

# How Apple lost China to two unknown local smartphone makers

BLOOMBERG

TWO years ago, Oppo and Vivo couldn't crack the top five in China's smartphone market. Now they outrank everyone after elbowing Apple aside, thanks to people like Cheng Xiaoning.

Cheng runs a thriving electronics store in the rural town of Miaoxia, tapping into her WeChat social media account to promote the brands that pay the biggest commission, and in her case that's Oppo and Vivo. While such payments start at about 40 yuan (\$6), they escalate for more expensive handsets and reach almost 200 yuan for Oppo's high-end smartphones.

"That's why I like to introduce the Oppo R9 Plus to potential customers," she said. "Business has been perfect, actually never been better."

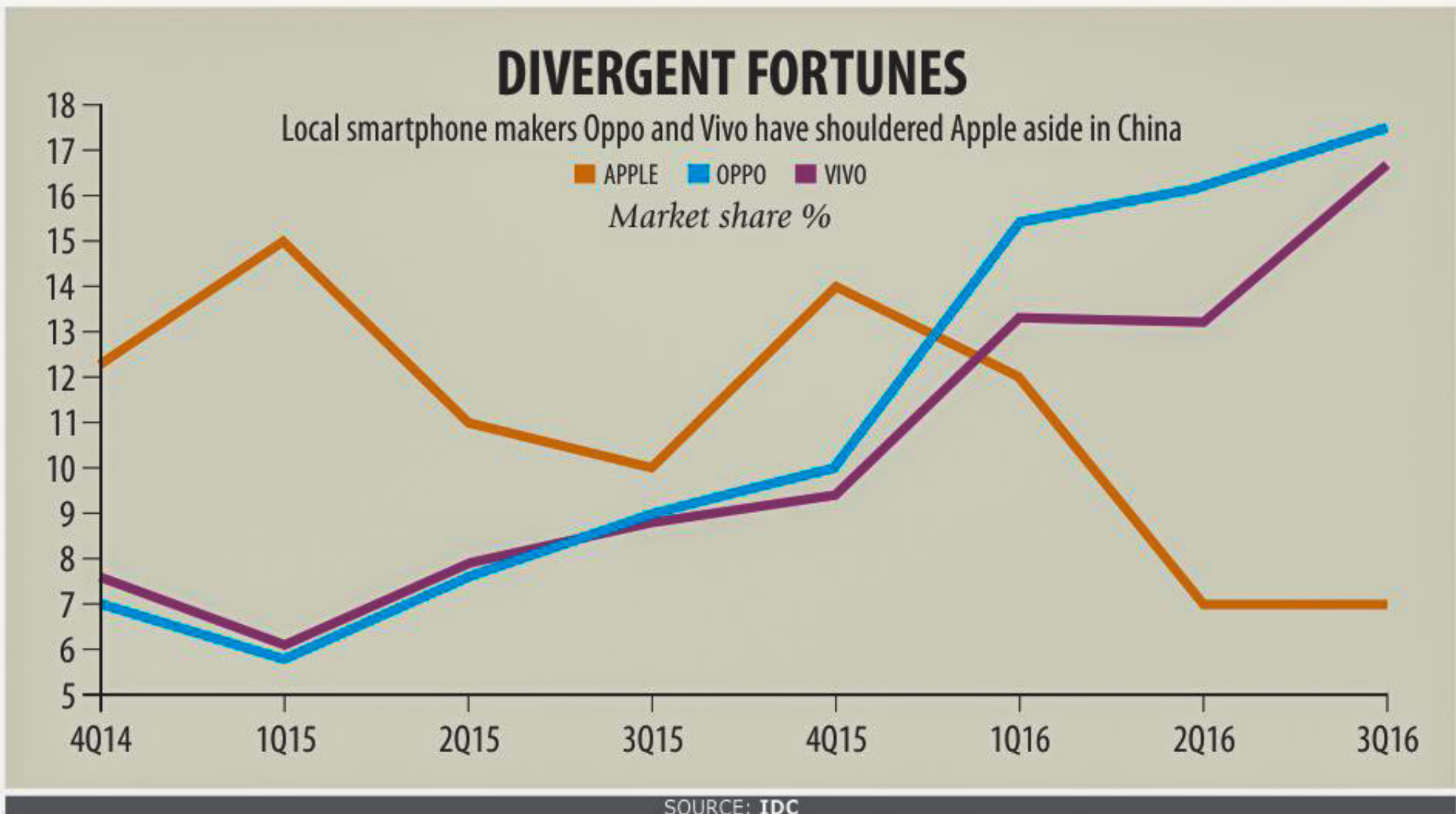
Cheng and tens of thousands of like-minded boosters form the vanguard of the pair's charge against Apple Inc. and Samsung Electronics Co. Working with the local stores that dominate sales in China's far-flung provinces, Oppo and Vivo came out of nowhere to upend the industry order and squeeze out former local darling Xiaomi Corp. Their labels graced one out of every three smartphones sold within China in the third quarter, while the iPhone's market share at 7 percent stood at its lowest in almost three years.

Oppo and Vivo trace their origins to reclusive billionaire Duan Yong Ping and employ similar strategies. That includes harnessing the spending power of rural customers away from top-tier cities such as Beijing and Shanghai. It's where Apple's vulnerable given the iPhone's lofty price tag. They eschewed e-commerce to instead court the stores where three-quarters of smartphone sales take place. Apple has been more reluctant to relinquish the retail experience to local free-agents, who sometimes charge brands for in-store displays and posters.

"Oppo and Vivo are willing to share their profit with local sales. The reward was an extremely active and loyal nationwide sales network," said Jin Di, an IDC analyst based in Beijing. While they declined to detail their subsidy program, she estimates the two were the top spenders in the past year. "They're doing something different -- they do local marketing."

China had for years driven Apple's and Samsung's growth. The U.S. company generated almost \$59 billion of sales from the region in fiscal 2015, which was more than double the level just two years earlier. During that time its shares surged more than 60 percent. At its peak, Greater China yielded almost 30 percent of its revenue and Apple was neck-and-neck with Xiaomi for the mantle of market leader as users clamored for the larger iPhone 6 models. Even as the domestic economy began to sputter, Chief Executive Officer Tim Cook spent a good chunk of an earnings call last year talking up the country's promise, saying Apple's investing there "for the decades ahead."

Then the country's slowdown and regulatory tangles



took their toll. Authorities intervened, blocking iTunes Movies and eBooks, ending a period of near-unimpeded growth in the country. But perhaps most crucial was the ascendancy of cheaper but just-as-good local alternatives. Oppo and Vivo's gains have come mainly at the expense of lower-tier names thus far, but if they climb further into the premium segment, the U.S. company will need an answer. Some think the 10th-anniversary iPhone due in 2017 could deliver.

"Apple needs to offer something cutting-edge to appeal to maturing Chinese smartphone users," Counterpoint Research director Neil Shah writes. Oppo and Vivo can use the time until then to cement their positions, he said.

Together Oppo and Vivo shipped about 40 million smartphones in the third quarter, about 34 percent of devices sold in the world's biggest market, according to IDC. In 2012, their combined share was about 2.5 percent. iPhone shipments plunged more than a third to 8.2 million during the period -- less than half of Vivo's. Samsung, which once led the market, now settles for roughly 5 percent, according to Counterpoint.

As Apple has faltered in China, Cook has stepped up his courtship of decision-makers. He visited the country several times this year, unveiled plans for research centers in Beijing and Shenzhen, and invested \$1 billion in Uber rival Didi Chuxing. Cook said on his last earnings call he remains confident of a return to growth this quarter.

Samsung declined to comment for this story, while Apple directed Bloomberg to Cook's previous remarks

on China.

It's unclear how Apple can reclaim lost ground in the interim. Previous attempts to drift down-market -- with the iPhone 5c and SE, for instance -- fizzled as local users shunned seemingly inferior devices. Apple doesn't run a vibrant online social community for users the way some of its local rivals do. And competing on price will jeopardize the industry's fattest profit margins.

Oppo and Vivo pack high-end specs into a phone that sells for a fraction of its rival's in China, where iPhone 7s start at 5,388 (\$784). Consider the Oppo R9 plus: for 2,999 yuan, buyers get an aluminum body, 6-inch display, 16-megapixel camera and a battery that claims 19 hours of calls, photo and web browsing. Vivo's high-end Xplay6, with a price tag of 4,498 yuan, also undercuts Apple.

"Both companies invested heavily in marketing," said Nicole Peng, Asia Pacific research director at consultancy Canalsys. Oppo and Vivo have a strong grip on the middle market for phones from \$200 to \$500, she said. "Their offline channel strategy paid off."

The man who's clobbering Apple started out low on the tech spectrum. Duan made his fortune selling DVD players, telephones and game consoles similar to Nintendo's. Bubugao Communication Equipment Co. Ltd., the parent of Vivo, emerged from a restructuring in 1999 that split his company. The billionaire later teamed with long-time colleague Tony Chen and others to found what came to be known as Guangdong Oppo Electronics Co.

## Modi says won't hesitate on tough decisions to help economy



REUTERS

India will not hesitate to make tough decisions to help support its growing economy, Prime Minister Narendra Modi said on Saturday, alluding to his recent scrapping of 500 and 1,000 rupee banknotes to tackle endemic corruption.

Modi told an event organised by the Securities and Exchange Board of India (SEBI), India's capital markets regulator that his government would continue to follow sound and prudent economic policies to ensure that India's long-term prospects are bright.

"We will not take decisions for short-term political point scoring... We will not shy away from taking difficult decisions if those decisions are in the interests of the country," Modi said.

"Demonetisation is an example. It is a short-term pain but it will bring long-term gain."

Modi announced the shock move to ditch 500 and 1,000 rupee notes with a combined value of \$256 billion on Nov. 8, saying the large denomination notes fuelled corruption and fraud and were even used to finance attacks by militants who target India.

With the cash economy estimated to account for a fifth of India's \$2 trillion gross domestic product, the decision has disrupted the daily lives of hundreds of millions of Indians.

But economists and some businesses say it could ultimately help broaden the formal economy and improve tax compliance.

Modi said the government had transformed the economy in less than three years by cutting and achieving fiscal deficit targets, keeping the current account deficit low, boosting foreign exchange reserves and lowering inflation.

"Developed countries and emerging markets are both facing slow growth. Against this background, India is being seen as a bright spot. Growth is projected to remain among the highest in the world," he said.

## China fines GM unit \$29m for 'price-fixing'

AFP, Beijing

Beijing has fined the Chinese unit of General Motors nearly \$29 million for "infringing on the rights of consumers and its competitors" via price-fixing, Shanghai authorities said.

SAIC-GM -- a joint venture between the American company and the state-owned SAIC Motor Corporation, China's biggest automaker by production volume -- has been ordered to cough up 201 million yuan (\$28.9 million), approximately four percent of its mainland sales last year, Shanghai's top development and economic reform body said on their website in a Friday statement.

"The fine is fair. We just aim to improve market order," the state-owned China Daily newspaper cited Xu Xinyu, the official in charge of the GM investigation, as saying.

"SAIC-GM will respect the views of the National Development and Reform Commission," a spokesperson from the company said Friday, according to Chinese website Today's Economic News.

It is the second time in weeks China has slapped a multi-million dollar fine on a US company for alleged monopolistic pricing behaviour, the paper added.

Earlier this month, the country's top economic regulator issued a 119 million yuan (\$17.1 million) fine to Medtronic, an American supplier of high-end medical devices.

As of Friday, China has issued 2.25 billion yuan in fines to automakers since 2014, according to the China Daily.

# How India lobbied Moody's for ratings upgrade, but failed

REUTERS, New Delhi

INDIA criticised Moody's ratings methods and pushed aggressively for an upgrade, documents reviewed by Reuters show, but the US-based agency declined to budge citing concerns over the country's debt levels and fragile banks.

Winning a better credit rating on India's sovereign debt would have been a much-needed endorsement of Prime Minister Narendra Modi's economic stewardship, helping to attract foreign investment and accelerate growth.

Since storming to power in 2014, Modi has unveiled measures to boost investment, cool inflation and narrow the fiscal and current account deficits, but his policies have not been rewarded with a ratings upgrade from any of the "big three" global ratings agencies, who say more is needed.

Previously unpublished correspondence between India's finance ministry and Moody's shows New Delhi failed to assuage the ratings agency's concerns about the cost of its debt burden and a banking sector weighed down by \$136 billion in bad loans.

In letters and emails written in October, the finance ministry questioned Moody's methodology, saying it was not accounting for a steady decline in the India's debt burden in recent years. It said the agency ignored countries' levels of development when assessing their fiscal strength.

Rejecting those arguments, Moody's said India's debt situation was not as rosy as the government maintained and its banks were a cause for concern, the correspondence seen by Reuters showed.

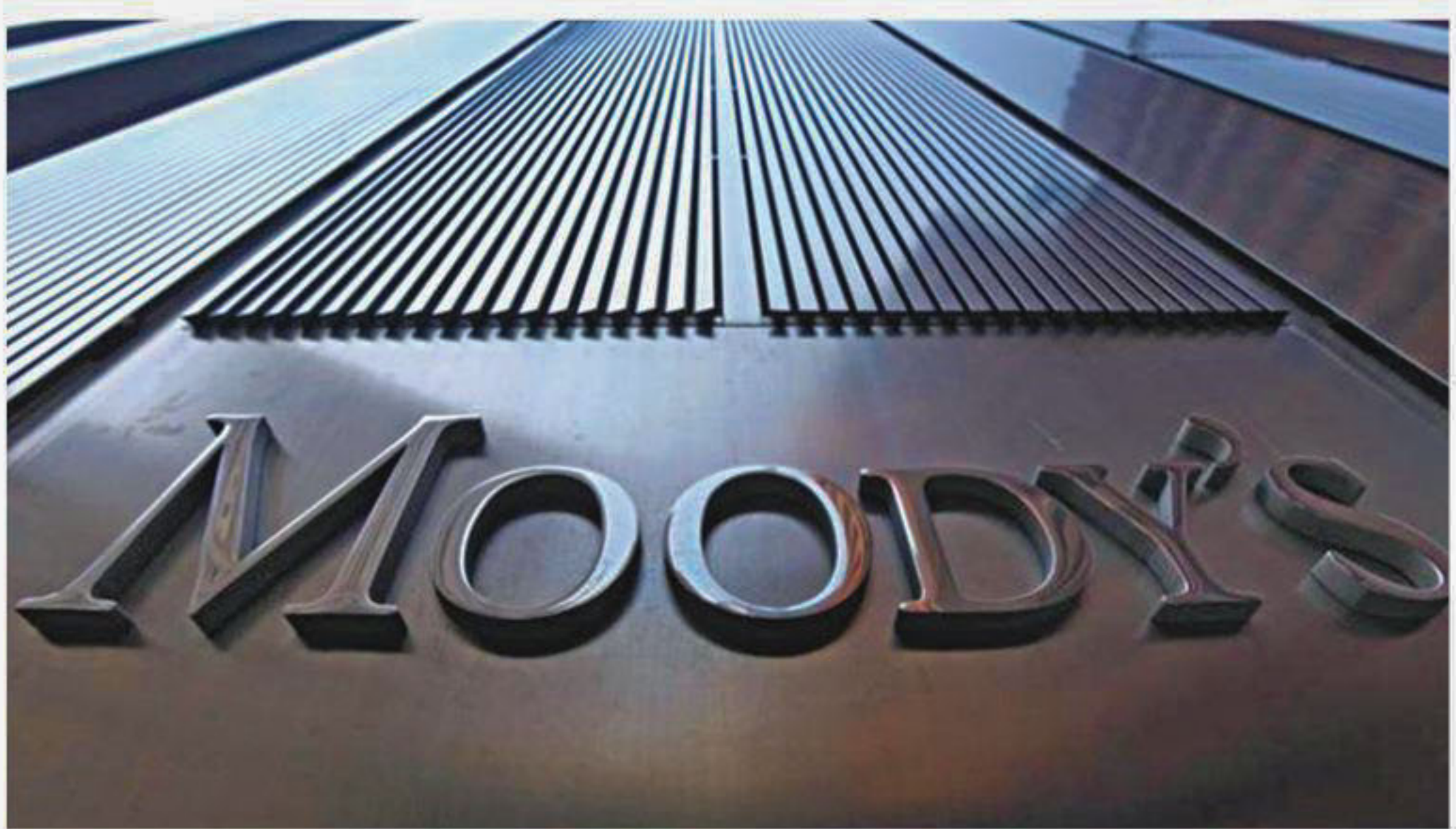
Moody's and one of its lead sovereign analysts, Marie Diron, declined to comment on the correspondence, saying ratings deliberations were confidential. India's finance ministry did not respond to requests for comment.

Arvind Mayaram, a former chief finance ministry official, called the government's approach "completely unusual".

"There was no way pressure could be put on rating agencies," Mayaram told Reuters. "It's not done."

India has been the world's fastest growing major economy over the past two years, but that rapid expansion has done little to broaden the government's revenue base.

At nearly 21 percent of gross domestic product (GDP), India's revenues are lower than the 27.1 percent median for Baa-rated countries. India is



rated at Baa3 by Moody's, the agency's lowest notch for debt considered investment grade.

A higher rating would signify to bond investors that India was more creditworthy and help to lower its borrowing costs.

While India's debt-to-GDP ratio has dropped to 66.7 percent from 79.5 percent in 2004-05, interest payments absorb more than a fifth of government revenues.

Moody's representatives, including Diron, visited North Block, the colonial sandstone building in the Indian capital that houses the finance ministry, on Sept. 21 for a discussion on a ratings review.

The atmosphere at the meeting with Economic Affairs Secretary Shaktikanta Das, one of the ministry's most senior officials, and his team was tense, according to an Indian official present, after Diron had told local media the previous day that a ratings upgrade for India was some years away.

On Sept 30, Moody's explained its methodology to Indian officials in a teleconference.

Four days later, the finance ministry sent an email to Diron questioning Moody's metrics on fiscal strength. The government cited the examples of Japan and Portugal, which enjoy better ratings despite debts around twice the size of their economies.

"Given that countries are on different stages of economic and social development, should countries be benchmarked against a median or mean number (as is done by Moody's)" the email asked.

In India's case, "while the debt burden

While Duan has kept a low profile since moving to the U.S. in 2001, he occasionally makes his way into the spotlight. In 2006, he bid a then-record \$620,100 to have lunch with Warren Buffett. Oppo's first smartphone came in 2011, when it unveiled a device with a BlackBerry-like keyboard. The same year, Bubugao created the business, that would become Vivo.

Today, Vivo touts its cameras and Oppo focuses on rapid-charging and battery life. But their offline strategies remain the same: mobilizing tens of thousands of private shop owners. Oppo said it sells its products through roughly 240,000 privately owned stores as of June -- six times the global count of McDonald's. Vivo manages about half that, said Jin. Oppo, which doesn't disclose sales figures, said about 90 percent of its phones were sold offline.

While Xiaomi shot to international prominence with flash online promotions, that success has been concentrated in densely packed cities. That doesn't work so well in the countryside, where novice buyers want advice and demonstrations. By cultivating a physical network, Oppo and Vivo are building a platform difficult to replicate in the short run.

Apple, in contrast, has fewer than 40 stores across the mainland, most of which are in large cities. Cook has said its iPhones are also sold through about 40,000 locations, though that includes stores controlled by wireless carriers and spots within nationwide electronics chains. While its retail network is lauded for helping weave an aura of exclusivity and chic around its higher-priced gadgets, Chinese consumers -- particularly in smaller, poorer cities -- value access to someone local who can work out kinks. That sort of after-sales support is in itself a powerful marketing tool, IDC's Jin said.

For now, neither Oppo nor Vivo appear overly concerned with the world's most valuable company. Their executives say they'll stick to their winning strategies, while exploring ways to keep pushing the smartphone envelope.

"We have to keep our minds clear in the fast-changing market," said Allen Wu, Oppo's vice-president in charge of sales. "All we need to do is to keep our heads down and make the correct moves."

To Vivo, that means targeting younger users with higher-performance devices. "Camera and music will be our key focuses in the future. We are seeing greater customer expectations out of these two areas," company vice-president Ni Xudong said.

That message resonates with the likes of Chen Siyu, an accountant who uses her Vivo phone at least four hours a day to chat with friends, watch videos and apply for jobs.

"I chose Vivo because of its design and photographing capability," said the 26-year-old who lives in the town of Pu'tian in Fujian. "It is not expensive and doesn't slow down after longtime use like many Android phones do."

lowered significantly post 2004, this did not get reflected in the ratings", the ministry argued. New Delhi urged Diron to look at improvements in the factors - better forex reserves and economic growth - that Moody's had considered when handing India its last ratings upgrade in 2004.

In a reply the next day, Diron said that, not only was India's debt burden high relative to other countries with the same credit rating, but its debt affordability was also low.

She added that a resolution to the banking sector's bad loan problems was "unlikely" in the near-term.

In a last-ditch effort on Oct. 27, Economic Affairs Secretary Das sent a six-page letter to Singapore-based Diron, addressed to Moody's New York headquarters.

Reiterating points on India's fiscal strength, Das asked Moody's for a "better appreciation of the factual position".

Das dismissed Moody's concerns on India's public finances as "unwarranted" and told the agency that there was "scope for further lowering" the political risk perception to "very low".

"In the light of stable external debt parameters and the slew of reforms introduced in the realm of foreign direct investment, you may like to reconsider your assessment on 'external vulnerability risk'," he wrote.

Moody's on Nov. 16 affirmed its Baa3 issuer rating for India, while maintaining a positive outlook, saying the government's efforts had not yet achieved conditions that would support an upgrade.