

The Strategic Path Behind the Success of China's Typical Internet Intelligent Terminal Manufacturing Enterprises: A Case Study Based on Xiaomi

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Abstract

Xiaomi has become the world's third largest mobile phone seller in just four years after its establishment has brought us both surprise and reflection. Theoretical and practical studies seem to indicate that traditional theories can no longer explain Xiaomi's success. This article will reveal the strategic management factors behind Xiaomi's success through a multi-level analysis of the enterprise's internal and external environment, strategic positioning, strategic thinking and strategic pattern. These analyses will also provide us with hints of Xiaomi's hidden risks. The study found that Xiaomi seized the opportunity of the Times to quickly capture a large market share through its cost leadership strategy. It has consolidated and expanded its market and achieved corporate growth through a diversification strategy in the last decade or so. The two strategies achieved a natural convergence and co-existence, intertwining to create Xiaomi's success. However, Xiaomi does need to make progress in two areas to avoid incoherent and unsustainable implementation of the strategy. Moreover, it is necessary to ensure quality control and high-cost performance, and create more of its own "unique activities". Further development of its artificial intelligence and independent system might be a good way forward.

Keywords: Xiaomi, positioning logic, cost leadership strategy, lock-in, diversification strategy

1. Introduction

What is strategy? Numerous researchers have given numerous different answers. Based on the views of Porter (1996) and Aldea et al. (2015), I believe that strategy should be connoted by a behavioral model of dynamically finding and creating a unique and advantageous position in the market and then organically organizing an enterprise's resources and activities based on this position. Based on the views of Hambrick and Fredrickson (2001), Porter (2001) and Kitsios and Kamariotou (2019), the outreach of strategy should be an organic combination of four elements: the goal and vision of the enterprise, the field that the enterprise chooses to set foot in, the value proposition and value chain of the enterprise in this field, and the logic of the success of the enterprise in this field. The "goals and visions" mentioned here include both economic and non-economic ones; The "value proposition and value chain" here refers to the value that the company wants to create and the plan of how to organize its internal activities to create such value. The "success logic" here includes the analysis and planning of economic feasibility and the analysis and planning of ethical, legal and psychological factors. In summary, strategy is the macro discipline that guides the success of modern enterprises.

Xiaomi had created a marketing legend and achieved overnight fame, bringing us a lot of surprises and thoughts. With the Internet as a carrier, Xiaomi cell phone realized a peer-to-peer communication mode between the enterprise and users, and achieved a role change from customer relationship to friend relationship. The SWOT model, PEST model and other classical theories are no longer enough to perfectly explain how Xiaomi can produce such cheap and well-received products, and how it can achieve the world's third largest cell phone sales

in just four years after its establishment. Some researchers have suggested that “Studying the methods Xiaomi uses to achieve its value and performance” has become a question worth studying.

Jia (2015) explained the reasons for Xiaomi’s success through the Grounded Theory based on Kambil et al.’s (1996) co-creation theory. The study concluded that the key reason for Xiaomi’s success is “Knowing what products to choose when developing product strategies”; Zhou and Yang (2017) explored the path of Xiaomi’s success based on strategic cost management theory and contingency theory. The study concluded that the key path to Xiaomi’s success lies in deepening innovation in value chain management and achieving precise cost control; Lu (2021) combines strategic environment analysis and financial analysis based on Jensen and Meckling’s (1976) principal-agent theory, Arrow and Hurwicz’s (1960) incentive compatibility theory and Myers and Majluf’s (1984) pecking order theory to analyze the advantages and risks that exist in Xiaomi. The studies concluded that the cost leadership strategy and diversification strategy provided Xiaomi with competitive advantages, but the variable interest entity (VIE) structure laid hidden dangers for Xiaomi. These studies suggest that the introduction of a strategic management analysis framework can be helpful in explaining Xiaomi’s success.

The article will reveal the strategic management factors behind Xiaomi’s success through a multi-level analysis of the enterprise’s competitive environment, strategic positioning, strategic thinking and strategic model. These analyses will also suggest us the hidden risks of the enterprise. At present, although most people are aware that Xiaomi’s success cannot be achieved without strategic management factors, few scholars have really analyzed Xiaomi’s success based on a professional and in-depth strategic perspective. This article tries to make some contributions in this regard.

2. Background and Environment

In order to do a better analysis, it is necessary for us to first understand the strategic environment in which Xiaomi is located. We will use the Five-force Model to help analyze the industrial structure and the competitive situation where Xiaomi is located.

2.1 Potential of New Entrants: Weak

Although Xiaomi’s strategy is somewhat imitable, it is almost inimitable for new entrants. First, in the cell phone and other smart home device industries, economies of scale are quite difficult to achieve. Consumers have developed trust in specific brands over the years, making it difficult for new entrants to achieve scale in production. Second, even if a new entrant wants to break the established pattern, it needs to have a high level of capital for R&D and marketing efforts. Third, policies within these industries require companies to meet strict licensing and legal requirements. The legal cost of compliance in a range of licensing areas is also high. As a result, the potential of new entrants is weak.

2.2 Power of Suppliers: Medium

With the exception of smartphone processors, Xiaomi is in an industry with a large number of suppliers that offer fairly standardized products, which means lower switching costs, so buyers like Xiaomi can easily switch to alternatives. In addition, the profitability of the industry is closely tied to the profitability of suppliers, who are forced to offer reasonable pricing to ensure the industry’s continued growth. As a result, suppliers have less control over prices. Even in smartphone processors, there are only two major suppliers, Qualcomm Snapdragon (US) and Media Tek (Taiwan, China). They are also reluctant to lose a major customer like Xiaomi, which is one of the top five in the world in terms of sales. However, if influenced by political factors, such as Snapdragon stopping supplying to any of the vendors as they did with Huawei, the result would be fatal, at which point Media Tek’s bargaining power would jump to a very high level. Combined with the probability of this happening, we consider the bargaining power of suppliers to be medium.

2.3 Power of Customers: Medium

Most of Xiaomi’s buyers have limited financial ability and are very price sensitive. Xiaomi is the best product that happens to fit their earnings. Although this situation has changed slightly recently, with Motorola, Vivo’s iQOO and Realme (Zhenwo, a new brand) all starting to launch cost-effective products, buyers still have few choices. In addition, product differentiation in the cell phone sector is high, and when buyers are familiar with one system, it is difficult to find alternatives that match their operating habits, i.e., buyers have a certain degree of switching costs. Many people have difficulty or are unwilling to switch from Apple to Android is also for this reason. As the ecological chain builds, the switching costs for consumers who own each enterprise’s smart home will rise sharply, and they will still want that enterprise’s product even if its price increases. On balance, the bargaining power of buyers is medium.

2.4 Threat of Substitute Products: Weak

Xiaomi is in an industry where there are few alternatives outside the industry, whether it is cell phones, smart

homes or wearable smart devices. There are only a few substitutes within the industry. But as mentioned above, for now, even intra-industry substitution is a weak threat to Xiaomi.

2.5 Competition Among Existing Companies: Strong

The competition within the industry where Xiaomi is located has become ultra-competitive and is full of Games at all times. First, there are few existing companies due to the high barriers to entry. The only competitors in the first tier are Apple, Huawei, Xiaomi, BBK (with its OPPO and VIVO), Samsung, and OnePlus. Each enterprise's actions are almost transparent and quickly detected by the others and responded to accordingly. Second, there is no absolute market leader, each enterprise's market share is distributed in a gradient, but the gap is not large, and each enterprise hopes to become the market leader. Third, from the perspective of the life cycle, the cell phone industry will continue to grow, far from maturity. With the iterative upgrading of processors, screen forms and interaction methods, cell phones as a carrier have unlimited possibilities in the future. Therefore, every enterprise is pursuing to become a front runner, such as the launch of full-screen phones, flexible screen phones, gaming phones, etc. Fourth, user needs, such as color-saturated screens, fast charging protocols, high-performance processors, interactive and friendly systems, beautiful bodies, etc., are becoming homogenized, and all manufacturers are trying their best to meet these requirements. And whoever can achieve better differentiation on this basis is likely to gain an advantage, which further strengthens competition. Fifth, the production of products within this industry requires a large amount of capacity. However, once there is an imbalance between supply and demand and a market is taken away, this often leads to overproduction. When this happens, companies must cut prices to ensure the sale of their products, which again strengthens the competitive interaction.

These analyses are helpful for us to understand Xiaomi and can also provide us with some preliminary conclusions. Xiaomi should try to find some "unique" activities to support its strategy like "fan economy". Traditional cost leadership strategies may be gradually imitated, but Xiaomi's long-standing relationships with users and brand loyalty will not. Under the effect of this "fan economy", even if the absolute price advantage is lost, the sales of the product will not decline too much, that is, the elasticity of consumer demand is reduced. In addition, Xiaomi should strive to change its image, pay more attention to the quality of its products, attract new consumers through more investment and research and development, and then consolidate these consumers through its ecological chain. And indeed in about 2017 onwards, Xiaomi did that.

3. Positioning Logic and Cost Leadership Strategy

In 2008, Professors Bingham and Eisenhardt published an article that attempted to explain some of the rationales for the success of growth strategies (Bingham and Eisenhardt, 2008). They categorized these strategic logics practiced by companies into three types: positioning logic (to form competitive advantage through activity combination), leverage logic (to form advantage through the use of key resources and core competencies), and opportunity logic (to form advantage through rapid market action and strategic innovation). Among them, the basic idea of positioning logic is to target a unique market position and effectively occupy it with a system of value-based activities, where the competitive advantage comes from the system of value-based activities and an effective combination of activities, technologies and other factors. On the basis of this logic, the task of strategy is to create a mutually reinforcing and closely linked system of value activities, to continuously improve activities and the coordination between them, and to optimize the whole system.

I believe that Xiaomi's success is based on the positioning logic, and on this basis, it has chosen a cost leadership strategy, which means seeking the enterprise cost situation in the industry-wide leadership, mainly to reduce the total cost of the product so that it is lower than the total cost of competitors' products. The strategic logic of cost leadership strategy requires, first, that the firm be the only cost leader in the industry, not just one of a number of leading firms; and second, that the firm has a significant cost advantage over its competitors, which is competitive enough to convince even competitors not to adopt a similar strategic approach (Wang and Liu, 2013). Cost leadership strategy also focuses on the efficiency of the value chain and argues that the entire value chain should be improved at a macro level or the efficiency of each value activity should be improved in order to control the cost behavior of the value activity.

At the very beginning of its creation, Xiaomi successfully innovated in value chain management. In the sales chain, it seized the opportunity of the booming Internet and e-commerce platforms by not setting up a single physical store and selling the phone entirely with the help of the Tmall platform, which not only expanded the sales scope but also reduced the cost. But the absence of physical stores does not mean that it does not pay attention to sales. Xiaomi sold out the mi1 on the day of its launch through online forums promotion and hunger marketing. In the design and R&D process, it absorbed design inspiration and product innovation points through online forums and enthusiast interaction, thus realizing social co-creation and lowering cost. In the production process, it outsourced all production lines to ENVADA (Nanjing), Foxconn (Hebei) and Wingtech (Jiaxing). In the logistics process, it has partnered with Shunfeng Express and EMS. In the product value chain, Xiaomi has outsourced almost everything except design and R&D. The whole enterprise exists in the form of a virtual

organization, which truly realizes light assets and low cost. Such cost leadership is the real effective cost leadership, which does not sacrifice product quality, but saves costs through the improvement of each link in the value chain. This ensures profits. So it can instead choose better hardware configuration and set strict quality standards. Before Xiaomi, other companies basically relied on the sacrifice of hardware quality to lower cost, which was often criticized.

Some other activities have helped Xiaomi to consolidate its leading position, including accurate analysis of cost drivers, cost control and accurate target market positioning for rapid market capture. Zhou and Yang (2017) pointed out that in terms of implementation cost drivers, Xiaomi reduced its cost by switching from specialized parts to common parts. Through the full operation of materials in procurement, production, sales and logistics, we achieve zero inventory and reduce inventory costs. In addition, Xiaomi had precise insight into business opportunities at the beginning of its establishment. From the release of iPhone in 2007, the smartphone trend swept the world, but the high price discouraged many consumers. Many Chinese domestic competitors such as Huawei, Coolpad and BBK (mainly its subsidiaries OPPO and VIVO) wanted to emulate Apple's path, but Xiaomi chose to avoid the strong. It knew it had limited resources and that cost leadership would suit not only its resource endowment, but also its target market.

In 2011, when mi1 quickly took over the market with its high-cost performance, Xiaomi's digital series had almost no rival for a long time. It wasn't until 2020 that phones such as Motorola, iQOO and realme started to hit its leading position. The ability to achieve light asset, efficient value chain may be the advantage of startups, for they don't have to pay to dismantle old equipment and Reorganize old organizations, and Xiaomi as a startup successfully grasped this advantage, and through years of operation to achieve economies of scale to expand this advantage, resulting in the current startups want to catch up is also quite difficult. Xiaomi's positioning logic and cost leadership strategy have helped it achieve success. However, its value chain has changed over the past decade or so, and these changes may have created some contradictions with its strategy. For example, Xiaomi has begun to build up its own factories, open offline stores on a large scale, and seek cooperation with more differentiated hardware manufacturers. We should not forget that one of the major flaws of the positioning logic is that "because of the rigidity of the system due to the close alignment of resources and activities, minor adjustments to the value activity system can lead to functional failures and declining returns (Wang and Liu, 2013)". We will explore these issues in the concluding chapter.

4. Locking Strategy and Diversification Strategy

At the beginning of the 21st century, Shapiro and Varian proposed a generic strategy for information technology-based new economy industries: system lock-in. They put forward that lock-in occurs when an enterprise creates high switching costs for its customers (Shapiro & Varian, 1998). Lock-in strategies that sellers can generally adopt include accurately recognizing the customer base, calculating customer value, adding specific improvements to the system to extend the lock-in cycle, making customers increasingly dependent on the firm, and maximizing the value of the customer base by selling complementary products to loyal customers and selling access to your customer base to other suppliers.

One of the important points of the diversification strategy is also to increase the switching cost of customers and enhance lock-in. Both have commonalities in concept and implementation. What calls for special attention is that diversification is not a product segmentation but must be a cross-industry behavior, an industrial combination strategy in which companies seek to grow among different industries as a business and growth behavior (Wang & Liu, 2013). Diversification strategy will help bring scale economies effect, transaction internalization effect, operating risk diversification effect and expand market influence, but it also faces negative effects from excessive management span and fragmentation of resources and goals.

Xiaomi is gradually building up its ecological chain through strategic investments. The ecological chain is the core action of its diversification strategy. On the one hand, Xiaomi started to clearly position itself as an Internet enterprise, seeing its buyers as users and its phones as a gateway to an ecosystem of content around 2016. It has entered into partnerships with hundreds of hardware and software companies that are connected to Xiaomi's platform and support the sale of its core business, smartphones, with complementary goods and services. Xiaomi, on the other hand, invests in these partner companies, giving them access to a wide range of resources - capital, designers, marketers, supply chain relationships and more - in exchange for minority stakes and the right to co-develop, brand and sell products. Xiaomi's approach differs from traditional investment approaches in that Xiaomi is looking to take only 20-30% equity in its venture capital investments, demonstrating its commitment to supporting new companies while still incentivizing them to innovate on their own and create value for themselves and the ecosystem as a whole. This is also different from traditional ecosystem systems, where Xiaomi takes a proactive, hands-on approach to supporting its partner companies. While companies like Apple or Google also provide tools such as operating systems and platforms to their partners, Xiaomi requires these companies to actively enforce consistent branding and quality standards (Tong, Guo & Chen, 2021). While

traditional corporate venture capitalists either focus solely on financial returns and select companies with long-term growth value, or focus solely on ecosystem replenishment and do so at any cost, Xiaomi's hybrid model truly balances both goals, benefiting both investors and investees.

Xiaomi's process of pursuing its diversification strategy has been very solid. Xiaomi first started to enter markets immediately adjacent to its core smartphone business, including powerbanks, headphones, smart watches, and smart bracelets, starting in about 2016. Once it established the first level of complementary products, it began integrating other IoT-connected consumer electronics and household appliances, such as scooters, rice cookers, air purifiers, and electric vacuum cleaners (Tong, Guo & Chen, 2021). After achieving the rollout of small household appliances, it focuses on large household appliances, including refrigerators, TVs, washing machines, sweeping robots, etc. Finally, throughout the process, it continues to launch lifestyle products such as backpacks, home furnishings, and running shoes, which may seem far removed from its core products, but in fact this step fills in the gaps in its ecological chain and makes "Xiaomi" a lifestyle attitude that is closely related to every of its life.

Today, Xiaomi's ecosystem has expanded into various fields such as home, daily use, kitchen, home appliances, audio and video, gaming, apparel, culture and creativity, health, and infants, and has brought good results. Xiaomi has not given up cost leadership while pursuing its diversification strategy, and it still aims to provide customers with cost-effective products. The benefit of this approach is that on one hand, locked-in users voluntarily continue to buy products from the ecosystem, increasing their "locked-in" level. On the other hand, customers outside the ecosystem are more than happy to try Xiaomi's products and are likely to be locked in if they try any of them. Some researchers have also taken note of this, and have used value chain analysis to describe Xiaomi's approach to achieving cost leadership after implementing a diversification strategy. This includes carefully selecting suppliers, establishing an evaluation system, and auditing suppliers in terms of production capacity, delivery price, business background, and product price. If the original supplier fails in the evaluation, a new replacement supplier is immediately selected to ensure daily operations (Lu, 2021); and in marketing it conducts its own promotion through social networks such as WeChat and Sina Weibo, which roughly reduces its marketing expenses by about 5% (Panigrahi, 2019).

However, the diversification strategy also faces the negative effects of excessive management span and fragmentation of resources and goals (Wang & Liu, 2013). Xiaomi's strategic investment approach has solved the problem of excessive management span, but critics argue that it has begun to lead to resource fragmentation and can cause Xiaomi to "forget its main business", deviate from its strategic positioning, and lead to confusion in strategy formulation and implementation. For example, Xiaomi is using a differentiation strategy in some of the industries to win a competition in its diversification strategy, while still maintaining a cost leadership strategy in others. We will explore these issues in the concluding chapter.

5. Conclusion and Outlook

Xiaomi seized the opportunity of its time and quickly captured a huge target market of young consumers seeking good value for money through its cost leadership strategy, and consolidated and expanded its market and achieved corporate growth through its diversification strategy in the last decade or so. The analysis in the article shows that the development and implementation of both strategies were the cornerstone of its success. The two have achieved a natural convergence and co-existence, interweaving Xiaomi's bright future, making Xiaomi a model for many companies who want to open up a blue ocean, expand and finally consolidate their own market share.

But skeptics point out that Xiaomi's strategy over the past five years has been fraught with inconsistencies. Xiaomi (smartphones) are gradually moving upmarket, with its new mi 12Ultra, released in July 2022, priced of 5,999 yuan, which is almost at the same price point as the iPhone and Huawei. Xiaomi's digital series of the most affordable Xiaomi 12X is priced of 2,699 yuan. Its price performance is far less than Motorola's moto S pro (1,749 yuan) or realme GT Neo2 (2,199 yuan). In addition, unlike Apple with its bionic processor and IOS operating system, and Huawei with its communication technology and Harmony operating system, Xiaomi may lack a key "unique activity" to support its strategy.

However, I believe that these problems are insignificant. First of all, Xiaomi's current strategy is coordinated, not under the cost leadership strategy, but under the diversification strategy. Under the diversification strategy, there is nothing wrong to adopt the cost leadership strategy for some industries and the differentiation strategy for some industries. In this day and age, where companies face hyper-competition, the assumption underlying the cost leadership strategy - a stable competitive environment - is inherently impossible to achieve, and therefore, it is not sustainable. But a diversification strategy is sustainable. If a family chooses Xiaomi's "Whole house intelligent customized solution" when decorating, it is almost difficult for them to leave Xiaomi again. Xiaomi knows exactly what it is doing.

However, Xiaomi does need to improve in two areas. One is to strengthen quality control and strengthen customer service. Xiaomi is launching high-end products. It is also forgetting that its biggest target market is still those consumers who seek cost-effective products. If Xiaomi's smartphone is 200-300 yuan more expensive than its business competitors, maybe its customers can still accept it, but when this price exceeds their conversion cost (some of its customers may only buy its wearables such as smart watches and bracelets), replacing a cheaper smartphone and then replacing the wearable device at the same time is a more rational choice. The cell phone business is the core of the Xiaomi brand, and Xiaomi can never give up on this segment of consumers. Failure of quality control is also a huge potential for market loss. In 2021, Xiaomi did not provide a good solution in time when mi11's wifi function failed due to its defective chip soldering on a grand scale. That has led many of its customers to be totally disappointed with Xiaomi and decide to switch brands forever. On the other hand, Xiaomi must find its own set of "unique activities". Diversification and providing customers with cost-effective products are indeed unique activities, but Xiaomi needs more. Perhaps combining its AI Small love (Xiaoaixue) with its system MIUI (based on Android) would be a good way out. Xiaomi's AI and system are highly acclaimed by its fans. But they have so far stayed within the console of its smartphone and IoT system. Xiaomi can invest more in its AI and improve its algorithms, such as working to reach the level of DPT-3 Davincci so that its AI can actually be used to solve some real-world problems and create value. It may be easier for Xiaomi to succeed in AI as an Internet enterprise compared to other fields. At the same time, Xiaomi can work to build MIUI into a standalone system like Harmony, to be carried on its own TVs and other IoT devices, and even in the future, to carry both its system and AI on its own cars, rather than just doing the assembly work again. In short, Xiaomi is not as good as Huawei in terms of AI and systems, but it has an advantage over other competitors in the same industry. It is expected to become the unique activity for Xiaomi's diversification strategy. Incidentally, Xiaomi is rumored to have installed its own Pinecone processor in its mi 12Ultra to boost its photography and gaming performance. And mi 12Ultra has truly provided consumers with an extraordinary experience, which can be seen as a successful step for Xiaomi. Processor is a key technology for smart device manufacturers, and while most enterprises can only rely on external suppliers, if Xiaomi can achieve independent design and even manufacturing, it will certainly consolidate its strategic orientation.

There may be many reasons for Xiaomi's success, but the strategy is the best way to provide a systematic interpretation. Whether it's cost leadership or diversification, Xiaomi has been at the forefront and has achieved remarkable success through deep insight and smartly implemented strategies. This model of occupation - expansion - consolidation - promotion is worth learning for all smart devices and Internet enterprises.

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