

CAN XIAOMI SHAKE THE GLOBAL SMARTPHONE INDUSTRY WITH AN INNOVATIVE 'SERVICES-BASED BUSINESS MODEL'?

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This case has been compiled from secondary published sources to illustrate the emergence of a new services-based business model in the smart phones segment by Xiaomi.

Abstract: The economic development in the third world countries is encouraging entrepreneurs to disrupt the existing and mature markets with an innovative model. This paper presents one such case of Xiaomi.

Xiaomi is the brain child of a serial tech investor and entrepreneur Lei Jun, who is creating the next wave in the Smartphone industry with the launch of smartly designed Android phones at very moderate costs. The company after coming into existence in June 2010, has already shaken the Chinese market in a span of 4 years and is aiming to be the next buzz word in the international market. This paper analyzes the company's innovative business model which doesn't rely on hardware to drive revenues but uses it merely as a platform to sell its services, it sells its products primarily through its website, doesn't maintain inventory and holds weekly sales, offers products at very reasonable prices, focuses on social media and hunger marketing and doesn't leverage traditional marketing and sales channels. The company has recently begun to expand internationally predominantly to Asian countries.

Keywords: Xiaomi, Global Smartphone industry, Services based business model, Entrepreneurship, Chinese Smartphone market, Android, Innovation, eCommerce, Social media marketing, Hunger marketing

"In a mobile-phone landscape, Xiaomi's rise to prominence is not an everyday occurrence" - Melissa Chau, Senior Research Manager for client devices, IDC Asia/Pacific

Background Note

With the rising economic development in the second and third world innovative countries such as China, the taboo associated with the "Made in China" brand is being redefined, especially in the Smartphone industry. Some serial entrepreneurs are relying heavily on innovation instead of the government connections and financial powerhouse, to let an incumbent and startup enter a mature market. One such prominent example is of Xiaomi.

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Xiaomi Inc., headquartered in Beijing, China, is a privately owned 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.

The company began its operations with the launch of its Android-based firmware MIUI (pronounced "Me You I") in August 2010, which is a heavily modified and hard-coded user interface which brings in features from Apple's iOS and Samsung's TouchWiz UI. Further, it expanded into other consumer electronics products, including tablets, smartphones, MiWiFi network router, MiTV Smart TV, MiBox set-top box, MiCloud cloud storage and cloud computing service, MiTalk instant messenger, and Mi power bank.

It has over 3,000 employees in China, Taiwan, and Singapore, and has based its international headquarters in Singapore for its global expansion activities. It runs six storage centers, 18 flagship stores, and 436 after-service outlets in China.

The predominant market for the vendor is Mainland China, though it has forayed into Taiwan, Hong-Kong, Singapore, and Malaysia recently, with plans to launch its products to other countries, including India, Indonesia, Philippines, Russia, Thailand, Turkey, Vietnam, Brazil, and Mexico in the near future.

To foster its growing sales and expansion activities, the local Smartphone vendor has raised three rounds of funding from various institutional investors amounting to \$317 million. During its third round of funding in 2013, Xiaomi was valued at \$10 billion. Xiaomi has also actively invested in other tech companies, including Cheetah Mobile, Westhouse, Shenzhen Thunder Networking, and Xunlier.

Within a short span of time, Xiaomi is stealing the show in the Chinese Smartphone market with a vision to replicate the same in the international boundaries. This local smart phone vendor has risen tremendously in previous few years, often being cited as the "Apple of China" and is giving cut throat competition to established players such as Samsung, Apple, Lenovo, Huawei, LG, ZTE, etc.

The catastrophic success of Xiaomi

Xiaomi has garnered tremendous market share in the Chinese market both in terms of shipments and revenues. It shipped 26.11 million smartphones in 1H 2014, while it had sold 18.7 million smartphones in 2013, and approx.7.0 million in 2012. Moreover, the company expects to ship 60 million and 100 million smartphones in 2014 and 2015 respectively. The overseas market contributed less than 5% of Xiaomi smartphone sales in 2013.

It earned \$5.22 billion in revenues in 2013, while forecasting revenues of \$11.2 billion for 2014. The company also generated over 1 billion Yuan (\$162 million) in FY 2013 from the sales of smartphone accessories and sideline products.

Several analysts are betting on the success of Xiaomi, including it in the list of top smartphone players. Per Bloomberg, Xiaomi constituted 3.5% of global shipments in 1Q 2014 focusing only on China and Singapore thus listing itself in the top 10 global smartphone vendors.

Per Counterpoint Technology, a market research firm, Xiaomi ranked third with an 11% market share in the Chinese smart phone market, while the other leading smartphone brands were Samsung with an 18% market share, Lenovo (12%), Coolpad (10%), Huawei (8%), ZTE (6%), and OPPO (3%).

According to CTMR, a Hong Kong-based market research organization, Xiaomi's smartphone products Redmi and MI3 ranked 7th and 10th respectively among the world's top 10 best-selling smartphones in February 2014.

What does this player do distinctively to achieve such high paced growth?

The success of Xiaomi can be attributed to its business model that leverages incremental improvements and innovative business models to reinvent the Smartphone business, which is exploding around the world. **Per Fast Company's list of 50 most innovative companies 2014, Xiaomi has been named as the the third most innovative company, just behind Google and Bloomberg.**

A unique service-based business model

Xiaomi names its strategy as "The triathlon model", which is an integration of software, hardware, and Internet service. This kind of an integrated model is unique to the smart phone industry. The company focuses on Software and Internet services as its primary business while hardware is just a platform to deliver the services. The three pillars to its strategy are - Hardware as a Service strategy, an e-commerce sales model, and a focus on software, services and content.

Xiaomi plans to adopt a model similar to that of Kindle of Amazon, which relies not only on hardware, but also on software to generate revenue stream in the long run. The company has not yet revealed exact plans for the same but users can purchase themes for their phone and alter the user interface's look by purchasing the company's Mi credits online.

"Xiaomi has a different business model than Apple or Samsung. Apple makes it profits on the hardware, while Xiaomi claims they will make their profits on services." - Ben Thompson, founder of Stratechery.com, a technology and strategy website.

The aggressive pricing policy

Xiaomi's success has predominantly been attributed to its cost leadership strategy, offering products at prices as close to the cost, rather 'Bill of materials' as possible. The

devices are offered at much lower cost as compared to the established players. Comparing the end price of Xiaomi with other players goes a great deal in explaining the rationale behind the rage for Xiaomi smart phones.

Devices	Price*
MI 1 [#]	1,999 Yuan (\$323.8)
MI 2 [#]	1,999 Yuan (\$323.8)
MI 2S	16 GB - 1,299 Yuan (\$210.4) 64 GB - 1,799 Yuan (\$291.4)
MI 3	16 GB - 1,699 Yuan (\$275.2) 64 GB - 1,999 Yuan (\$323.8)
HongMi/RedMi 1	8GB - 799 Yuan (\$129.4)
HongMi/RedMi 1S	8GB - 699 Yuan (\$113.2)
RedMi Note/HongMi Note	1GB RAM - 799 Yuan (\$129.4) 2GB RAM - 999 Yuan (\$161.8)

**The prices are as on May 26, 2014, and have been converted into US\$ at the exchange rate on the same date; 1\$=0.162 Yuan*

[#]These models are no longer listed on Xiaomi website and are speculated to be phased out by the company. The prices listed for these models are their launch prices

Though, there are several quality differences when Xiaomi Mi3 phones are compared to that of Apple iPhone or the Galaxy of Samsung, but when it comes to pricing the Chinese vendor takes the lead.

The Mi3 handset from Xiaomi includes a Nvidia Tegra 4 chip, a 13-megapixel Sony camera and 2-gigabit RAM and sells for \$327. Comparatively, in China, the retail price for Apple’s iPhone 5S is \$866 without a service plan, while for Samsung’s 32GB Galaxy Note 3 it is \$884.

Moreover, Xiaomi has launched its first tablet, which is said to be a replica of Apple Inc.’s iPad Mini-series. The selling price for the 64-gigabyte version tablet is 1,699 Yuan (\$273), which is approx. 3,500 Yuan cheaper than the 64GB iPad Mini, offered by Apple.

Focus on Social media and Hunger marketing tactics

Xiaomi relies basically on Internet to market its products and fuel sales. It maintains very few, if any, physical stores and doesn’t spend on traditional forms of advertising, which eschews a major portion of the cost incurred in maintenance and staffing of these stores, unlike other vendors. The company maintains its own online store and offers products on Tmall.com, one of China’s largest online retail sites.

Xiaomi leverages social media and word of mouth marketing to create a viral effect among the internet acquainted youths of China. It encourages regular discussions and

interactions that engages customer to give inputs on product plans and make up for the advertisement through word of mouth publicity. It runs frequent events, such as the “Fan Festival” online shopping event with discounts and coupons. The company’s Weibo micro blogging account is tracked by approx. 8.5 million followers. The company runs various pages on Facebook and has a good following even though Facebook is banned in its home country China. Xiaomi Facebook page has 565,400 page likes, while its other country pages are also gaining popularity, such as, Xiaomi Taiwan (226,300 page likes), Xiaomi Hong Kong (148,100 page likes), Xiaomi Singapore (56,700 page likes), Xiaomi Malaysia (19,400 page likes), Xiaomi Indonesia (1400 page likes), and Xiaomi India (1300 page likes). Xiaomi's Twitter account is being followed by 19,200 followers and has 2,190 tweets since the company created the page in September 2011. Further, its YouTube page has 336,516 views and 4,894 subscribers.

The company has a "Customer-obsessed" strategy where it allows customers to participate in its design and development process by taking inputs from users through its online forums and incorporating their feedback to new models/devices.

"One of the key success factors for Xiaomi in China (apart from devices with high end features at affordable costs) is that they've successfully managed to engage the consumers in their product development and marketing." Jayanth Kolla, co-founder and partner at telecom research firm Convergence Catalyst.

The limited inventory concept

The carrying cost of inventory creates a huge cost for any company that offers tangible products. Xiaomi undercuts that by maintaining a very low inventory. When Mi 3 phones were launched initially, the first batch of 100,000 units sold out in less than two minutes and the company took another seven days to release 100,000 more units, which were then immediately sold out again.

“Xiaomi addresses a segment that has been underserved by major brands, which craves the coolness of the latest technology at affordable prices” says Sandy Shen, Analyst, Gartner Inc.

An eco-system of Smart products

With the Smartphone industry expected to saturate in China in the coming few years, Xiaomi has already started its focus on building a smart family, a service platform with better potential for growth. It launched a second television model, first tablet computer, set-up boxes, and, routers that can connect electronic devices, such as televisions and tablet computer and build a family integration system.

This model is expected to evolve the value chain of the smartphone industry, which is expected to witness chunks of financial gains coming through the applications and services. Xiaomi provides an integrated model of hardware and software to achieve this.

After a sparking performance in the Chinese market, what lies ahead for Xiaomi is its Global ambition

After capturing a major chunk in the Mainland China market, Xiaomi forayed into Hong Kong, Taiwan, Singapore, and Malaysia, with further plans to foray into other international markets including, the Philippines, India, Indonesia, Thailand, and Vietnam, followed by Russia, Turkey, Brazil, and Mexico being the next targets. It has adopted a more practical strategy of entering other developing markets rather than the US and Europe. The company translated its MI interface from Chinese to English before reaching to Singapore and Malaysia. Although, the dynamics of each market is different and the capabilities of Xiaomi in international expansion have often being questioned, Xiaomi has forayed well into the Hong Kong and Taiwan markets. It sold online 10,000 lower-end Hongmi phones in Hong Kong within 36 seconds, and had an almost similar result in Taiwan. Per IDC, Xiaomi cracked the ranks of the top five smartphone brands in Taiwan in 1Q 2014.

“The company was “just getting started,” but that successful sales in Taiwan and Hong Kong proved that the company’s model also works in developed markets where carrier subsidies make consumers less sensitive to the pricing of phone.” - Lin Bin, co-founder and President, Xiaomi.

Moreover, Xiaomi is undertaking efforts to better reach the international audience. It has partnered with telecom carriers in several countries such as Hutchison Whampoa Ltd and PCCW Ltd in Hong Kong, Flipkart in India, StarHub in Singapore, etc. It partnered with Manu Kumar Jain, cofounder of an online venture Jabong.com in India to kick start its operations in the country. It has launched its new international website "mi.com," which is an acronym for “Mobile Internet”. The new domain is expected to better reach the diverse international audience than the previous URL. Also, in October 2013, the company appointed Hugo Barra, Google's former vice-president, in a bid to boost its global expansion plans.

However Xiaomi encounters several tricky problems that needs solutions to behold the success

Generating profit is a big challenge to the Smartphone industry, with most of the companies incurring a net loss in the segment except Apple and Samsung. While Apple’s success can be attributed to its operations in the premium and profitable end of the market, Samsung benefits from an integrated supply chain and a huge channel presence. Although the pioneers of Xiaomi are quite confident of its success, there are several eyebrows being raised as to the longevity and the scale of its performance. The company is expected to face several hurdles as it tries to make a mark in geographies beyond South Asia or in a new product line.

Xiaomi might face challenges in implementing its online flash sales model in South Asian countries like India, Indonesia, Philippines, etc. where internet penetration rates are very low.

The mobile device market in China is mostly retail based wherein any manufacturer gets a shelf space to sell its products, but in mature markets such as US, the devices are carrier based. The player will need to partner with the mobile network operators to sell their devices directly and through authorized dealers.

“Xiaomi will be successful in Asian markets as its product line and price hit the mark for sophisticated users. But the US and European markets will be hard to penetrate as the channel strategy is different, and building the brand will require a marketing budget that is going to require huge resources.” - Tom Kang, mobile device research director, Counterpoint Technology Market Research.

Though the company has forayed into smart integration, it lacks the support of the platform for such integration and has performed only in mediocrity in this division. Xiaomi doesn't manufacture its own devices and relies on contract manufacturers, such as FIH Mobile Ltd. and Inventec Corp to build it. It needs to constantly assure the suppliers of its outshining prospects, so as to persuade them invest in the plant and machinery. This could pose a challenge in scaling up the production as per international demand. If we consider geography such as India wherein the customers are not the best of a patient lot, they could end up with another device rather than waiting for Xiaomi.

"We will continue to improve manufacturing capacity as we expand into more countries" says Bin Lin, Xiaomi's president and co-founder.

Xiaomi also suffers a bottleneck in terms of providing repairs and service to its customers. The company will have to expand its investment in building maintenance and service centers and hiring adequate people to deal with repairs and service.

Moreover, there are several legal issues that Xiaomi may encounter as it enters the mature markets of US wherein the firms are adept in dealing with the litigations related to licensing fees and patent. Xiaomi is expected to encounter high cost in cutting-edge 4G, where patented technology is particularly expensive. It would need to hire a strong litigation team to counter the tricky lawsuits in the Western market.

Xiaomi will need to raise more funding so as to meet the huge scale and presence that the global Smartphone pioneers have in this industry and to find a neglected niche to cater in these markets.

Conclusion

Will Xiaomi be able to overtake established players such as Apple and Samsung?

Apple sells as a premium product but Xiaomi has still not made a brand appeal. Marketing, combined with a strong product line at the middle to lower end of the market, represent Xiaomi's competitive strengths. Other lower-end makers can offer similar

quality but lack the buzz that Xiaomi is able to generate. Top-tier names like Apple and Samsung can generate buzz, but can't come close on price.

"Whether it can rise to the next big milestone of becoming a global player is its next big challenge" –

Bloomberg

Questions

1. Will Xiaomi succeed in the international market, with each having its own peculiar need?
2. Can the existing model which offers more bang for the buck sustain in other geographies?
3. Will Xiaomi be able to do away with the stigma associated with carrying a Chinese brand?
4. Is Xiaomi's services-based model capable of disrupting the Smartphone industry?
5. Can Xiaomi survive in the long run without leveraging the traditional marketing and advertising platforms?

Appendix

Table 1: Timeline of Xiaomi

June 2010	Xiaomi was co-founded
August 2011	Announced the MI 1 phone
August 2012	Announced the MI 2 phone
September 2013	Milestone - Sold over 10 million MI2 devices
	Announced plans to launch an Android-based 47-inch 3D-capable Smart TV, to be assembled by Wistron Corporation, a Sony TV manufacturer based in Taiwan
	Announced the MI 3 phone
	Announced plans to open its first retail store in Beijing, China
October 2013	By October 2013, Xiaomi was reported as the fifth most used Smartphone brand in China
January 2014	Announced international expansion plans with Singapore being the first country and also international headquarters for the company
February 2014	Xiaomi's Redmi makes its debut in Singapore
March 2014	Xiaomi Mi3 makes its debut in Singapore
	Announces plans to expand to Malaysia
	Announced two versions of the RedMi Note (also known as HongMi Note)
April 2014	Purchased a new domain - mi.com for \$3.6 million, the most expensive domain name in China replacing Xiaomi.com as the official website domain of Xiaomi

Table 2: Key Management executives

Name	Details
Lei Jun	Founder, Chairman and CEO Lei Jun was part of the founding team of Kingsoft in 1992. He later became

	CEO of Kingsoft in 1998. He founded Joyo.com in 1999, followed by further investments in many startup companies like Vancl, YY and UC as an angel investor. On April 6, 2010, Lei Jun co-founded Xiaomi. In July 2011, Lei Jun returned to Kingsoft as Chairman of the Board of the company. Forbes has listed him as the 23rd richest man in China.
Lin Bin	Co-founder, President Lin Bin graduated from Sun Yat-sen University in electronics engineering in 1990, followed by a master's degree in computer science from Drexel University in 1992. Moving ahead, he joined Microsoft as a Project Leader Engineer, and was promoted to Senior Development Manager, Engineering Director. He joined Google in 2006 as Vice President of Google China Institute of Engineering and an Engineering Director of Google Global.
Li Wanqiang	Co-founder, Vice President Presently, Li Wanqiang is responsible for marketing at Xiaomi. He graduated in Industrial Design from Xi'an Science & Engineering Institute with a degree in 2000. He served in various positions at Kingsoft as the Chief Designer of UI department, Director of Design Center, and Director of Internet Content.
Zhou Guangping	Co-founder, Vice President Currently, Zhou Guangping is responsible for Xiaomi's Mi-Phone Team. He obtained a PhD from Georgia Tech in 1991. He joined Motorola as a core expert engineer in 1995 and served as the Senior Director of Motorola Beijing R&D Center, Chief Engineer and Director of R&D Center of Motorola Personal Communication, Vice Chairman of Mobile Patent Committee in Motorola China Research Academy, and Vice Chairman of Cell phone Quality Control in Motorola Asia-Pacific.
Huang Jiangji	Co-founder, Vice President At present, Huang Jiangji is responsible for MiTalk at Xiaomi. He graduated from Purdue University and worked for Microsoft from 1997 to 2010 and oversaw the development of products such as Microsoft's business server, B2B system, Biztalk auto-logistics distribution system, Chinese version of Windows Mobile, Windows Phone 7 multimedia, Internet Explorer, and instant messenger.
Hong Feng	Co-founder, Vice President Currently, Hong Feng is responsible for the MIUI firmware at Xiaomi. He graduated in computer science engineering from Shanghai Jiao Tong University and received a master's in computer science from Purdue University. Hong Feng joined Siebel in 2001. He further moved to Google in 2005 as a Senior Software Engineer who oversaw Google Calendar, Google Map and Google 3D Street View. He was promoted to Senior Product Manager of Google China, and led the Google China team to develop a series of localized products like Google Music and Google Pinyin Input.
Wang Chuan	Co-founder, Vice President

	Presently, Wang Chuan is responsible for MiBox at Xiaomi. He graduated in computer hardware from the Beijing University of Technology. He founded Thunder Stone Technology Ltd. In 1997 and Beijing Duokan Technology Co. in 2010.
Liu De	Co-founder, Vice President Liu De is responsible for Xiaomi's industrial design. He post-graduated from Art Center College of Design. He was the founding member at the Industrial Design Department of Beijing University of Technology.
Hugo Barra	Vice President, Global Hugo Barra is responsible for Xiaomi's Global division and the company's foray into global markets. Prior to this, Hugo Barra was the Vice President of Android Product Management and Director of Product Management for Mobile at Google. He is a graduate from Massachusetts Institute of Technology with bachelors and masters degrees in computer science, electrical engineering and management science.

Table 3: Worldwide Smartphone Forecast by region, shipments, market share and growth, 2013-15

Region	2013 Shipment Values (Mn)	2013 Market Share	2017 Shipment Volumes (Mn)	2017 Market Share	5 Year CAGR
Asia/Pacific	528.2	52.3%	986.0	58.5%	23.2%
Europe	182.1	18.0%	261.0	15.5%	11.1%
North America	151.0	5.0%	189.0	11.2%	7.8%
Latin America	91.1	9.0%	154.7	9.2%	23.7%
Middle East and Africa	57.6	5.7%	95.0	5.6%	18.5%
Total	1,010.1	100.0%	1,685.8	100.0%	18.4%

Source: IDC (November 2013) Forecasts

Table 4: List of suppliers/partners

Name of the supplier/partner	Details
Qualcomm	Provides its power processor chips and other semi-conductor chipsets to Xiaomi
Mediatek	Provides its power processor chips and other semi-conductor chipsets to Xiaomi
Foxconn International Holding (FIH/Hon Hai Precision)	Manufacturer/assembler of Xiaomi phones
Sabic	Provides Thermocomp compounds for thinner, more durable walls, and an antenna-integrated frame in Xiaomi devices

Tongda	Provider of Xiaomi smartphone components
AAC Tech	Provides handset antenna for Xiaomi
Inventec Corp.	Manufacturer/assembler of Xiaomi phones
Bank of Beijing (BOB)	Development of mobile payment and settlement business based on near field communication (NFC), sales of money management products, insurance, currency funds and other standardized financial products, and applications for personal loans on mobile devices

Table 5: Partnership with telecom operators

Name of the country	Telecom Operator
Hong Kong	Hutchison Whampoa Ltd.
	PCCW Ltd.
	Three Hong Kong
Singapore	StarHub
	Singapore Telecommunications
Taiwan	Chunghuwa Telecom Co.
	Far Eastone Telecommunications
China	China Mobile
India	Flipkart
Phillipines	Lazada

Table 6: Fund-raising rounds

Round	Amount	Investing companies
Round A	\$41 million	Morning Side, Qiming, and IDG Capital
Round B	\$90 million	Qiming, IDG, Qualcomm, Morning Side, and Temasek
Round C	\$216 million	Government of Singapore Investment Corporation Pte Ltd (GIC), Yuri Milner (A Russian tycoon), and other small investors*

*C round investors have not been disclosed by the company and are as per market speculations

Table 7: Key Investors

Name of the Investor	Details about the Investor
Temasek	A Singaporean government-owned investment vehicle
IDG Capital	A Chinese venture capital fund
Qiming Venture Partners	A venture capital firm investing in young, fast-growing companies across China in the media and

	internet, IT, consumer and retail, healthcare, and clean technology sectors
Qualcomm	A mobile processor developer
Digital Sky Technologies	An international investment firm focused solely on the Internet sector
Government of Singapore Investment Corporation Pte Ltd (GIC)	A Singaporean-based sovereign wealth fund

Table 8: List of investments made by Xiaomi

Name of the entity	Investment Amount	Reason for investment
Cheetah Mobile	Class-A ordinary shares of \$20 million	Superiority and growth potential in the mobile security field
Westhouse, a core game studio at Kingsoft	\$20 million with a 4.71% stake	To develop enhanced gaming capabilities
Shenzhen Thunder Networking	\$200 million	To accelerate cloud service and apply them into its own products like mobile phones, set top boxes, and TVs
Xunlier	\$200 million	To develop video content capabilities

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