

A BASIC OVERVIEW OF CHINA'S RESIDENTIAL WATER TREATMENT SECTOR

- **100+** Chinese and foreign residential water treatment companies interviewed
- **104** Consumers surveyed in Shanghai

Linked with insights from key industry-experts

Understand Chinese consumers' purchasing behavior, how you can compete with domestic and foreign competitors, and what you need to succeed in the Chinese market.

WHAT YOU WILL LEARN



Chinese consumer's awareness of water pollution



Consumer demand for residential water treatment



Comparison of Chinese and foreign RWT* companies



How foreign RWT companies are competing in China



The future RWT market outlook

*RWT: Residential Water Treatment

KEY TAKEAWAYS

- The Chinese residential water treatment (**RWT**) market is at its tipping point and is following a similar trajectory as the air-pollution market.
- However, Chinese consumers, even those that are highly educated, still have a relatively low awareness and education level on water pollution in China.
- Because of the unfamiliarity with RWT products, Chinese consumers prefer to purchase products in specialty retail-stores and require tangible proof that RWT systems work as advertised.
- Chinese consumers' main concern is the quality of filtration. In contrast to the United States, where consumers are more concerned with the softness, taste of water and water flow-rate.
- POU systems still make up the vast majority of the market – specifically countertop systems, under- the-sink systems and water pitchers.
- The current Chinese RWT market is highly fragmented and there are no dominant players in the market. We are seeing more product specialisation in the market as it starting to mature.
- Chinese consumers are generally not used to the concept of self-maintenance and as a result are unsure when and how to provide maintenance to their RWT systems. Good after-sales service is therefore crucial to generate satisfied customers and increased revenue from filter replacements.
- Foreign brands have a strong competitive advantage in the Chinese market. They are perceived to be of high quality and trustworthy, the top two priorities of Chinese consumers in the RWT market.
- There is a steady shift towards online sales as consumers awareness increases, but specialty retail stores remain important due to lack of familiarity with RWT products.

Subscribe to our newsletter to gain free access to our premium reports and to receive our upcoming report with in-depth insights into the Chinese RWT market.

ABOUT LAUNCH FACTORY 88

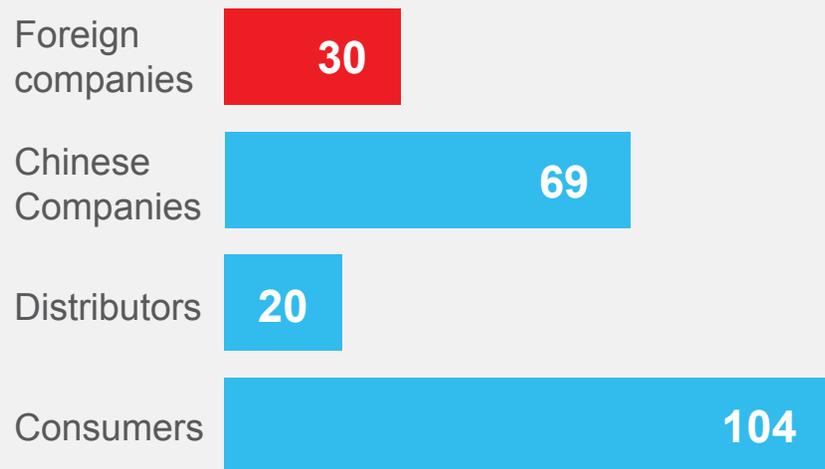
Launch Factory 88 supports industrial SMEs in the water technology sector to increase their sales and become more competitive in the Chinese market. We do so by offering two core services; a distribution support platform and localized manufacturing and assembly.

Launch Factory 88 is part of the CHC Group, which was established in 1998 by two Dutch entrepreneurs and has since then developed multiple market leading companies in diverse industries in China. We help your company succeed in China using the same careful methods we employed to build our own businesses

Contact us to learn how we can help increase your sales in China.

A MARKET REACHING ITS TIPPING POINT

Number of Respondents Interviewed



Every year, nearly 200 million residents in China fall ill from drinking contaminated water.

Fueled by increasing awareness of pollution and its effects on people's health, the Chinese RWT market is now growing quickly and reaching a tipping point.

We have recently experienced a tipping point in the air pollution industry in China, which brought forth an explosion in demand for air filters. Based on our conversations with over 100 companies and consumers – it seems the water industry is on a similar path.

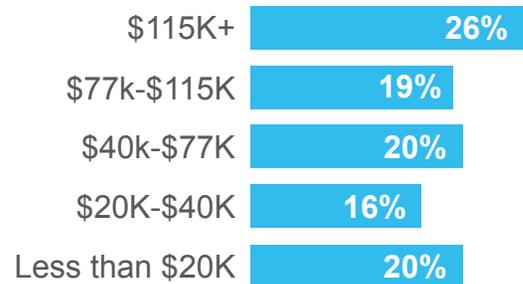
In this research we have focused primarily on the drinking water sector. However, it's safe to say some of these insights can be extrapolated to the Chinese water industry as a whole.

01. UNDERSTANDING THE CHINESE CONSUMER

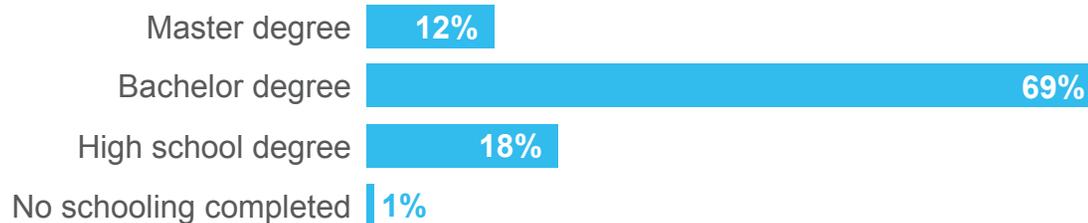
CONSUMER DEMOGRAPHICS

Working Location Shanghai 100%

Annual Household Income (USD)



Level of Education



We surveyed consumers with certain demographic requirements: a high level of education, a high class income level, and living in a first-tier city – to outline an ideal consumer of residential water treatment.

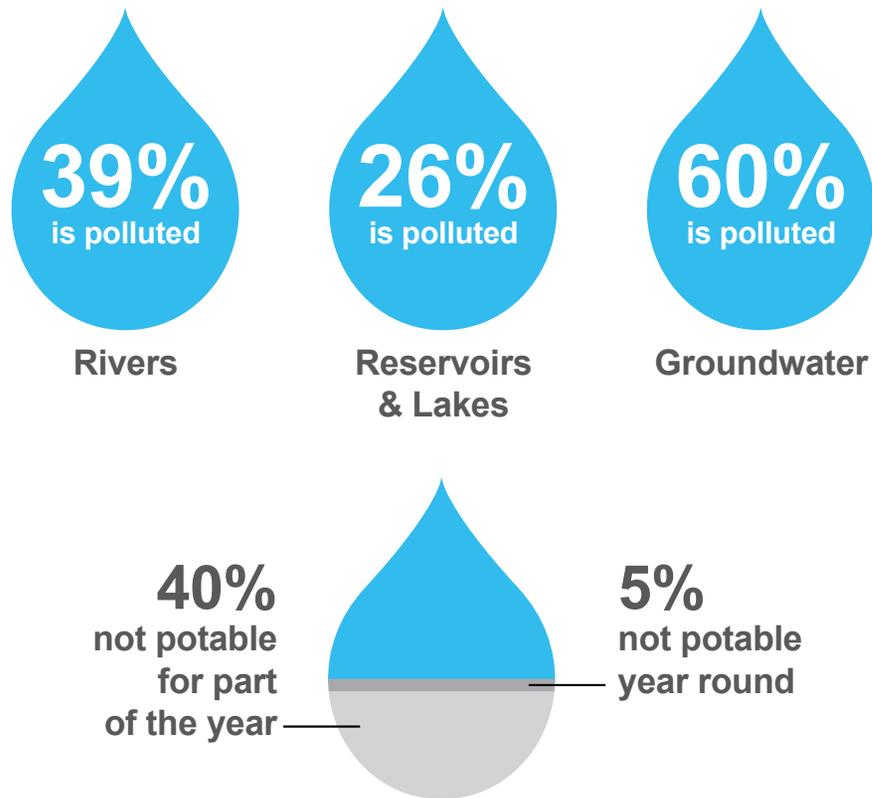
However, keep in mind: the respondents we interviewed are not representative for China's entire populace.

Below you can see some basic demographics of those we interviewed.

As a reference: in 2014, according to China Daily the average (official) income level in Shanghai was 7108 RMB per month – which translates into a (double-income) annual household income of approximately \$27,000 US.

CHINA'S CURRENT STATE OF WATER

China's State of Municipal Water Sourced From Surface Water



Source: China Water Risk

China's water sources are severely polluted.

Only 55% of water resources are potable year round.

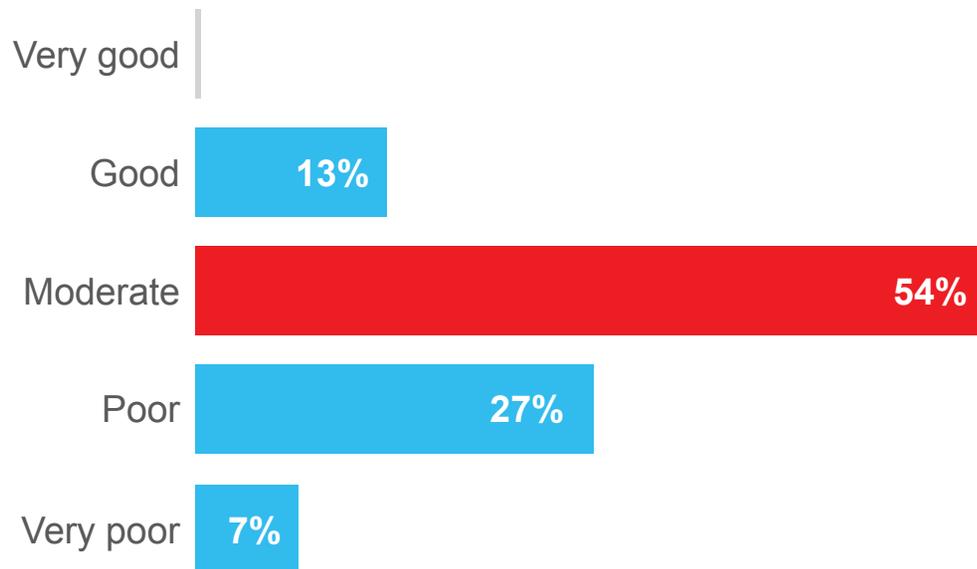
The main factors contributing to China's water pollution are industrial waste from factories and agriculture.

As a result, much of the water pollution in China is in the form of heavy metals and chemicals.

Even if China's water sources were to be cleaned up, around 60% of the water distribution network and many domestic pipes are corroded, rendering it undrinkable again.

CHINESE CONSUMERS LACK EDUCATION ON WATER-RELATED PROBLEMS

How Respondents Rate Their Unfiltered Municipal Water Supply in China



How do you rate the quality of water in your home?

54% believe it's moderate quality.

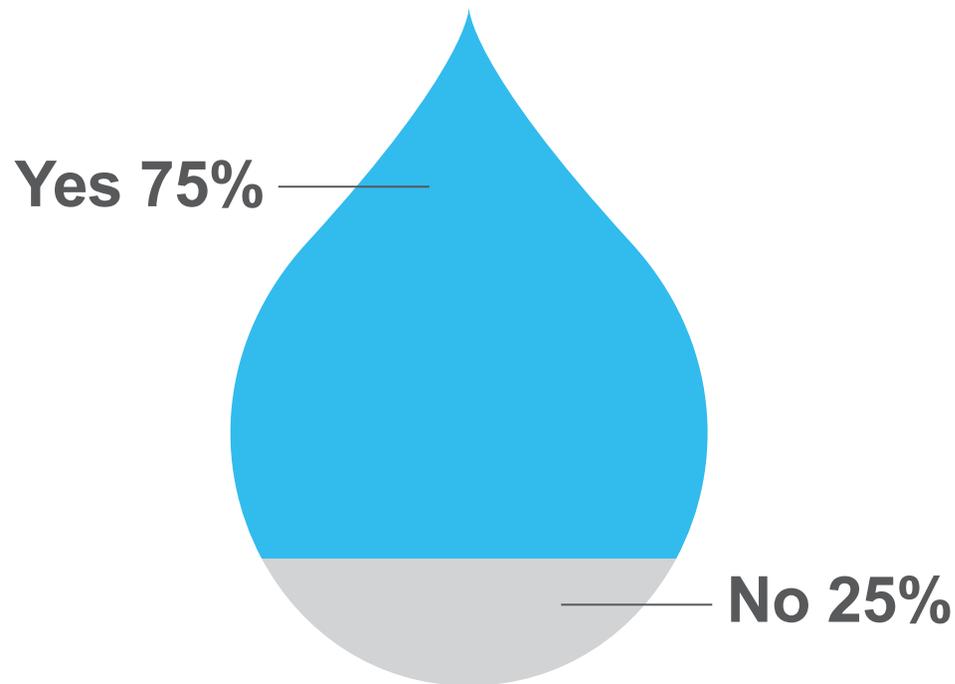
Although municipal water supply is heavily polluted, only 34% of consumers rate the quality as poor or very poor.

Bear in mind the income levels and education of those we interviewed were significantly higher than average. Hence, the results show that the awareness level of Chinese consumers in downtown Shanghai is still low and the Chinese drinking water market is still in its early stages.

Consumer education will therefore play a crucial role in your sales process in China.

EDUCATION IS KEY

Percentage of Respondents Who Believe Boiling Water is Effective



Do you think boiling water is an effective way to make it potable?

75% say yes.

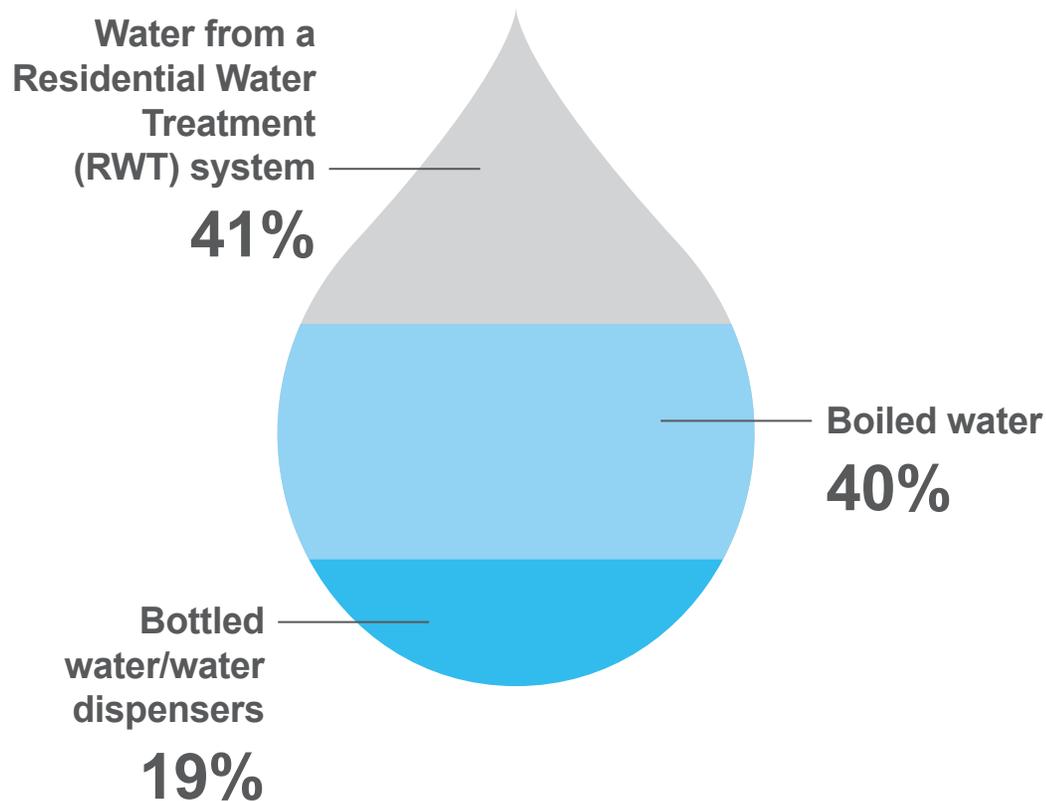
Surprisingly even the consumers we interviewed, who live in a first tier city and possess relatively high levels of education, still believe boiling water is an effective method to make tap water potable.

This also means the majority of consumers are not aware that boiling water is an ineffective method to remove heavy metals from the water.

Again, many consumers need to be educated before they will consider making a purchase.

CHINESE CONSUMERS DON'T TRUST BOTTLED WATER

Respondents' Opinion on Safest Source of Drinking Water



What's the safest source of drinking water?

Only 19% say bottled water.

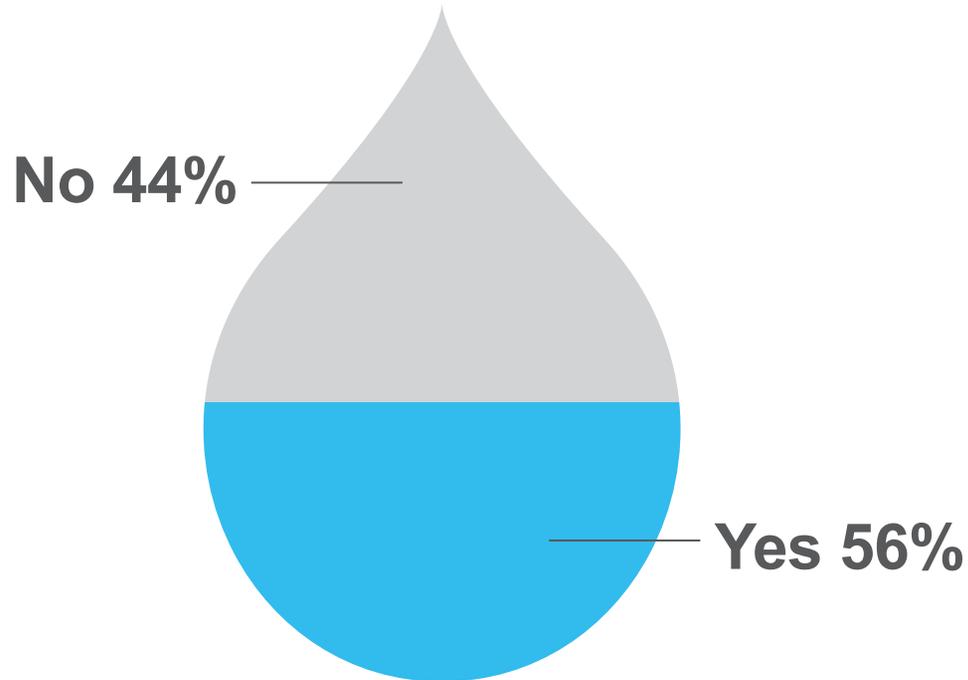
In the past years, many scandals involving bottled water companies have come to light. This has severely impaired consumer trust in bottled water companies.

As a result, more and more consumers are taking the water filtration process back into their own home. This takes two forms, traditional boiling of water or modern RWT systems.

As a company, providing consumers with a method to test their filtered water at home, or offering pre-purchase demonstrations, is an effective way to build consumer trust.

CHINESE CONSUMERS ARE ADOPTING RWT IN LARGE NUMBERS

Percentage of Respondents Who Own a Residential Water Treatment System



Do you own a Residential Water Treatment System?

56% say yes.

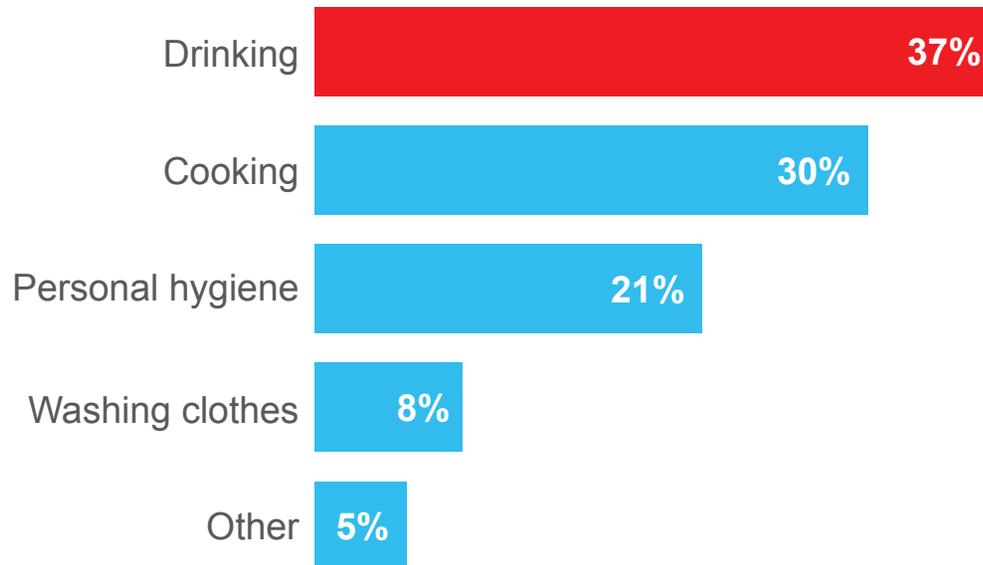
As noted earlier, the majority of our respondents were highly educated residents of Shanghai that enjoyed a high annual income.

Hence the proportion of those with RWT systems is significantly higher than average and not representative of the entire populace. This group can be considered the early adopters in the Chinese market.

With the simultaneous increase in income and education levels in China, more and more consumers are realizing the extent of the water pollution problem they face. With no municipal solution in sight, they are searching independently for ways to ensure safe drinking water in their own home.

FOOD SAFETY, AS WELL AS DRINKING SAFETY, IS IMPORTANT

Consumer's Most Important Uses of RWT Systems



What do you use your RWT system for?

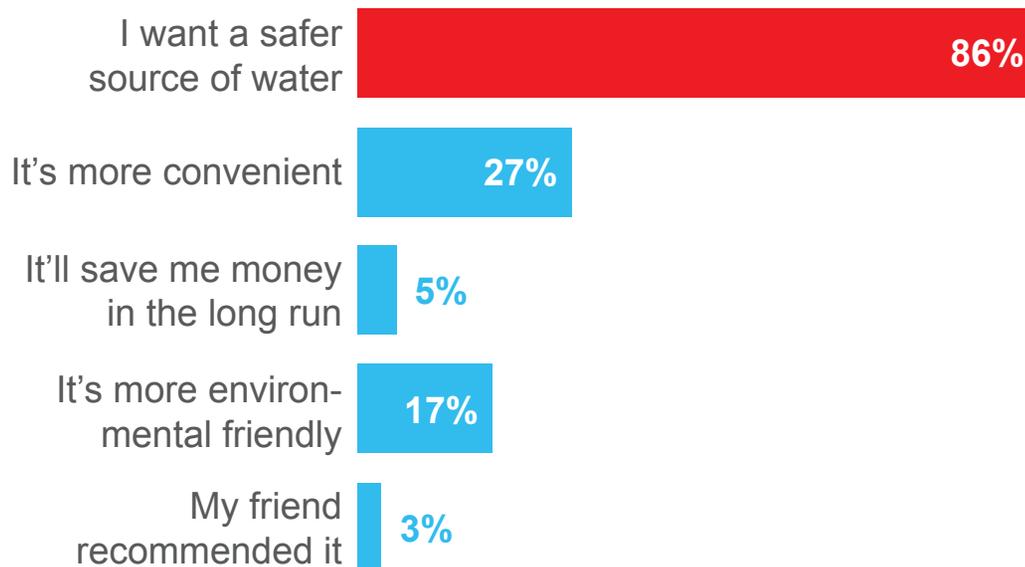
37% and 30% say for drinking and cooking, respectively.

China has been plagued by food scandals during recent years. Because of the fear of food contamination, consumers wash their vegetables and fruits religiously before cooking or consuming them.

Using RWT systems to prepare food means that they are likely used more intensively in China than in other markets where food can be washed safely with water straight from the tap/faucet.

CONSUMERS WANT A SAFE AND CONVENIENT SOURCE OF WATER

Main Reasons Consumers Purchase Their RWT Systems



Why did you purchase your RWT system?

86% say they want a safer source of water.

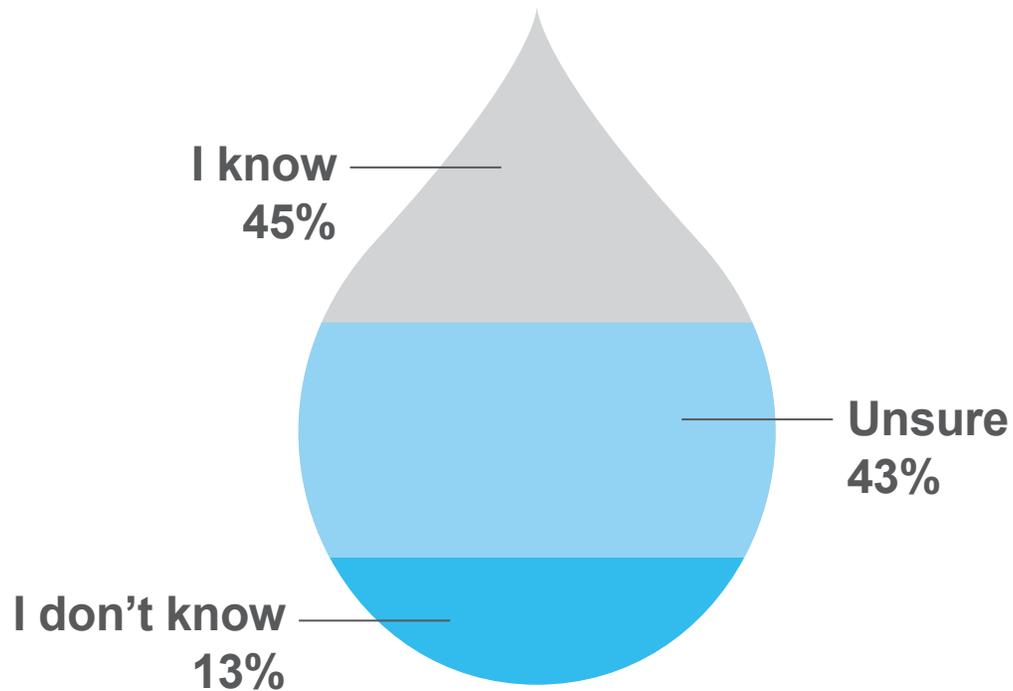
Almost all consumers who own an RWT system purchased it because they want a safer source of water. Filtration results are of paramount importance for Chinese consumers. They have shown a willingness to sacrifice other features for better filtration.

Long term cost savings were revealed not to be among the main reasons for purchase. However, this could be used to market to those consumers with lower income levels than featured in our sample.

Not surprisingly, convenience also plays an important role. Consumers should be able to use and maintain their RWT system in the most convenient way possible.

PROVIDE COMPREHENSIVE AFTER-SALES SERVICE

Percentage of Consumers Who Know When to Replace Their Filters



Do you know when to replace your filter?

**56% say they don't know
or are unsure.**

Not knowing when to replace filters gives rise to two problems:

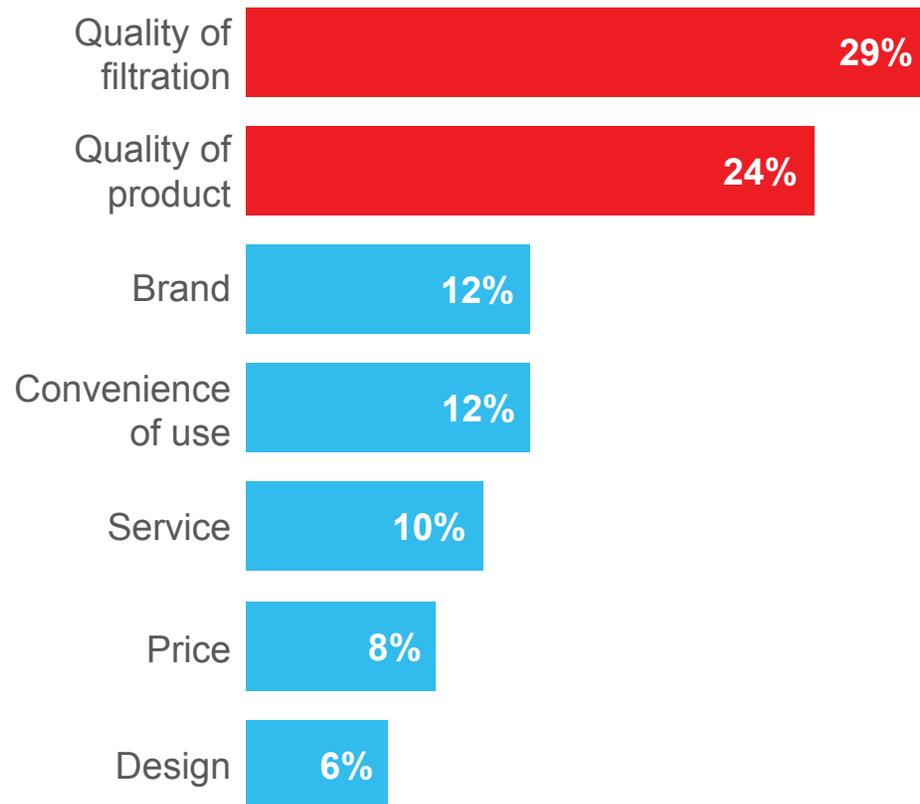
First, it directly affects the quality of water from RWT systems. This will in turn negatively affect consumer's health as well as the product's brand image.

Secondly, companies lose out on the potential revenue from after-sales purchases of filters.

Customers need to be well educated, and kept well informed, on when and how to replace filters. This not only benefits them, but is also an important revenue stream.

FOCUS ON A HIGH QUALITY OFFERING

Consumer's Most Important Uses of RWT Systems



What is most important to you when purchasing an RWT system?

29% and 24% say level of filtration and quality of product, respectively.

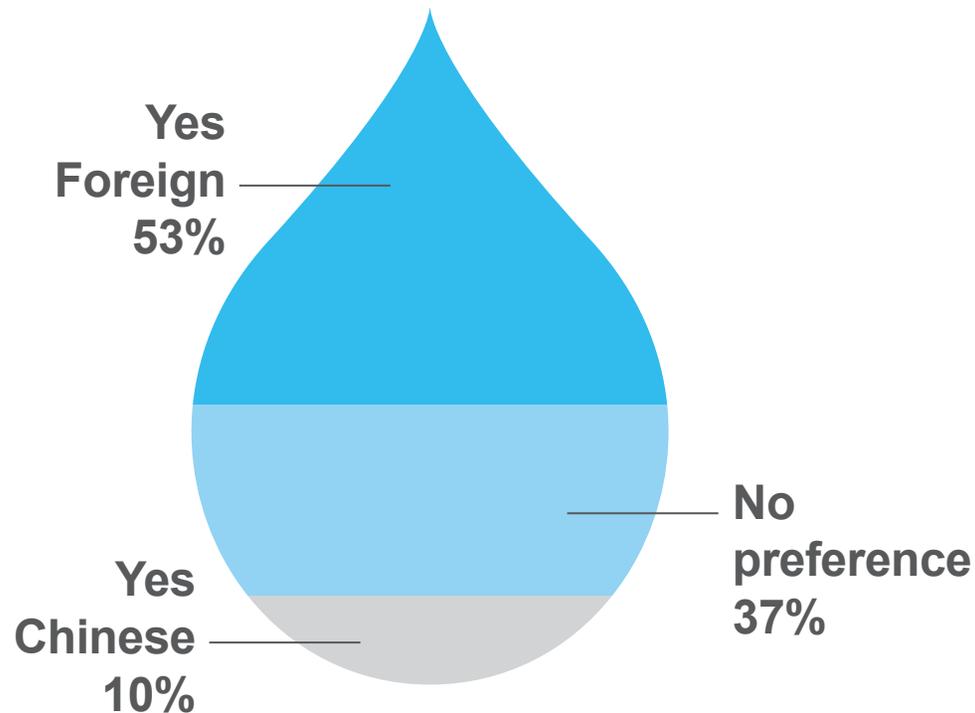
Chinese consumers are above all, most worried about quality. Quality being, both of the machine itself but also the level of filtration. Remember, the desire for a safe source of drinking water is the most common reason for purchasing RWT.

Only 8% regard price as a priority. This reinforces the fact that this demographic is willing to pay more for a foreign product.

Chinese consumers are willing to sacrifice flow rate for more thorough filtration. Compare this to American consumers who, faced with a different set of issues, prioritize high flow rates, water softness and taste.

AS A FOREIGN COMPANY, YOU HAVE AN ADVANTAGE

Consumer Preferences



Do you prefer foreign or Chinese brands?

53% say foreign.

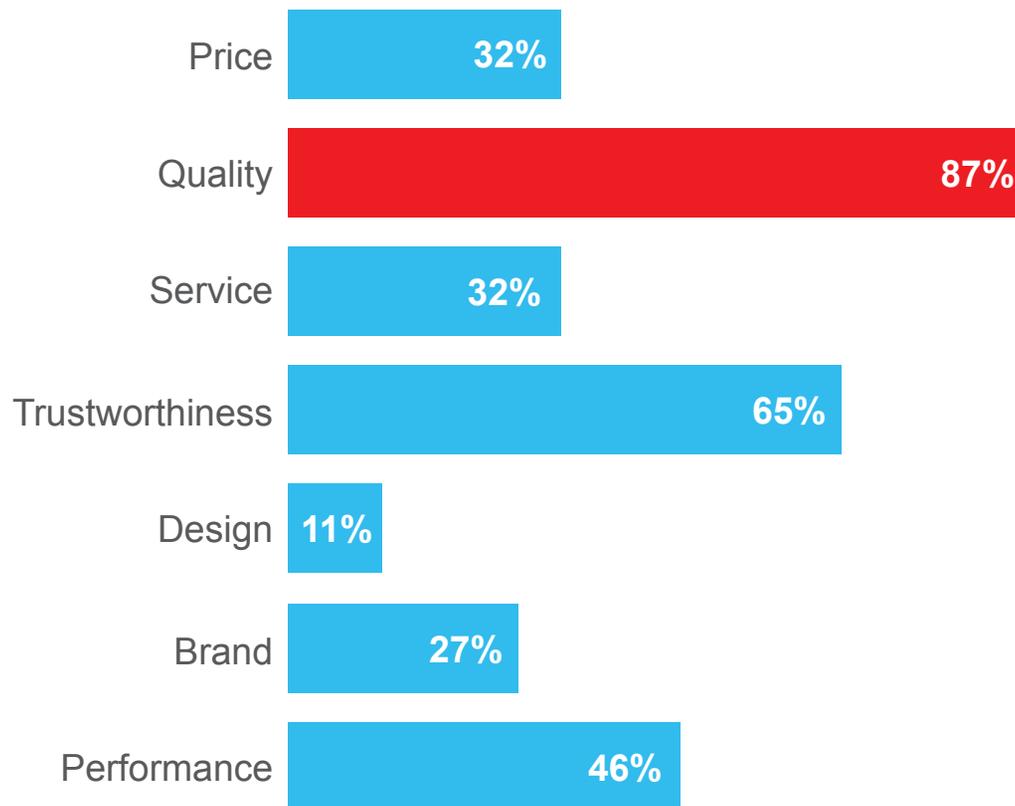
As is evident in many industries in China, foreign brands are favored over domestic brands.

Foreign brands in China are considered more trustworthy, and of higher quality. They almost always enjoy a better reputation and command a higher price tag.

Multiple Chinese brand-owners also voiced their complaints about foreign brands enjoying a better reputation in the market than domestic brands.

CONSUMERS VALUE THE QUALITY AND TRUSTWORTHINESS OF FOREIGN BRANDS

Why Consumers Prefer Foreign Brands



Why do you prefer foreign brands?

87% say it's because of higher quality.

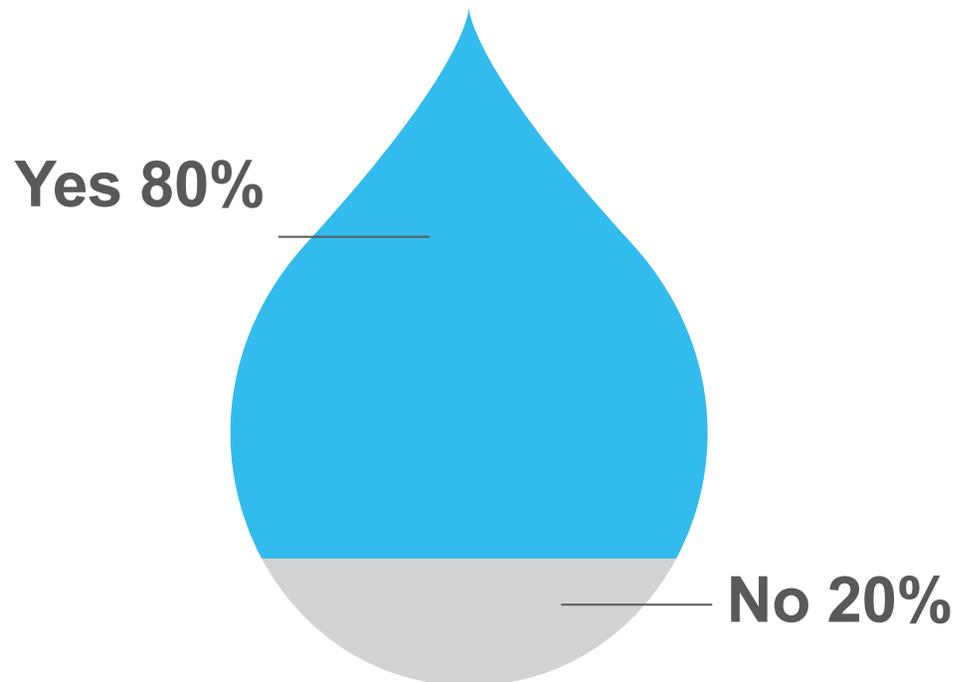
Chinese brands still suffer from a poor brand image, negatively impacted by numerous scandals and ideas of poor quality.

This offers foreign brands a unique opportunity to provide high quality and trustworthy products that consumers can't find domestically.

Consumers main priority is to secure a safe source of drinking water. Many believe that foreign companies can provide them with this.

FOREIGN BRANDS CAN DEMAND A HIGHER PRICE TAG

Percentage of Consumers Who Will Pay
More for a Foreign Brand



Are you willing to pay more for a foreign brand?

80% say yes.

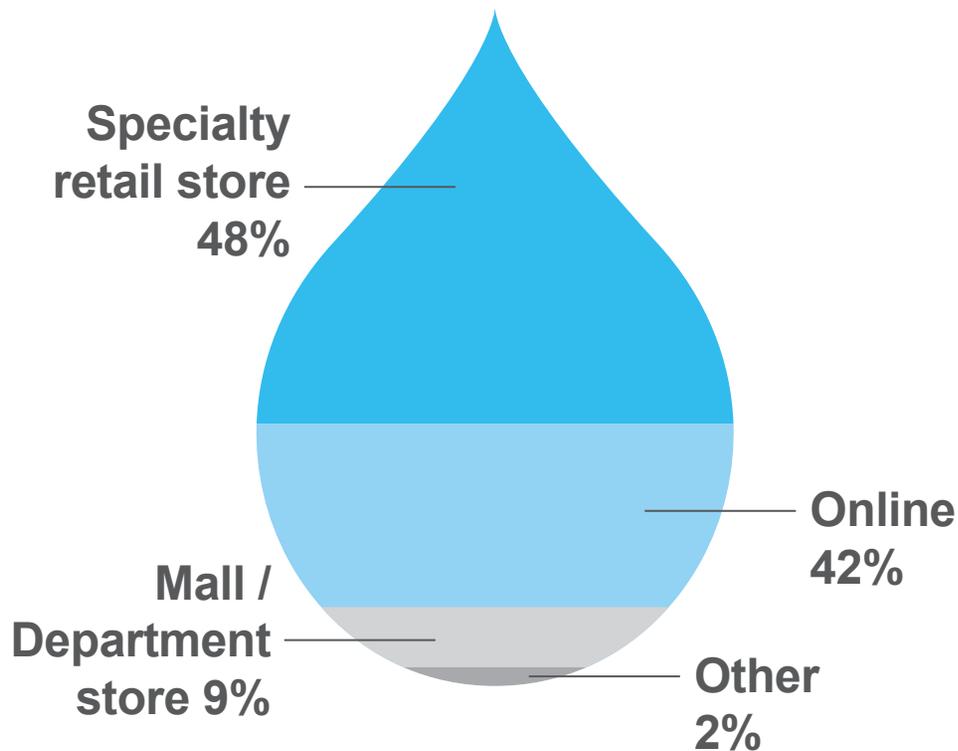
A McKinsey's study on Chinese consumers in 2010 found that 45% of Chinese consumers believe that higher prices correspond to better quality, compared to just 16% in the United States and 8% in Japan.

General consumer mistrust has fuelled a perception in China of higher priced foreign brands being better quality and more trustworthy.

For this peace of mind, consumers are willing to pay more for a foreign brand. It's common to see foreign brands charging a 200-400% price premium, and sometimes even higher.

ONLINE IS RISING, BUT SPECIALTY STORES REMAIN IN DEMAND

Consumers' Preferred Sales Channel



Where do you prefer to buy your RWT system?

48% say in a specialty retail store.

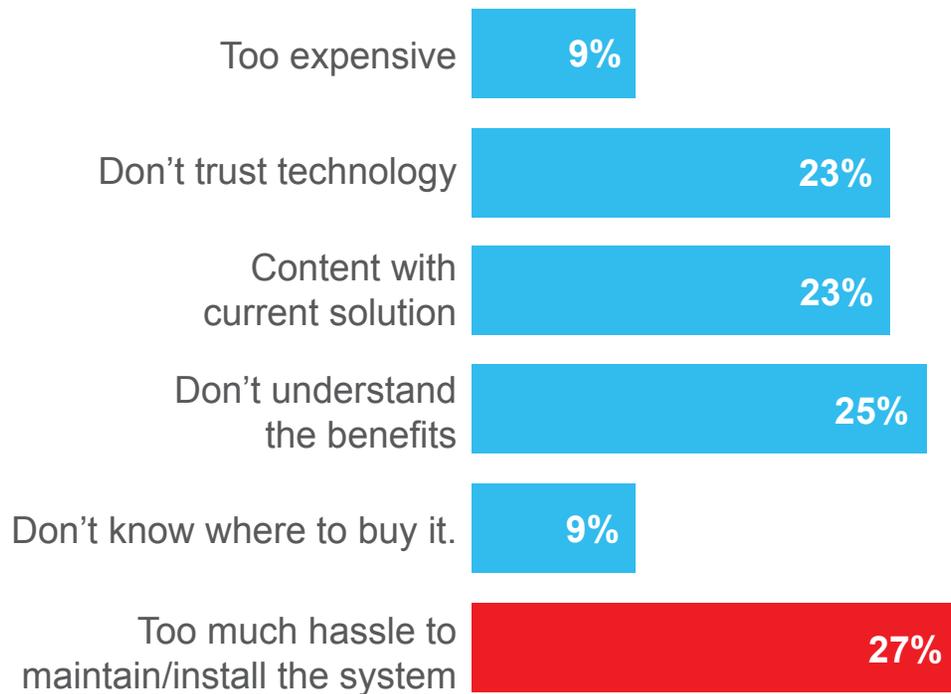
Selling through online channels is gaining popularity. However, there is still a demand for specialty stores as consumers are not yet well-aware or educated about RWT systems.

Consumers often want some form of tangible proof to see the product, and the way it works.

Air filtration products faced the same barriers when they began to become mainstream in China. The market is now at a more mature stage than water filtration with online sales more common. It seems the water filtration market will follow a similar trajectory.

REMOVE THE HASSLE FOR THE CONSUMER

Reasons Why Consumers are not Purchasing RWT Systems



Note: This data is only based on consumers who make the purchasing decision within their household.

What is stopping you from purchasing an RWT system?

27% say it's too much hassle to install and maintain the system.

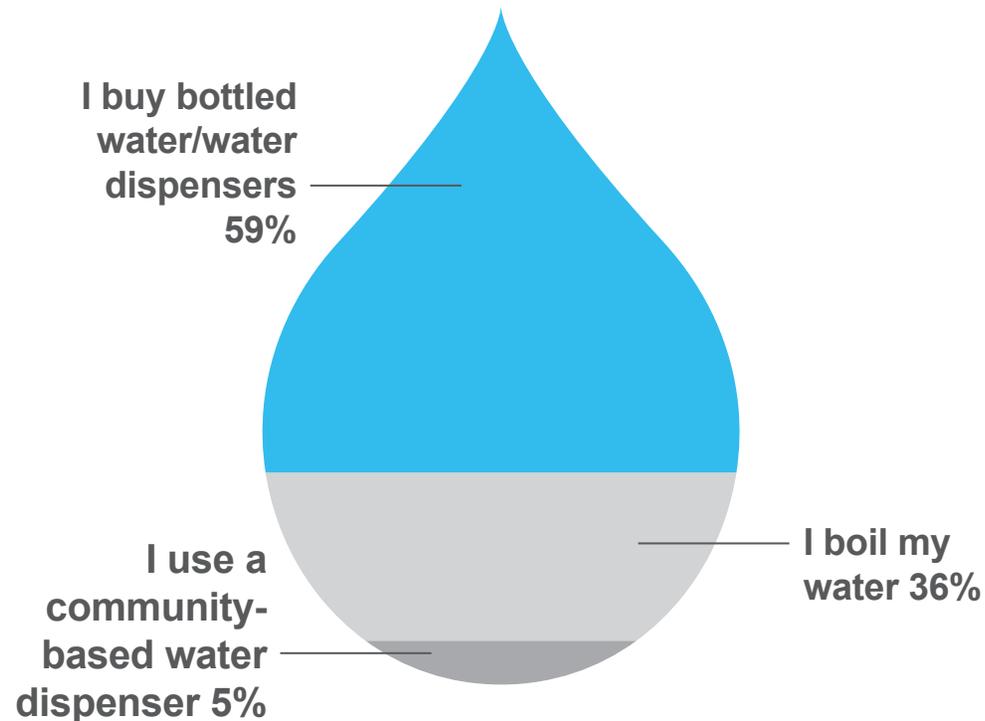
Lack of trust and education is once again evident as one of the top reasons that stop consumers from purchasing RWT systems. Building trust and enlightening the consumer to the benefits of RWT systems over their current solution is vital whilst the market is still in its infancy.

However, the main purchasing barrier is the fact that consumers find it too much of a hassle to maintain and install the system. As we have seen in many other industries, Chinese consumers do not like to personally install their products and would like to avoid it as much as possible.

Companies could potentially thrive off marketing the ability to provide a specialized service that would personally install and maintain customers' systems.

WHERE DO NON-RWT-CONSUMERS GET THEIR DRINKING WATER NOW?

Current Source of Water of Non-RWT-Consumers



Note: This data is only based on consumers who make the purchasing decision within their household.

What is your current source of water?

59% say they buy bottled water or water dispensers.

Even though only 19% of respondents believe bottled water and water dispensers are safe, it is still non-consumers' main source of water.

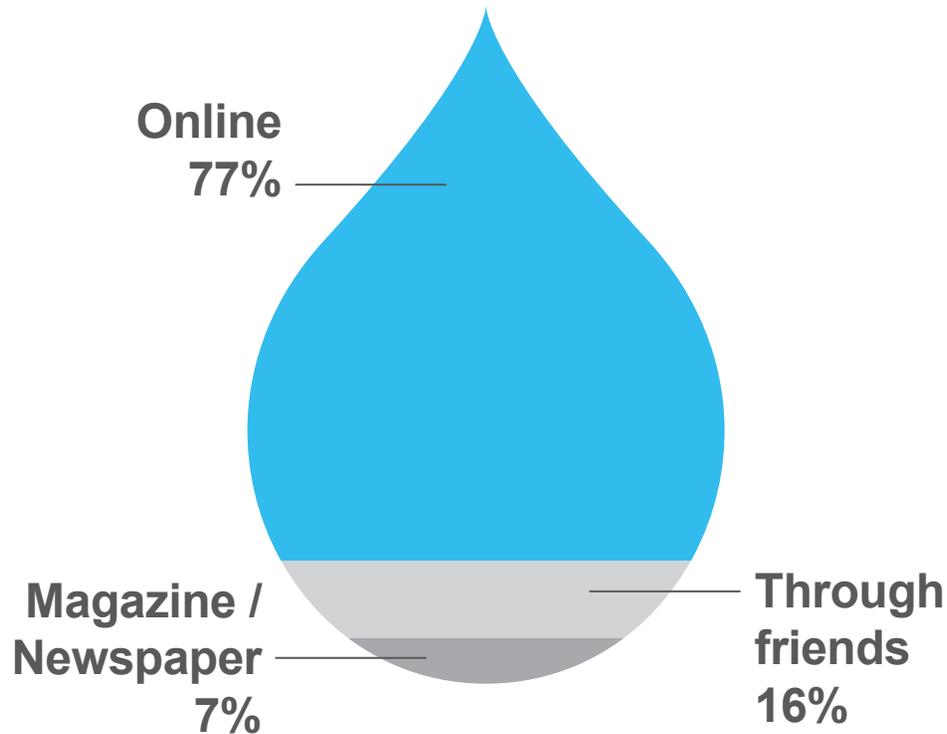
Non-RWT-consumers top barriers to purchase is that RWT systems are not convenient, trustworthy and they don't fully understand the benefits of it. Buying bottled water or using water dispensers remains the most convenient alternative to using RWT systems.

On the other hand, education is the best way to tackle the deep-rooted Chinese habit of boiling water. Many Chinese consumers are simply not aware of the ineffectiveness of this method.

Although very common, almost no one uses community-based water dispensers because of the lack of maintenance on these machines.

BE VISIBLE ONLINE

Where Non-RWT-Consumers Would Go to Find RWT Information



Where would you go to find information on RWT systems?

77% say online.

Chinese consumers are typically very open to adopting new technologies. The internet is no exception, and today China's internet economy is thriving. A 2010 McKinsey survey concluded that Chinese consumers regarded manufacturers' and retailers' websites as particularly credible sources of information.

Word of mouth also remains very important in China. McKinsey also found that 66% of Chinese consumers would consider recommendations from friends and family. Compare this to just 38% in the US and UK.

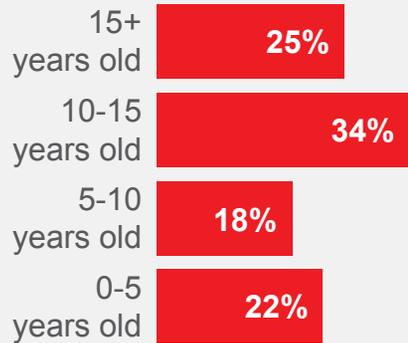
Nonetheless companies should look to the future and focus on marketing, and providing information about their product, online.

02. COMPARING CHINESE AND FOREIGN PRACTICES

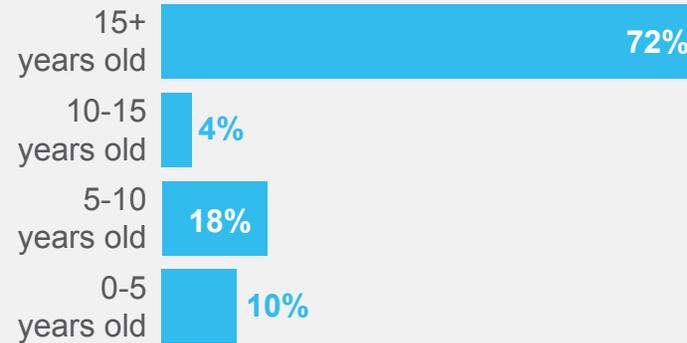
CHINESE

FOREIGN

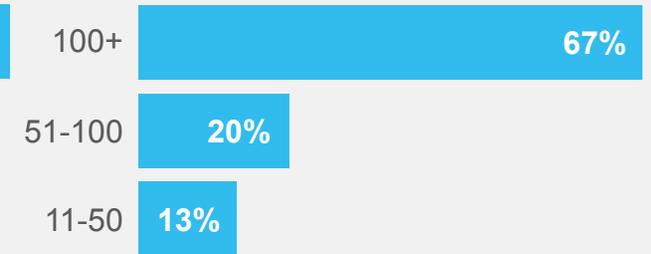
Company Age



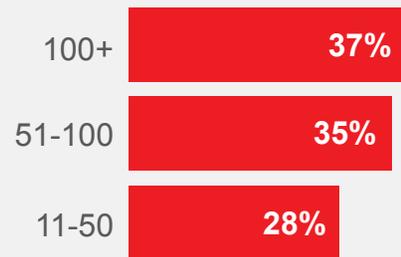
Company Age



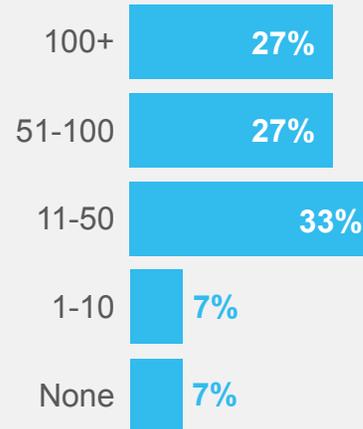
of Employees Worldwide



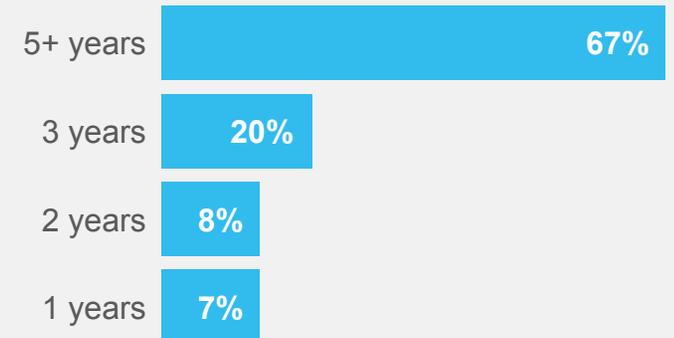
of Employees in China



of Employees in China

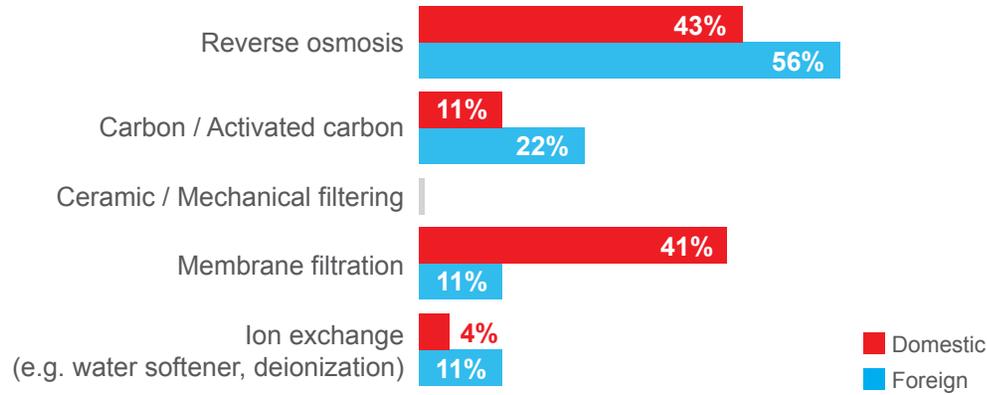


of Years Selling to China

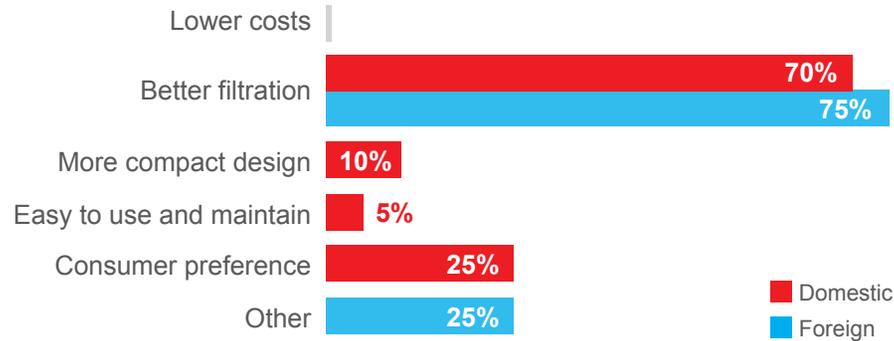


REVERSE OSMOSIS IS PARTICULARLY SUITED TO CHINA

Primary Technologies Used



Reasons for Focusing on Reverse Osmosis



What technology does your company primarily use?

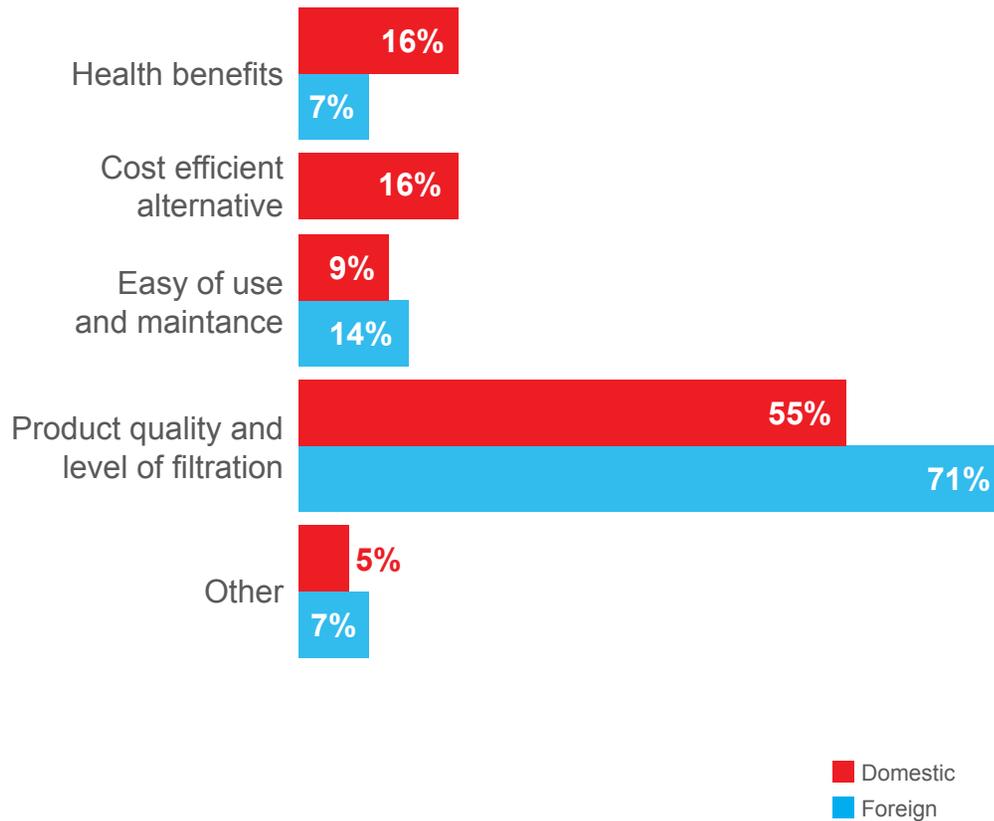
49.5% say reverse osmosis.

The majority of domestic and foreign companies focus on reverse osmosis as their primary technology as it (arguably) offers the most thorough filtering process.

In contrast to the United States, water softeners and economical filtrations such as activated carbon are the most common, as water pollution is less serious.

MARKETING STRATEGIES ALIGN WITH CONSUMER DEMANDS

Companies' Primary Marketing Strategies



How does your company primarily market your product?

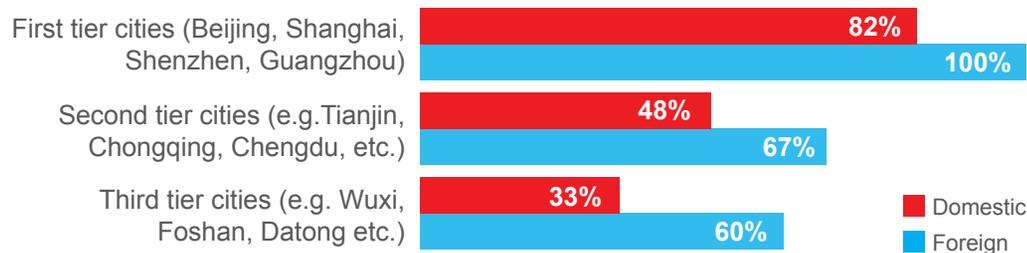
Majority of foreign and domestic companies say they market their product quality and level of filtration.

We asked companies to choose their one primary marketing strategy. Most companies answered quality and level of filtration, which directly correlates with the needs and demands we heard from Chinese consumers.

Lowering prices was once a common competitive strategy amongst Chinese companies, but they are coming to realize that this is typically not consumers' main concern in this market. Now, only 16% of the Chinese RWT companies we spoke to still use low prices as their main marketing strategy.

THE RISE OF 2ND AND 3RD TIER CITIES

Companies' Selling Regions



Percentage of Companies Who Have Seen an Increase in Demand Outside First-Tier Cities



Have you seen an increase in demand outside first-tier cities?

96.5% say yes.

As China's economic growth spreads West, companies have noted a significant increase in demand from lower-tier cities.

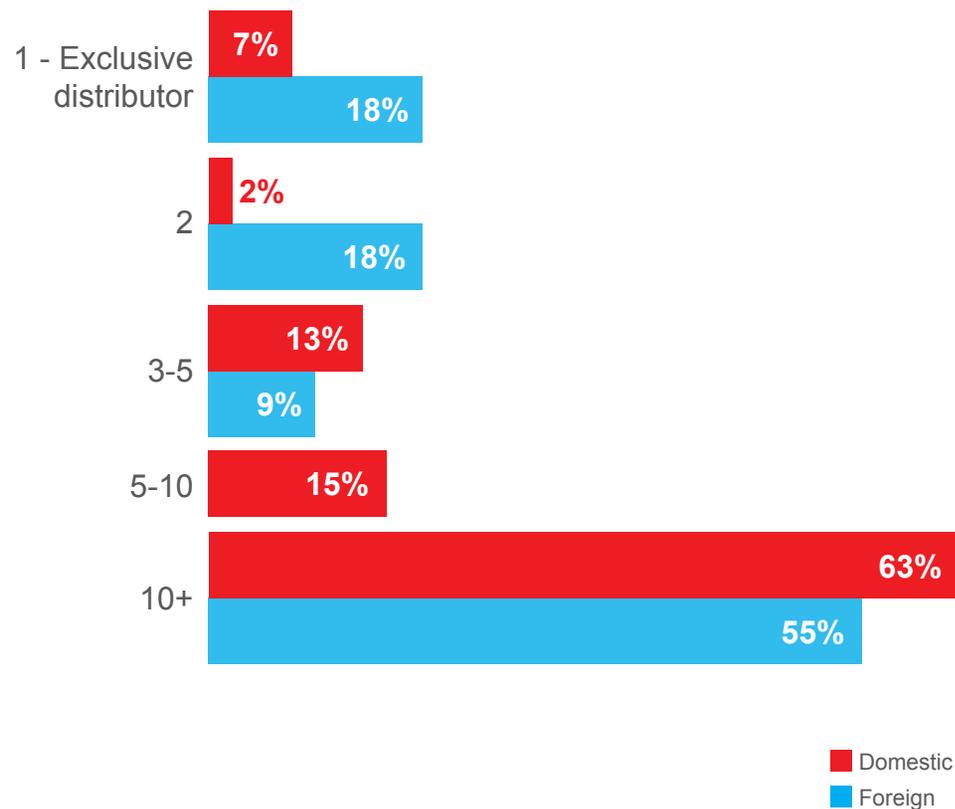
Almost unanimously, the companies we interviewed agreed that demand outside first-tier cities has increased.

Surprisingly, foreign companies seem to be more active in penetrating the growing markets in second and third-tier cities.

Many companies we spoke to expressed their surprise at the speed at which this trend was occurring.

AVOID USING AN EXCLUSIVE DISTRIBUTOR

Number of Distributors Used in China



How many distributors do you use in China?

59% say they use more than 10 distributors.

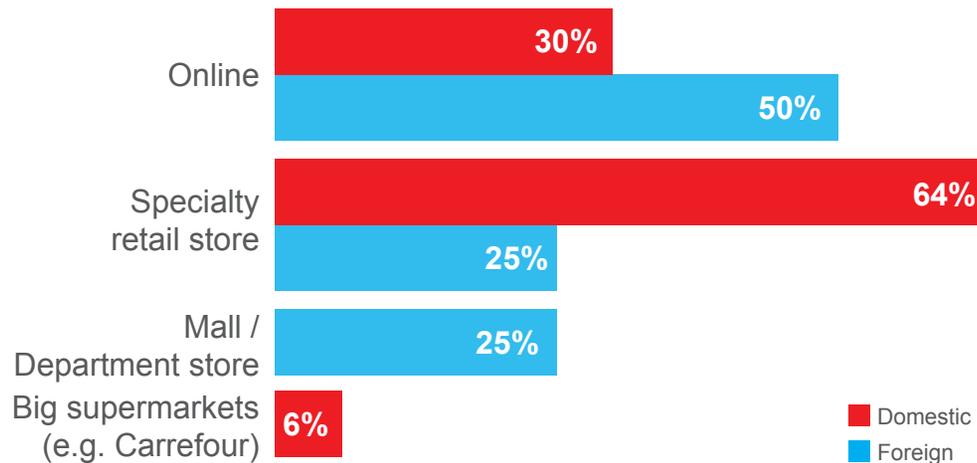
In the past, many foreign companies worked with one nationwide distributor in China. This is usually not advisable. Not only can it limit your reach, it also gives too much leverage to your exclusive partner in China.

More and more companies are now recognizing this and are using multiple distributors to reach their full sales potential.

Perhaps foreign companies can learn from domestic companies in this respect. Domestic companies are more likely to use more distributors, whilst at the same time less likely to use one exclusive distributor.

SPECIALTY RETAIL STORES REMAIN IMPORTANT FOR NOW

Sales Channels



Note: this data is based on POU/POE sales;

Which sales channel do you sell the most products through?

64% of Chinese companies say specialty retail stores.

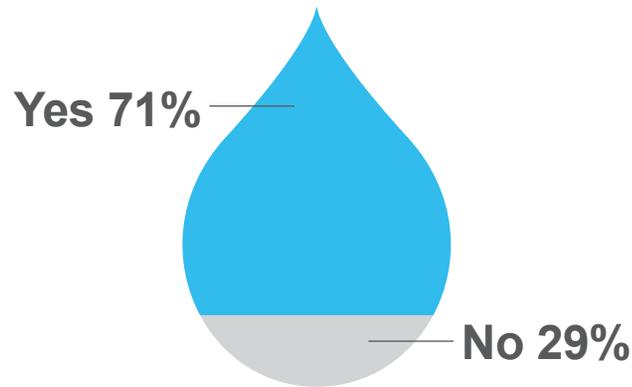
Foreign, and particularly Chinese, companies understand the need for offering consumers a chance to see, feel and learn about the product before purchase. Specialty retail stores allow you to educate consumers directly, without relying on distributors.

Foreign companies are mainly relying on e-commerce, which is a common strategy in more developed markets. However, the Chinese consumer still prefers to touch and feel the product before purchasing an RWT system online.

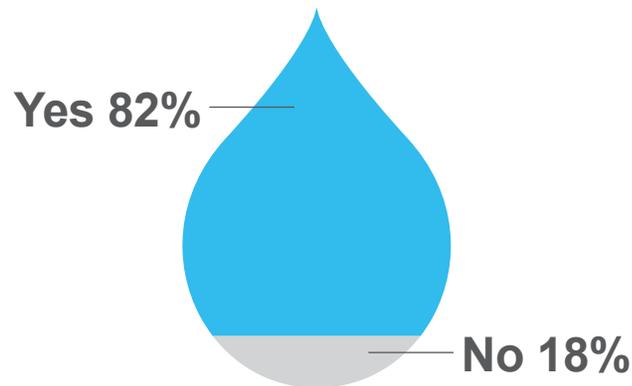
As the market moves out of its infancy, online channels will become increasingly important.

BOTH DOMESTIC AND FOREIGN COMPANIES HAVE THEIR ADVANTAGES

Percentage of Foreign Companies that Believe Chinese Companies Have a Competitive Advantage



Percentage of Chinese Companies that Believe Foreign Companies Have a Competitive Advantage



Do you believe foreign companies have an advantage over Chinese companies?

82% of Chinese companies say yes.

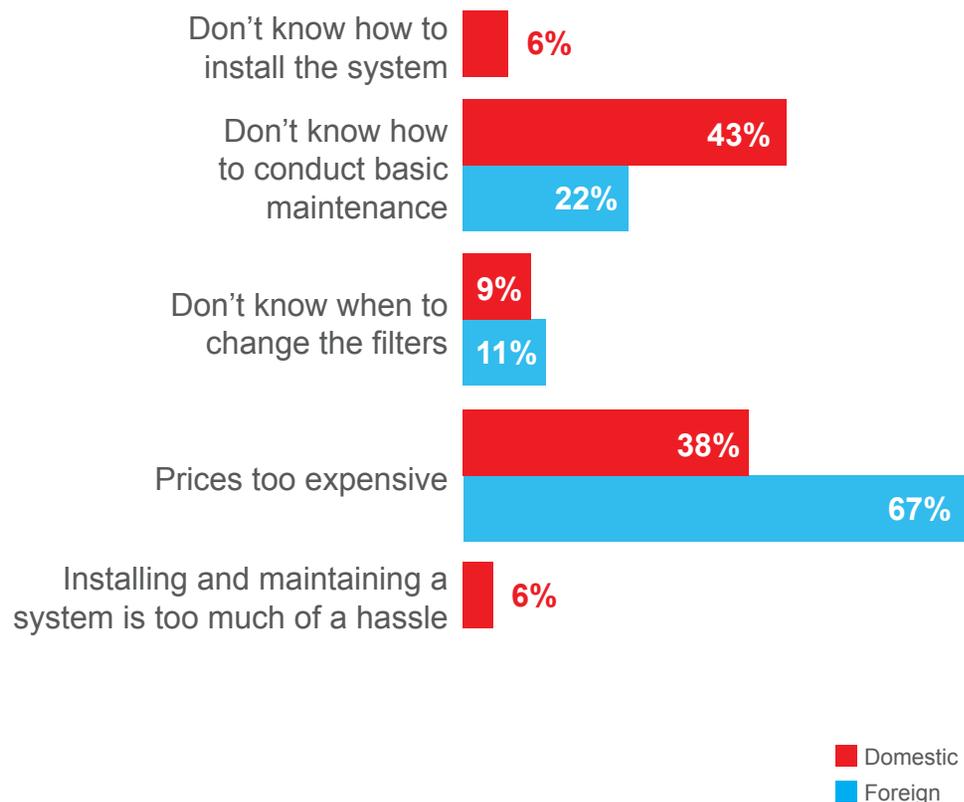
It is interesting to see that both parties think the other have the advantage.

Foreign brands have the advantage of being perceived as higher quality and more trustworthy. Chinese companies have no way to imitate this.

On the other hand, Chinese companies are able to benefit from a better understanding of the Chinese market, a stronger local network and -in some cases- preferential tax policies and conditions.

CHINESE CONSUMERS ARE COMPLAINING ABOUT MAINTENANCE

Companies' Main Complaints from Consumers



What are the main complaints you receive from your customers?

67% of foreign companies say Chinese consumers complain about price.

We found many of the consumers we interviewed complained about price. However, they seem to still be willing to pay a premium for foreign brands.

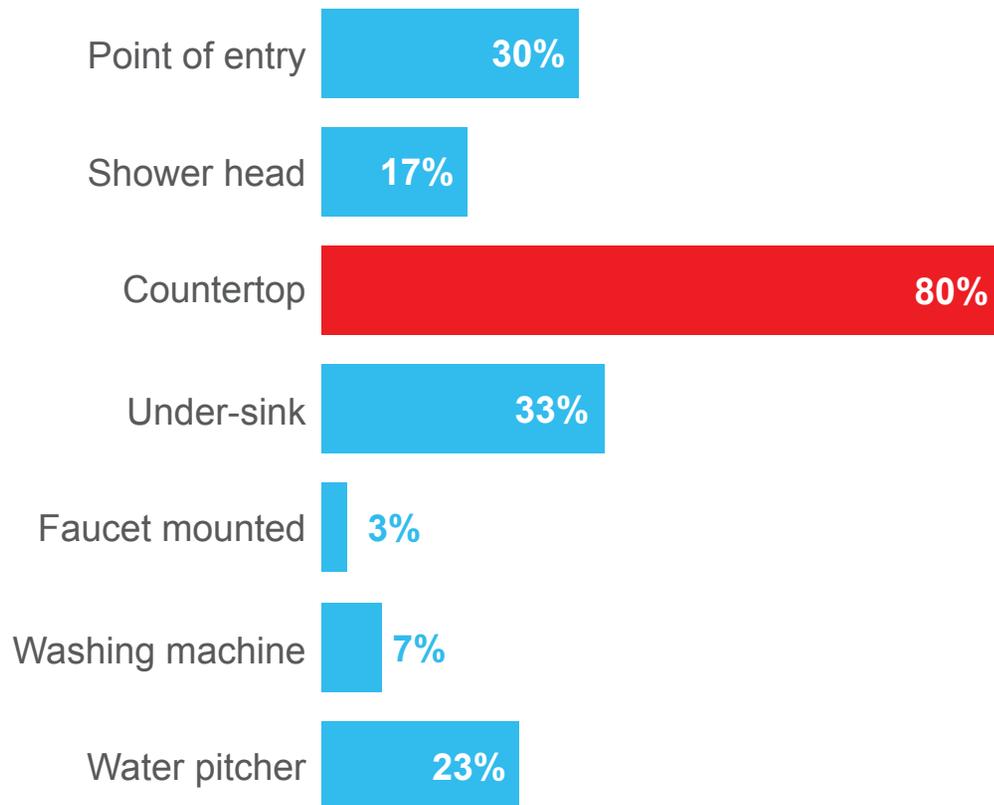
An easier takeaway is that many consumers complain about maintenance. As we mentioned before, Chinese consumers require intensive support.

It seems foreign companies are doing a better job educating consumers on how to maintain their system, but there is still room for improvement.

03. TAKING A CLOSER LOOK AT CHINESE COMPANIES

POU PRODUCTS CONTINUE TO DOMINATE

Chinese Company Product Sales



What products do you sell?

80% say countertop systems are part of their product portfolio.

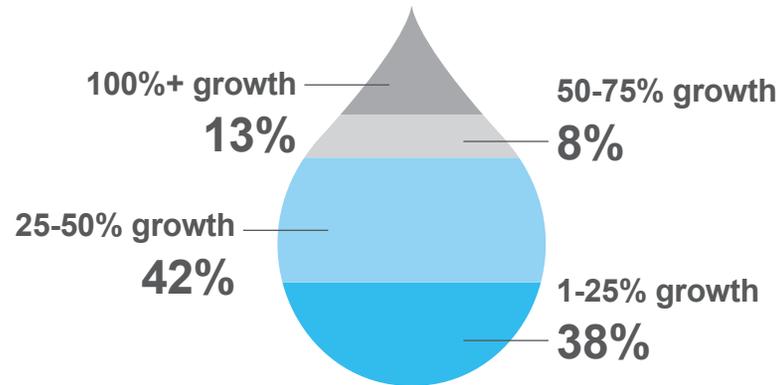
The most commonly sold RWT systems are countertop. Countertop systems are considerably cheaper on average and are easier to install and maintain.

POE systems have failed to gain as much traction as POU partly because pipes in homes are often corroded. This means that POE systems must often be used in conjunction with a POU system.

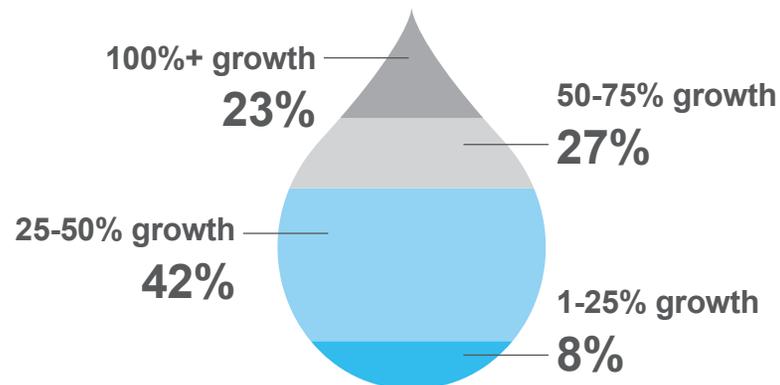
Unfortunately, the majority of respondents declined to share their revenues and product sales.

RWT MARKET GROWTH IS ACCELERATING

Past 3 Years Performance in China



Predicted Future Growth in China



Note: this data is based on POE/POU brand-owners, excluding suppliers.

What is your company's expected annual growth in the next 5 years?

50% say they expect a future growth of 50% or more.

Chinese brand-owners see a high future growth in comparison to the past. Only 8% have seen a 50% or higher growth in the past 3 years. This number increases to 27% for their future predicted growth.

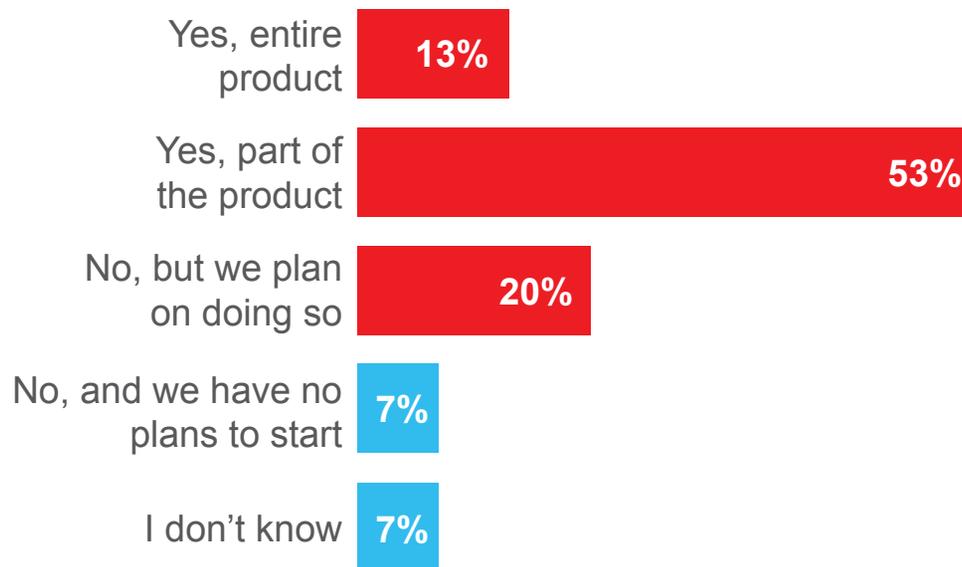
Market growth outlooks are optimistic, and this is supported in other sources:

- In 2013, A.T. Kearny reported 20% growth in water treatment sales in China
- Professors Tao Tao et. al. predict a 40% annual growth in China's water-purification industry.

03. FOREIGN COMPANIES IN CHINA

MANUFACTURING LOCALLY IS THE NORM

Percentage of Foreign Companies that Manufacture in China



Does your company manufacture locally in China?

86% say yes or are planning to do so.

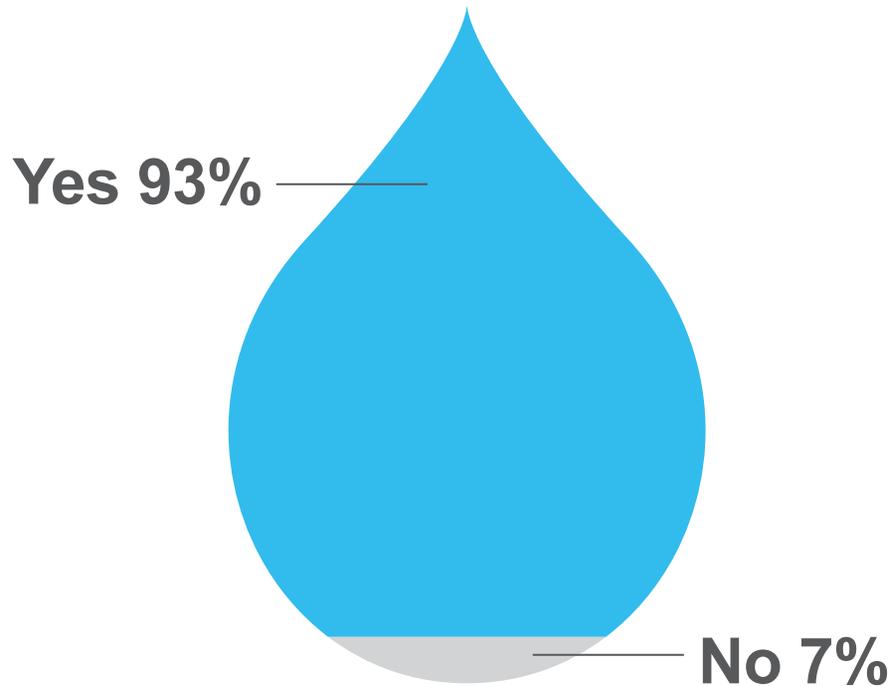
Only 7% of foreign companies are not currently manufacturing in China and do not plan to do so.

The majority of foreign companies manufacturing part of their product in China, typically retaining manufacture of IP sensitive parts at home.

Some manufacture their entire product in China, which is possible providing the appropriate measures are taken with regard to IPR and selecting manufacturers.

GET FEET ON THE GROUND FOR FULL CONTROL

Percentage of Foreign Companies that Have a Local Sales and After-Sales Office



Do you have your own presence in China in the form of a sales and after-sales office?

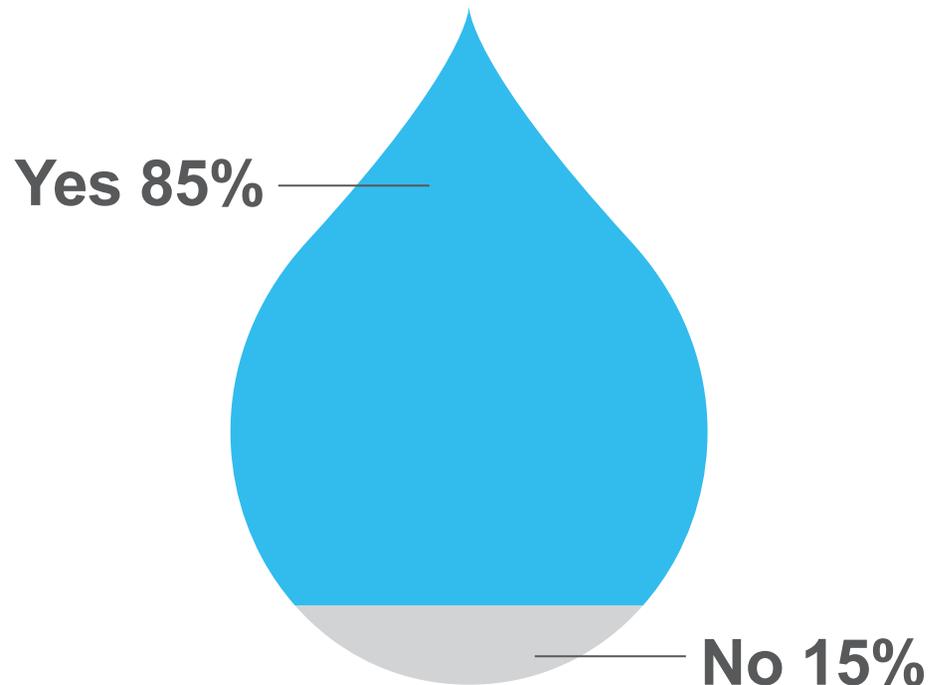
93% say yes.

Almost all foreign companies we spoke to had a local presence. Without a local presence, customers are unable to receive appropriate and sufficient amount of sales support – and most importantly – after-sales support.

Trusting your distributors to provide good after-sales service puts your brand image and customer satisfaction in the hands of another party- and this usually does not work well.

TAILOR YOUR PRODUCT TO THE CHINESE MARKET

Percentage of Foreign Companies Adapting their Product



Did you adapt your product to the local market?

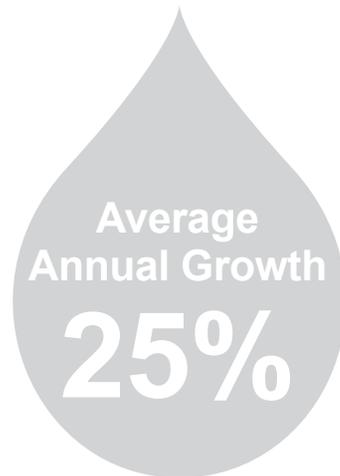
85% say yes.

The majority of foreign companies have adapted their products to appeal to the local market and to lower their product costs. This ranges from the design of the product to specific technologies used within.

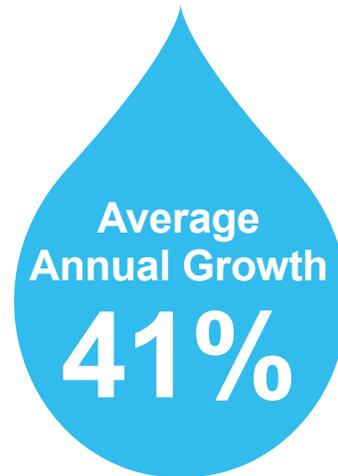
Adaptation usually takes two forms:

- More thorough filtration to combat more serious water pollution
- Simplifying the product to reduce costs

THE CHINESE MARKET IS GROWING, AND FAST



Past 3 Years
Performance
Worldwide



Past 3 Years
Performance in
China

How has your company been performing annually over the past 3 years in China?

An average annual growth of 41%.

Foreign companies have experienced higher growth in China over the past 3 years than they have worldwide.

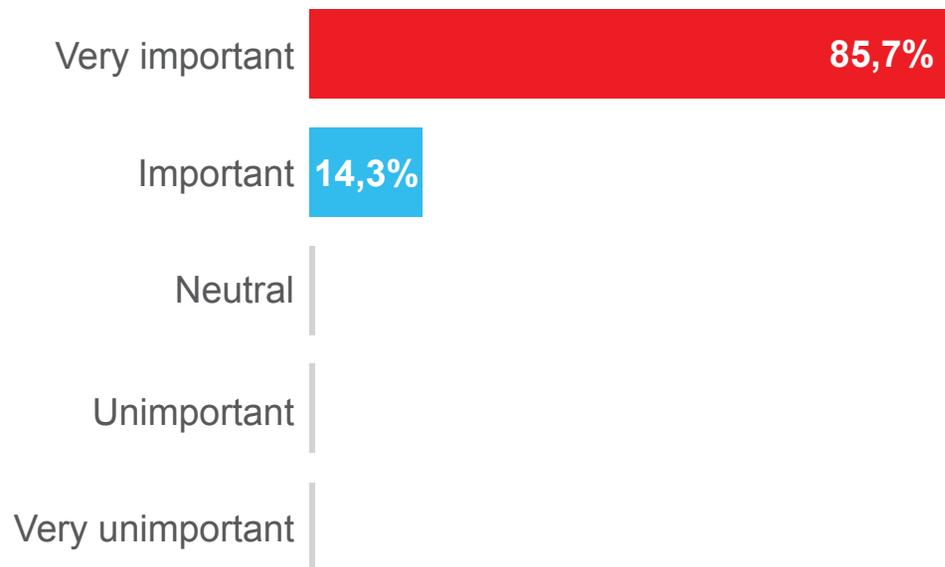
The majority of foreign companies have been selling to China for over 5 years, so this data is not representative of growth from companies just starting in China.

Many companies we spoke to were mature companies in the RWT market, yet they still see an average annual growth of 41% in China.

The real question remains: how profitable are companies in China?

CHINA HAS BECOME A PRIORITY RWT MARKET

Foreign Companies Rate the Importance of the Chinese Market



How important is the Chinese market to your company?

85.7% say it's very important.

China's RWT market is reaching its tipping point. The foreign companies we spoke to unanimously agreed the crucial importance of the Chinese market to their business.

Testament to the growing market, all the foreign companies we interviewed are now witnessing high growth in their sales. China is now recognized as one of their priority markets.

MORE REPORTS AND INFORMATION

Check out our website for more information about the Chinese water technology market and how to increase your sales in China.

Visit our website now



Download our premium reports for free:

- **An in-depth look into China's RWT consumer market** (coming soon)
- **Sales and distribution in china's residential water treatment market**
- **A guide to registering your water treatment products in china**

METHOD OF RESEARCH AND LIMITATIONS

Over the past six months, we have utilized both surveys and in-depth interviews with companies and consumers to obtain an in-depth understanding of the market. Much of the data was gathered during the water-technology trade fair Aquatech 2015. Consumer data was collected in Shanghai.

Limitations of our research

- The consumers that were interviewed enjoyed a high level of education and income, which is therefore not representative for China's entire populace. Our goal was to focus on those with sufficient purchasing power to buy foreign brands.
- We interviewed a relatively small number of foreign companies compared to domestic companies. To combat this we cross-referenced our data with other sources to verify its validity.