

MINERAL WATER REPORT

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INTRODUCTION

ONE of the laws of the drinks market is that a product selling well at home should succeed further afield. And when that commodity is bottled water, those companies that sell successfully in Europe and the United States seem primed to expand into the developing world.

It's not that the market is overheated in the west, according to Stephen Kay, vice-president for Communications at the US-based International Bottled Water Association. "Growth continues in the 7%-10% range and analysts expect it to continue along this path in the US," he said. "But with any business, expansion and increased return on investment, development of new markets and return to shareholders and owners may cause companies to look to developing markets for opportunity."

Accordingly, the big names, such as Danone Group and Nestl , are turning to the developing world. "The global bottled water market is doing very well," said Hans Mommsen, manager of the European Bottled Water Association (EBWA). "Sales in Asia and South America are growing by 10 to 11% a year. It's a good market to get into."

Indeed, Nestl  Waters is looking to expand significantly beyond its traditional base, according to Jeff Caso, Senior Vice President, marketing & HOD (home and office delivery) Europe. "Volume growth opportunities on the bottled water market are particularly coming from developing regions of the world," he said. "They are generally showing double-digit growth, so these regions of the world offer real volume growth opportunities. Nestl  Waters is constantly looking at opportunities for development in these regions. However, profitability in the short-term remains uncertain, as prices are generally low and competition strong."

The fact that bottled water can often be cleaner and safer than local tap water in developing countries is only a small factor, suggests Mr Mommsen. "Bottled water sells the image of healthy living, it's friendly and it's hip. The emerging middle class and their disposable income is very important. They consume high amounts of bottled water."

The operating strategy of the multinationals is to buy local. "The big names have been selling their top brands in developing countries for 20 years or so," said Mr Mommsen. "They've targeted the upmarket group you get everywhere. Today they are going for established local brands with potential. They look for companies that are diligent, have the potential for increasing supplies and processing plants that don't need too much improvement. They need good economies of scale. They will market it as the mid-range brand, while they will put the European brands in the luxury category." Home and office delivery is one significant sub-sector for the bottled water majors, with Danone claiming a number-one position in this global market through a series of acquisitions following its purchase of Canada's Aquaterra in 1994. This has secured itself a strong position in the buoyant water markets of Mexico and Argentina, for example, where Danone claims to be number two and number one in the HOD markets. This is important, given the size of Latin American markets for bottled water. A TGI Mexico study in 2002 found that 59% of respondents said they drank natural or unflavoured bottled water in the previous seven days. It cited annual sales of US\$6.56 billion that year, making Mexico the second largest market in the world for the product, after the United States. Just-drinks.com, however, will be examining other regions of the world where there is maybe less obvious potential for sales, but where demand for bottled water could take off significantly in the near future.

EASTERN EUROPE

RUSSIA and eastern Europe offer an intriguing market contrast to developing countries in Asia and South America. In some respects, the market in eastern Europe can be compared to those in poorer parts of the world. For example, growth rates are similar, according to the European Bottled Water Association, with annual increases in production and sales of around 11 per cent. "Some of the countries, such as Poland, Czech Republic and Hungary are very strong," said the EBWA's Mr Mommsen. "Slovenia is also doing well. The bigger companies such as Nestl  and Danone are going in there, but there are also local entrepreneurs investing their capital. There is a middle class emerging there and they have the same desires as the middle class elsewhere."

However, one London-based analyst, who declined to be named, said the bottled water companies should be wary of investing in the Czech Republic. "There is a bit of an attitude problem over there," he said. "Some people have a very nasty attitude towards business and are poaching one another's customers. They are not thinking strategically. They are dropping their prices and that won't work. Some time soon there will be company collapses. If I worked for a bottled water company, I'd be worried about getting my fingers burnt in the Czech Republic. The same applies to Slovakia. It's basically the fact they are trying to go too fast, too soon and they don't seem to want any foreigners. Conditions for bottled water companies are not very good."

The ride in Russia appears to be similarly bumpy, though more for reasons of logistical problems, such as unstructured

distribution channels. But there are lucrative gains to be made for those prepared to persevere. The big brands have again moved quickly to establish a foothold, and Nestl  has bought up the two biggest bottled water companies in the country.

According to the Department of Hydrogeology at St Petersburg University, Russia possesses "almost all types of groundwater, ranging from lightly mineralised water suitable for drinking to very highly mineralised waters." In all, some 300 mineral water sources have been developed as spas and health resorts - some of these date back to the 19th century, when the urban elite of Moscow or St Petersburg would "take the airs" in the southern Caucasus mountain range. Today, more than 150 of these spas produce bottled mineral water, though the region's proximity to Chechnya - just 150km from Kislovodsk, the headquarters of Narzan, a popular, state-owned mineral water enterprise during the Soviet era - has raised the issue of security.

Growth of the bottled water market in Russia is more than 20% a year, according to EBWA. "The market is growing like hell," said Mr Mommsen, who is in the process of establishing a bottled water association for the country. "It is very strong in Moscow, St Petersburg and a couple of other cities. It's the hidden jewel of those markets that don't have much exposure to bottled water. Everything is up for grabs there. You don't need a negative strategy or look to take any customers away from rivals because there are plenty to go around."

Nestl  Waters has subsidiaries in Russia, along with Hungary and Poland, each offering local brands, Nestl  brands and international brands such as Perrier, Vittel and S.Pellegrino. In Hungary, Nestl  brands grew by 9.8% in 2002/2003; 6.4% in Poland and 17.9% in Russia. "With a relatively low consumption per capita, and double-digit growth rates, Eastern Europe offers very attractive potential markets," said Nestl  Waters' Mr Canso.

But, though the Russian market is increasing in size and strength, market analysts AC Nielsen warn that aggressive marketing, promotion and price cuts from Coca Cola's BonAqua and Pepsi's Aqua Minerale brands are challenging established names like Narzan and its Georgian counterpart, Borjomi. The interest in the Russian market is reflected by the decision of the European Bank for Reconstruction and Development (EBRD) to acquire a minority stake in Narzan, as part of a US\$12.25 million combined loan and equity investment.

The EBRD financing package will help Narzan, which was, expand its bottling capacity, develop new products and provide it with working capital. The company reported a turnover of US\$23 million in 2003, the first year it reported under international accounting standards. Narzan produces 70 million litres of water a year, 25 million more than in Soviet times. "Narzan is a traditional Russian mineral water, which we believe has good potential to capture a growing share of the booming Russian beverage market," said Hans Christian Jacobsen, director of the EBRD agribusiness team.

Mr Mommsen advises caution, however. "It's a difficult market to crack because of the language," he said. "You need good local managers and logistics are important. The roads, the infrastructure and the winter are the biggest challenges. You have to remember that water does freeze and it gets cold in Russia."

SOUTHERN AFRICA

Another key emerging market is South Africa, where the natural bottled water market has grown to US\$106 million for the year 2003 on sales of 100 million litres, representing a nine fold increase for the years 1993 to 2003, according to consumer goods research company BMI Foodpak. However, a problem currently facing the industry appears to be the lack of a rating system or national regulations governing water quality. Mark Lilje, sales and marketing director at Eau De Vie, a South African bottled water producer says that there is no differentiation on quality. "We need a system that will rate the water according to the source, how it is treated and how it is bottled. With out these measures in place we can expect to see more fly by night and back door operators entering the market, since the market is currently not developed to the point where the consumers will differentiate on quality but focus rather on price," he told just-drinks.com. Indeed, - as in other countries around the world - recently Coca Cola came under fire in South Africa after it was found that the company's bottled water brand Bonaqua was treated tap water. However, Casper Durandt, Coca-Cola's technical manager for the Southern African region, insists that the purifying process remains an expensive and effective one that is particularly effective in a low rainfall area such as South Africa. "The water is stripped down and passed through a multi-barrier filtration system to make it pure. The result is that the consistent in quality unlike mineral water which changes with rainfall," he said. That said, Salmen Khen, managing director of Waterval Minerale and national director of the South African Natural Bottled Water Association (SANBWA), says that in the interest of the consumers a distinction should be made between mineral and processed water, and that this should be indicated on the bottles. SANBWA, has developed a series of guidelines and standards which its 19 members must adhere to. These state that the source of its authorised water products must be certified by a qualified hydrologist and must be free of e.coli, coliforms and pathogenic bacteria. In terms of developing an export market two schools of thought are emerging from the South African bottled water industry. The first is to focus on developing home markets before expanding as the recent strengthening of the SA Rand has made South African exports less competitive. Eau De Vie's Mr Lilje said: "In the immediate future we intend to become stronger in our home market. However, in the SADC (Southern African Development Community) region we do see opportunities emerging in the DRC (Democratic Republic of the Congo) and Mozambique which we will pursue through agents based in country." However, contrary to this, the new owners of Karoo Mineral Water - Mathias Bode and Christopher Miller - have announced that the company will begin exporting its product to Europe before the end of 2004 and intend to raise exports to 10% of the company's turnover, while

increasing its local market share from 1.2% to 5% in the next three years. Meanwhile, in Namibia and Botswana, companies have been rebottling South African mineral. Their target market is currently the local tourist trade; bottling companies have their own brands such as, Etosha Springs in Namibia and Kalahari Mineral Water in Botswana, both relabelled products from South Africa. Meanwhile, some local hotels are seeking to re-label these products with their own brands.

ASIA-PACIFIC

These generally positive developments in eastern Europe and southern Africa are however dwarfed in terms of opportunity by the rising demand in for the global bottled water industry in Asia (including Australasia), which stands out as the fastest growing consuming region.

Of course there are still millions of people in east and south Asia, as well as the Pacific, who are living below the poverty line and who cannot and may never be able to afford to buy clean bottled water in supermarkets or corner stores but those who can afford it are clearly doing so more frequently.

According to the 2004 Global Bottled Water report produced by UK-based drinks consultancy Zenith International, Asia/Australasia's bottled water market advanced by 11.2% in 2003 to reach a total of 36 billion litres, while the region's compound annual growth rate in sales for the 1998-2003 period was 18.1%.

The report showed that consumption per person has more than doubled in the past five years pushing the regional consumption per person average to a high of 10.3 litres in 2003. Previously consumption in the region overtook that of North America in 1999 and Latin America in 2001. The Zenith International report also noted that although China was the region's largest bottled water market in 2003 with a one-third regional share, the highest consuming nation was actually Thailand with consumption per person exceeding 80 litres for this 12-month period.

The United States and Mexico were still the two largest single markets in 2003 but, significantly, China and Indonesia looked likely to demote Italy (which has always been seen as a big consumer mainly through its successful tourism industry) back to fifth place by 2008.

The Zenith International report also said the global market continues to surge ahead, advancing by 9.2% to 155,400 million litres in 2003 - the same growth rate as 2002 - and it predicted that in the next five years Asia/Australasia's consumption statistics will see the region overtaking western Europe in 2007. This growth will be led by demand in the huge markets of China, Indonesia, India and South Korea.

According to the vice-president for communications at the US-based International Bottled Water Association (IBWA), Stephen Kay, bottled water companies that sell in Europe and the United States have the countries of the developing world, including Asia, on their radar screens.

"Analysts expect growth to continue in the US and at the global level. As with any business, expansion and increased return on investment, development of new markets and return to shareholders and owners may cause companies to look to developing markets for opportunity," Mr Kay said. The larger companies, such as the Danone Group and Nestlé, are among those who are training their sights on the huge potential markets of the developing world.

The European Bottled Water Association's (EBWA), Hans Mommsen, agreed that the Asian bottled water market looked bullish, highlighting sales which are growing by 10 to 11% a year. "It's a good market to get into," he said.

The key, he said was that companies have been preparing the ground for take-off. "The big names have been selling their top brands in developing countries for 20 years or so," Mr Mommsen he stressed. "They have targeted the up-market group you get everywhere. Today they are going for established local brands with potential. They look for companies that are diligent, have the potential for increasing supplies and processing plants that don't need too much improvement.

"They need good economies of scale. They will market it as the mid-range brand, while they will put the European brands in the luxury category," he said.

One factor fuelling this growth, certainly in the poorer nations of the Asia-Pacific region, is health. Increased health programmes across the south east Asia region have highlighted the importance of drinking safe water and using it for preparing food and brushing teeth, and as a healthy alternative to sugar-rich soft drinks, some of which have been targeted as contributing to an unhealthy life style.

Now only the most remote and poorest rural areas of nations in the region are without supplies of bottled water. Yet even in some of the least accessible hill towns of Vietnam and Laos visitors are still offered a bottle of fresh and iced mineral water straight from a fridge.

Zenith International's 2004 report said the "rise of bottled water consumption illustrated that health is becoming an

increasingly influential factor in consumers' choice of soft drink".

"In particular the rising issue of obesity is a major challenge for the soft drinks industry. There are currently more than 300 million obese people in the world, according to the World Health Organisation (WHO), and the high consumption of sugar rich soft drinks has been accused of contributing to this problem," said the report.

"Health issues are already influencing the dynamics of the soft drinks industry and this is likely to become more pronounced as time goes on. In this climate, bottled water remains a likely beneficiary."

A 2002 report from the global industry analysts AC Nielsen, entitled "What's Hot Around the Globe", found that "in addition to new product entries into the category, consumer concern over the quality of local water was one of the contributing factors driving 'still' (bottled water) growth". When combined with the marketing kudos attached to bottled water highlighted by the EBWA that the product is "young and hip", its rising popularity seems destined to be sustained for some time to come.

What is harder to fathom is the extent and type of bottled water production in south east Asian nations because statistics are notoriously unreliable in what can be considered still to be a young industry here. Some markets do not rely heavily on natural mineral or spring water but instead favour taking potable water and purifying it using a variety of methods such as reverse osmosis and distillation. Then the water is bottled and sold.

Across the Asia region the ratio of natural mineral/spring to purified water is respectively 60:40 with the following countries showing a strong penchant for purified water: South Korea, Thailand, Malaysia, Vietnam, the Philippines and India (source: Zenith International). Each of these markets has less than a 10% share for natural water formats.

Purified is still also the bottled water of choice in China but there is a distinct and ongoing shift away towards mineral water.

CHINA

All this aside, in east and south east Asia one country is dominating business and trade at the moment and this is reflected quite clearly by the bottled water industry.

China, which is undergoing seismic shifts as it shakes off communism and dons the unfamiliar robes of the world's newest mass market economy, is having a big impact on the industry in the region and worldwide.

It boasted the largest bottled water market in 2003, holding a one-third regional share (source: Zenith International 2004 Global Bottled Water). A year earlier the company's 2003 Asia/Middle East Bottled Water Report, noted that China was home to two of the top five bottled water companies in Asia for 2002: Wahaha (Danone) and Robust (Danone). The other leading brands are Aqua Group (Danone) in Indonesia, Boon Rawd in Thailand, and Ades (Coca-Cola) in Indonesia, and these top five companies claimed a one-fifth regional volume share in 2002 while the top 10 companies held more than one quarter of volume in the region in 2002 (figures exclude Australia and New Zealand).

China's crucial position and potential are both understandable given that it is the world's most populous nation with a total head count of roughly 1.3 billion. However, China also has significant reserves of water, which could be tapped for the industry. Although there are no official or estimated figures on natural water resources, according to estimates from its Ministry of Water Resources the total groundwater resource volume could measure as much as 828.8 billion cubic metres.

The large proportion being used for the production of beer and food must be subtracted before arriving at any bottled water resources figure, as well as non-commercial sources, and large amounts are used locally in rural areas as well.

Whatever, there will be plenty of resources left over for bottled water, whose current production and consumption levels in China leave plenty of room for expansion, according to the China representative for the bottled water industry analysts Canadean, Philippe Chan. He told just-drinks.com: "It is estimated that in 2004 around 6.5 billion litres of bottled water will be sold in China, and exports will only be around 12 million litres, which is insignificant".

Some caution should be injected here, though, because although this might seem small to industry experts, nationwide accurate figures about the sector are still hard to come by.

Mr Chan explained: "It is hard to gauge the total size of the bottled water market since anyone that has production capabilities can enter the category with low investment costs. "A large number of soft drinks companies in China produced packaged water in some capacity. The real problem in getting accurate figures lies in the fact that there are thousands of other small seasonal beverage manufacturers that are producing in lower tier cities and towns, and these companies are not measured in terms of volume produced, nor by the number of people they employ," he added.

Also, while it is clear is that bottled water has definitely become part of the culture in the more populous metropolitan areas, the picture is clouded by the fact that growth is slowing due to heavy competition coming from bulk or 'carboy' (water cooler) water, which on average is cheaper than bottled water.

"For instance," Mr Chan explained, "a 500 ml PET bottle of water costs on average Yuan 1 (US\$1.20) while a 19 litre carboy water might cost Yuan 8 (US\$9.60) to 10 (US\$12.00) in most areas. An increasing number of households, offices, shops and even airports and train stations have water coolers now, and it is cheaper in price per litre terms compared to bottled water."

Mr Chan also added that whereas in most markets around the world water coolers are mainly for offices, in China it is common across households as well as in retail shops in major cities.

Furthermore, demand for smaller packages of water is currently being stifled a little because the large distances from production sources to the points of consumption makes it costly and ineffective to distribute packaged water over very long distances due to high costs.

Looking at the breakdown of packaged water sold in China, he added that a large percentage is either table water or distilled water. "The proportion of mineral water to distilled water was 32% to 68% in 2004. That figure compares to 25% to 75% in 1999, so there is a gradual but noticeable shift towards mineral water in China," he said.

On the plus side for large exporters to China, Mr Chan noted that "overall packaged water prices are low in general and the market is attracting more imports of niche brands from overseas". And there are signs that Chinese mineral water producers are becoming aware of the marketing opportunities posed by the source of their products. "In Hainan, in southern China there is a company called Coconut Palm which places a strong emphasis on the water coming from a local volcano," he said.

Zenith International's research and development director, Gary Roethenbaugh, said generally speaking, the price of bottled water has seen a dramatic downward shift in markets such as China.

"In China, the one overriding strategy employed by the majority of bottled water operators - small pack and water cooler alike - is aggressive pricing," he said.

"Over the past few years the market has witnessed a dramatic surge in new entrants. These often gain market share through very low price points, which in turn makes it very difficult to remain in business in the medium to longer term. Also, new entrants may often be inexperienced entrepreneurs, riding the wave of bottled water's rising popularity.

"Unfortunately," added Mr Roethenbaugh, "highly competitive market conditions make it difficult to remain in business once the necessarily high levels of marketing investment, to gain a footing in bottled water, have been exhausted.

"The net effect of the aggressive price-discounting environment is that brand loyalty has been eroded and the national share of the major brands has been worn down by the onslaught from new, local bottled water players. As a consequence of price discounting, consumers, understandably, have come to expect that water is a low cost offering."

So what of the future for the world's most dynamic new market economy?

Canada's Mr Chan predicts the market for bottled water will continue to show promising growth over the next three to five years, averaging 10% a year.

"However, as consumption growth is near its peak in the major cities, companies are focusing their sales and marketing efforts in the smaller tier cities and towns and it is anticipated that it will take longer to penetrate in these areas due to less disposable income by people living there," he said.

Local producers are less likely to try and increase sales by exports, he added, as they face an uphill battle against better-established western rivals such as Evian and Perrier for example. "Therefore I cannot envisage any serious efforts will be made by players to export and market their products overseas in the near future," said Mr Chan.

TAIWAN

Across the Taiwan Strait in Taiwan, bottled water is also making its mark on the economy. The drinks analyst company Datamonitor Asia Pacific reported that the Taiwanese bottled water market grew by 3.2% in 2003 to reach a market value of US\$90 million.

The market volume of the Taiwanese bottled water sector grew by 0.6% in the same period to reach 160 million litres. Datamonitor Asia Pacific also reported that Taiwan accounted for 1.7% of the Asia Pacific bottled water market in 2003.

INDONESIA

Indonesia is also a significant player in the industry in south east Asia. The secretariat of the Asia Bottled Water Association is based in the capital, Jakarta. According to Coca-Cola's regional headquarters in Sydney, Australia, (the drinks giant's South Pacific HQ covers Indonesia but the rest of south east Asia comes under the Hong Kong bureau), the size of the total

bottled water demand in Indonesia is 5.4 billion litres per year.

"The largest brand in Indonesia is Aqua, owned by Danone. The Ades brand, owned by the Coca-Cola Company, is the second largest brand," said Geoff Walsh of Coca-Cola (South Pacific and Korea), noting that Indonesia's Aqua brand sells more volume than any other brand worldwide, (three billion litres a year, says Danone). Noting that the bottled water sector in Indonesia is "highly competitive", Mr Walsh said: "Affordability is critical for this market due to low purchasing power among the majority of consumers. Danone is the market leader in Indonesia with more than 50% of the segment. Ades is manufactured in seven plants and the biggest plant is located in Cibinong in West Java. Bottled water is certainly part of the culture in urban areas where the quality of water is especially poor."

As for the future in the world's most populous Muslim nation, Mr Walsh believes there is room for growth.

"Currently consumption per capita in Indonesia is still low (25.8 litres). Therefore, the category has large opportunity to grow further. The category enjoyed solid growth over recent years and is still growing even though it is now the seventh largest water market in the world," he said.

THE FUTURE

The future for the bottled water industry in south east and east Asia is hard to predict. In some ways it looks extremely prosperous with the market here looking bullish and living trends moving towards the increased consumption of more mineral water.

Zenith says the Asia/Australasia bottled water market is forecast to reach a total of 55 billion litres by 2008 and, of course, much of this will be led by countries with the larger populations - China in particular but possibly Indonesia as well - and their untapped penetration of bottled water.

There has been a reliance on mass (bulk) water in some markets which has meant people can choose between drinking mineral water at home or when they are commuting to work or maybe in the gym. Although the substantial volumes gains in bottled water are encouraging there is always the threat of price depreciation because in many locations in south east Asia more expensive foreign imports are sold alongside low cost locally produced products.

One key factor in the growth or otherwise of bottled water sales in south east Asia could be the niche markets which are also gaining momentum in the region's traditional economic motor and key developed country, Japan. Indeed, Zenith's Gary Roethenbaugh believes Japan is the best Asian example of the new niche bottled water markets.

"Through an embracing of functional beverages and innovative beverage products in general, Japan has been at the forefront of creating niches," he said. "The 'near water' concept took off in Japan in the 1990s. Near water is essentially bottled water with a dash of juice (typically less than 5%), sugar/sweetener and a range of functional ingredients. These products can be pitched at a variety of consumption occasions.... from increasing energy levels to heightening libido.

"Recently, Japanese consumers have been increasingly willing to pay a high price for bottles of desalinated Hawaiian deep sea water, which has been selling for as much as US\$33 per bottle. This form of bottled sea water is being marketed as a mineral rich, dietary supplement that helps with weight loss, stress control and digestion," according to Mr Roethenbaugh.

"Beyond Japan, a number of other Asian markets have embraced 'functional waters', including China and Malaysia."

These views are echoed by AC Nielsen's 2002 report, which noted that "new innovations in the water category drove growth, including fortified water, "sports" water and flavour-enhanced water.

Whatever, with such potential demand evident for the bottled water industry, companies will have to keep a careful eye on government trading and commercial policies in such countries as China and Indonesia (with its new president) and the effects will be of various acquisitions and market strategies within the region.

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