

Taking a bite out of Apple

Xiaomi, often described as China's answer to Apple, is actually quite different



It feels more like a rock concert than a press conference as the casually dressed chief executive takes to a darkened stage to unveil his firm's sleek new smartphone to an adoring crowd. Yet this was not the launch of the new iPhone by Apple on September 10th, but of the Mi-3 handset by Xiaomi, a Chinese firm, in Beijing on September 5th. With its emphasis on snazzy design, glitzy launches and the cult-like fervour it inspires in its users, no wonder Xiaomi is often compared to its giant American rival, both by admirers and by critics who call it a copycat. Xiaomi's boss, Lei Jun (pictured), even wears jeans and a black shirt, Steve Jobs-style. Is Xiaomi really China's answer to Apple?

Xiaomi sold 7.2m handsets last year, in China, Hong Kong and Taiwan, earning revenues of 12.6 billion yuan (\$2.1 billion). Apple sold 125m smartphones globally, earning about \$80 billion of its \$157 billion sales. But since it was founded in 2010, Xiaomi has grown fast. A recent funding round valued it at \$10 billion, more than Microsoft just paid for Nokia's handset unit. That made Xiaomi one of the 15 most heavily venture-backed mobile start-ups ever, says Rajeev Chand of Rutberg, an investment bank. In the second quarter of 2013 Xiaomi's market share in China was 5%, says Canalys, a research firm—more than Apple's (4.8%) for the first time.

Yet "we have never compared ourselves to Apple—we are more like Amazon," says Lin Bin, Xiaomi's co-founder, who once worked for the Chinese arms of Microsoft and Google. Apple sells its iPhone 5 for around \$860 in China and has the industry's highest margins. Xiaomi offers its handsets at or near cost: the Mi-3, its new flagship, costs 2,000 yuan (\$330). Xiaomi sells direct to customers online, rather than via network operators or retail stores, which also keeps prices down. Crucially, its business depends on selling services to its users, just as Amazon provides its Kindle readers at low prices and makes its money on the sale of e-books. The idea is to make a profit from customers as they use the handset, rather than from the sale of the hardware, says Mr Lin.

Xiaomi's services revenues were 20m yuan in August, up from 10m yuan in April. It is a classic internet business model: build an audience then monetise it later, as Google and Facebook did, notes Mr Lin. Selling games, custom wallpapers and virtual gifts may not sound very lucrative, but China's internet giants have found a huge market for virtual goods: the biggest, Tencent, sold \$5 billion-worth of them last year.

Another big difference is their openness to user feedback. Apple takes an almost Stalinist approach to its handsets, limiting user customisation in favour of a “we know best” design philosophy. Xiaomi is more guided by its users, releasing a new version of its MIUI software (based on Google’s Android operating system) every week in response to their suggestions. In some cases Xiaomi asks users to vote via weibo, the Chinese equivalent of Twitter, on whether particular features should be included or how they should work—a form of democracy its American rival would never countenance.

Apple’s launch this week of the iPhone 5C, a colourful, slightly cheaper version of the iPhone aimed at consumers in China and other developing countries, marks a shift in its strategy as it faces competition from Xiaomi and many other Chinese firms. Apple’s handsets have sold well in developed countries, but those markets are maturing. Global sales of smartphones are growing by 50% a year, notes Canalys, but by 108% a year in China, which now accounts for over one-third of global sales.

For the first time, Apple held an official launch event in Beijing this week, indicating its growing interest in this market. Yet there was widespread surprise at the high price of the 5C, which will cost \$733 in China, limiting its appeal among less wealthy buyers. A rumoured deal with China Mobile to distribute the iPhone 5C and subsidise its cost has so far failed to materialise. (Apple also unveiled the iPhone 5S, its new high-end smartphone, which features a fingerprint reader for improved security.)

Xiaomi the money

As Apple looks to tap the rapid growth of the Chinese market, Xiaomi is heading the other way. It recently hired Hugo Barra, a Google executive responsible for product development for Android, to develop new products for international markets.

Yet Xiaomi and other Chinese firms sell so many games, apps and add-ons in large part because the Chinese government requires handsets to run a neutered version of the Android operating system, without Google’s app store, mail service, maps and other features. That helps Xiaomi sell its own replacement services, an advantage it will lose once it steps outside China. How scared should Apple be, really, of a rival that has yet to prove that its business model will work at home, let alone abroad?

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