries

Since listing in 2018, Xiaomi's management has been given an additional tool to boost morale through stock allocation to employees while the company as a whole to raise funds from the public if necessary. Recent award of shares to employees when Xiaomi became a Fortune 500 global company is a good example of using shares to boost morale in Xiaomi. (Tao, L 2019)^[22]

Xiaomi management has also gained enormous insight in investor's expectation from a listed technology company and this has started to bear fruits for Xiaomi as an increasing number of its investee companies have gone public. As Xiaomi businesses continue to grow, many of its 290 investee companies will go public going forward, potentially becoming financial drivers for Xiaomi as well. One example is the listing of Roborock in February 2020 in, Science and Technology Innovation Board of Shanghai Stock Exchange (“STAR Market”) in China.

3) External Audit

Regardless of its internal strengths, Xiaomi's business success is ultimately measured by its ability to sell and how popular are its products amongst customers. Hence, external factors exert a decisive influence on the success of its business in Indonesia and they are listed below and can be the starting reference for Xiaomi's market development strategy in Indonesia.

3.1) External Audit Findings Summary

Strengths	Weaknesses	Threats	Opportunities
i) Extensive Sales and Distribution Network in Indonesia	i) Currency and Foreign Exchange Risk	i) Geo-Political Considerations	i) Alignment of Business Vision with BRICS and Belt & Road Initiatives
ii) Social Media Marketing and Branding Strength			ii) Enormous Smartphone Market Potential in Indonesia
iii) Established Partnerships with Local Outsourced Manufacturers	ii) Overseas Manufacturing Exposure	ii) Ongoing Competition from Other Smartphone Suppliers	iii) Online Banking and e-Commerce Enable Xiaomi to Diversify its Services Offerings
iv) Attract Local Application Developer Participation through Incentives		iii) Unexpected Disruption due to Pandemic such as COVID-19	iv) Expand Market Share with Locally Manufactured Devices
			v) Tremendous Growth Opportunity in Indonesia for Smart Home and IoT solution vi) Internet Services Sales Opportunities from User Behaviour of Indonesian

3.2) Strengths Of Xiaomi

3.2.1) Extensive Sales and Distribution Network in Indonesia

Xiaomi itself operates around 30 plus authorized Mi Stores and co-operates with Erafone, which has 200+ stores, to cover all major cities across Indonesia. This physical network of stores is supported by another 2000+ cellular phone sales shops and another six distributors to cover areas outside Java island. Its physical presence is complemented by selling online through its own Mi.com website and co-operation with popular online marketplaces in Indonesia such as Shopee (ranked 1st), Lazada (4th), Blibli, JD.ID and Akulaku for online sales. (Xiaomi Corp. 2019)^[8]

3.2.2) Social Media Marketing and Branding Strengths

According to YouGov BrandIndex, Xiaomi is now the third most popular mobile phone brand in Indonesia, with a score of 28.4, and one of the top index improver in 2019. (YouGov plc 2019)^[23] Its brand ranking is very close to the third most popular online retailer, Bukalapak, which has a score of 28.8. With over 160 million social media users, (Hootsuite 2020)^[30] Xiaomi's brand recognition is an invaluable asset for its online marketing expansion in Indonesia. Internet and social media centric

campaigns such as regular flash sales through ecommerce partners or mobile gaming, and continuous support to its fanbase community has successfully promoted Xiaomi's brand and its value for money reputation.

3.2.3) Established Partnership with Local Outsourced Manufacturers

Xiaomi has been producing its smartphone for the Indonesian market since February 2017 in the province of Batam with a monthly capacity of at least 1 million units.(Yu, E. 2017)^[24] This is in accordance to the regulation on local content requirements (TKDN- Tingkat Komponen Dalam Negeri) for laptop computers, smartphones, and tablets which required manufacturers having no less than 30% of the components made locally in Indonesia.(Theinsider 2018)^[25] By April 2019, Xiaomi and its three local partners, namely Erajaya Swasembada, Sat Nusapersada, and TSM Technologies has produced 10 million smartphones in Indonesia since 2017. (The Jakarta Post 2019)^[26] The local manufacturing regulation has indeed benefited Xiaomi as it also became an entry barrier for low volume brands such as Sony, LG and HTC and for Apple and Huawei which has been protective of their technology.

3.2.4) Attract Local Application Developer Participation through Incentives

Xiaomi has focused its effort on building a local Indonesian ecosystem in recent years. In September 2019, it held its first MIDC (Xiaomi Developer Conference) to attract local developers to develop and create products for its app store. In the second half of 2019, Mi App Store launched the “Seagull Project” which will invest Rp 200 Billion (USD 12m) to support local developers and start-ups to expand its 24 million active MIUI users in Indonesia through giving awards, featuring apps on the start page, publishing reviews, giving editorial recommendations, and holding events. (Blog Xiaomi, 2019)^[50]

3.3) Opportunities Available

3.3.1) Alignment of Business Vision with BRICS and Belt & Road Initiatives

In 2013, Chinese President Xi Jinping announced the Belt and Road Initiatives (BRI) during official visits to Kazakhstan and Indonesia, highlighting the importance of Indonesia as a participant. This initiative, involving 32.3% of World GDP in 2017, is to provide a platform for business and trade for all the countries involved. (OECD 2018)^[27] With its fast growing economy and a large population of price-performance sensitive young people, expanding Xiaomi's business in Indonesia is well aligned to Chinese business interest in BRI.

3.3.2) Enormous Smartphone Market Potential in Indonesia

Although Indonesia is currently the fourth-largest smartphone market in the world after China, India and the United States, the lack of fixed line infra-structure means Indonesia represents a big growth opportunity for all smartphone makers, including Xiaomi, if 80% of total its population (208m) become smartphone users. With only 82m smartphone users today (Statista 2020)^[28] and assuming an average selling price of 130\$ USD for Xiaomi, (IDC 2019)^[29] Indonesia represents a market opportunity of at least 126m units at USD \$16.3B. By maintaining its market share of 22%, (Canalys 2019)^[4] Indonesia could provide USD \$3.6B of revenue to Xiaomi.

3.3.3) Online Banking and e-Commerce Enable Xiaomi to Diversify its Services Offerings

Indonesia has an unbanked population of 180 million (Nugroho Y, Ilham Samudera I 2018)^[7] and many are smartphones users now, opening up opportunities for higher margin mobile banking and financial services. Mi Finance and Sichuan XWBank have been established for two and three years respectively so their experience can be used to expand Xiaomi's internet financial services in Indonesia.

Besides online banking, mobile payment is another opportunity for Xiaomi as e-commerce payment via credit card and ewallet accounts for only 49% of ecommerce payment methods in Indonesia. Only 2.4% of people above the age of 15 have a credit card while only 3.1% from the same age group own a mobile money account. With an average annualized digital payment value of 220\$ USD per user (Hootsuite 2020)^[30] and GDP per capita of 3932\$ in 2018 (The World Bank Group, 2020)^[2], the opportunity for FinTech applications in Indonesia is huge.

Indonesia has the biggest e-commerce growth potential in South East Asian countries as it is only around 4% of GDP but growing at 49% a year. (Google & Temasek / Bain 2019)^[31]

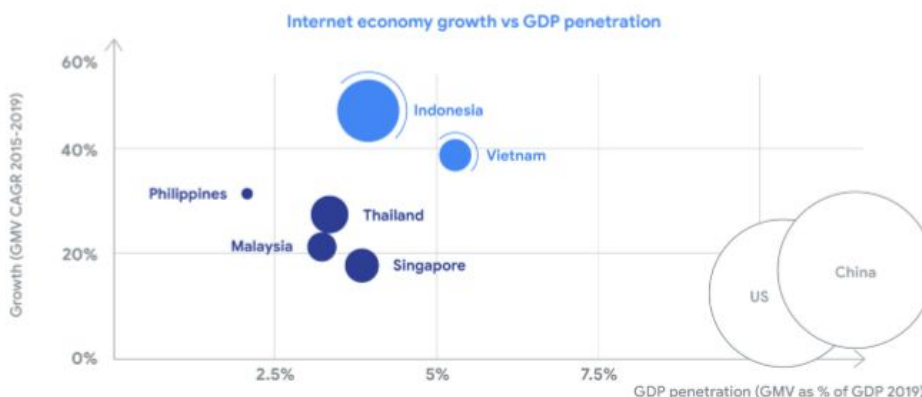


Fig 1 - Internet Economy Growth vs GDP Penetration (Google & Temasek / Bain 2019)^[31]

3.3.4) Expand Market Share with Locally Manufactured Devices

Although the Indonesian smartphone market is still expanding, stronger players like Huawei and Apple remain in the planning stage of starting local manufacturing. Right after the establishment of local content regulation in 2017, Indonesian government has been planning to offer further protection for locally manufactured phones by blocking the use and distribution of cell phones bought in the black market. Government has since completed the development of a system that implements the blockage of illegally imported phones based on International Mobile Equipment Identity (IMEI) number identifications. Hence, the bias towards local manufactured smartphones and restriction of illegal import has created a favorable opportunity for Xiaomi to expand further in the higher margin segments due to the low penetration of Huawei and Apple.

3.3.5) Tremendous Growth Opportunity in Indonesia for Smart Home and IoT Solutions

According to the National Statistical Office of Indonesia, there are 71.9 million households nationwide in 2019 but only 1.29 Million homes have smart home devices, achieving a total device sales of only 376M USD.(Hootsuite 2020)^[30] This indicates a significant growth opportunity going forward for Xiaomi since it can offer multiple smart home products ranging from Smart TV, Wi-Fi router, cleaning robot to electric kettle.

3.3.6) Internet Services Sales Opportunities from User Behaviour of Indonesian

With an estimated value of \$40 billion in 2019, Indonesia's Internet economy has more than quadrupled in size since 2015 at an average growth rate of 49% per year. As the largest and fastest growing internet economy in southeast asia, Indonesia is well on track to cross the \$130 billion mark by 2025. (Google & Temasek / Bain 2019)^[31] Although 80% of internet users aged between 16 to 64 make an online purchase via a mobile device in 2019, average revenue per online user for consumer goods purchased is only 2.9% of GDP per capita, (Hootsuite 2020)^[30] representing a significant upside for e-commerce companies in Indonesia.

3.4) Weaknesses Due to External Forces

3.4.1) Currency and Foreign Exchange Risks

The transactions of Xiaomi are denominated and settled in the United States dollar. However, many of its subsidiaries and suppliers primarily operate in China and other regions such as Indonesia. Hence, there is always an exposure to foreign exchange fluctuation primarily with respect to the United States dollar. Like many emerging countries, the Indonesian Rupiah value against USD and RMB has been steadily declining in recent years so Xiaomi needs to monitor changes in currency exchange rates and take necessary measures such as currency hedging to mitigate exchange rate impact continuously.

3.4.2) Overseas Manufacturing Exposure

Although outsourcing manufacturing to Indonesia partners is required by government regulation, Xiaomi has limited control of its manufacturing partners so it has to monitor the quality and delivery schedule of locally made products. Growth potential may also be impacted if partners' manufacturing capacity becomes the bottleneck and Xiaomi cannot restrict its manufacturing partners from serving other customers. Pegatron, an outsourcing production partner of Apple, started partnering with Sat Nusapersada, which is also a Xiaomi supplier, to assemble components for Apple. (Silviana, C. Hogue, T. Neely, J 2019)^[32] This may be the first step to establish Apple within the local manufacturing community and Xiaomi needs to monitor this carefully.

3.5) What's Threatening

3.5.1) Geo-Political Considerations

The current trade war between US and China is definitely a big threat for Xiaomi business in Indonesia as it uses many components from US companies (e.g. processing chipsets from Qualcomm). Any escalation in the trade war that impacts technology exports to Chinese companies will also affect Xiaomi. Furthermore, any modification of Indonesian policies, such as taxation and personal data protection against foreign companies, could create unfavorable conditions to Xiaomi Indonesia.

3.5.2) Ongoing Competition from Other Smartphone Suppliers

Oppo and Vivo originally made a game changing impact in Indonesia with their aggressive marketing campaigns and lucrative profit margins to channel partners, disrupting the market previously dominated by local Indonesian brands such as Advan. However, as opposed to Oppo and Vivo strategy, Xiaomi sold to customers at lower price, used minimal marketing campaigns and thin margins for channel partners but successfully became the second largest player in Indonesia after Samsung in Q2 2018 through its lower average selling price (ASP) and competitive price-to-specification against higher priced Oppo and Vivo phones. (IDC 2019)^[29] However, as lower end customers dry up , Xiaomi needs to sell higher price products and increase its marketing spending. For instance, the opening of around 30+ Mi Stores in Indonesia has increased Xiaomi's exposure but created higher operating costs. The ongoing competition for market share among suppliers will impact profit margin and market share of Xiaomi if not managed carefully.

3.5.3) Unexpected Disruption due to Pandemic such as COVID-19

Government lock downs and factory closures will impact the production and delivery of products in Indonesia and its duration will impact the business activities level carried out by Xiaomi in Indonesia. For example, a chipset supplier, Broadcom, just announced a 6 month lead time for its product ordering cycle. Wu, D., King, I. 2020^[33]