

Study on  
Returns to Kao's Stakeholders  
In FY2017

May 18, 2018

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## 1 Objectives

The Kao Group strives for the wholehearted satisfaction and enrichment of the lives of people globally and to contribute to the sustainability of the world, with products and brands of excellent value that are created from the consumers' and customers' perspectives. We have been seeking to improve our corporate value, aiming for sustainable, profitable growth and to contribute to social sustainability through the Kao Way, our corporate philosophy that has been in existence since our establishment. Going forward, we will hold fast to the fundamental value of the Kao Way – Integrity – as we strive for further growth. We will stay true to the slogan, “Transforming Ourselves to Drive Change,” set forth in the Mid-term Plan K20, and elevate the use of our assets to a higher dimension. We will accelerate our efforts to return the benefits of our sustainable growth to all stakeholders, including shareholders, employees, clients, and society. We would like all stakeholders to become keenly aware that Kao is a must-have in this world and to have higher expectations for us.

Through the operations of the Kao Group in FY2017, this initiative is the first step toward finding methods to maximize benefits for stakeholders by quantifying and monetizing social and environmental externalities (both positive and negative). We are fully cognizant that there is room for improvement in the way we have estimated the monetary value. We aim to make continuous improvements and better reward our stakeholders in line with the Mid-term Plan K20.

## 2 Scope, Data, and Methods

### (1) Scope of data collection

Kao Corporation,<sup>1</sup> a consolidated subsidiary of Kao Corporation,<sup>2</sup> and its equity-method affiliates\*.

\*1 and 2 include manufacturing sites including logistics hubs and non-manufacturing sites.

### (2) Data used for monetary valuation

The following data is for the period from January 1, 2017 until December 31, 2017:

- Retained earnings
  - Earnings (sales, other operating revenues, financial income, and share of profit in investments accounted for using the equity method), expenses (cost of sales, selling and general administrative expenses, other operating expenses, financial expenses, and income tax), and dividends
- Social externalities

- Health and safety (the numbers of deaths and people who are sick or injured), community investments (expenditures of both sanitation and education programs), and economic losses due to corruption (expenditures and others due to business operations in countries / regions where corruption risks are supposedly high)
- Environmental externalities
  - CO<sub>2</sub> emissions (Scope 1 and Scope 2), other emissions (PM10, NO<sub>x</sub>, SO<sub>2</sub>, mercury, arsenic, cadmium, chromium, lead, nickel, dioxin and furan, VOC, benzene, and polycyclic aromatic hydrocarbons), water withdrawal, biodiversity (altered/restored land areas), and waste (the amounts of landfill and incinerated waste)

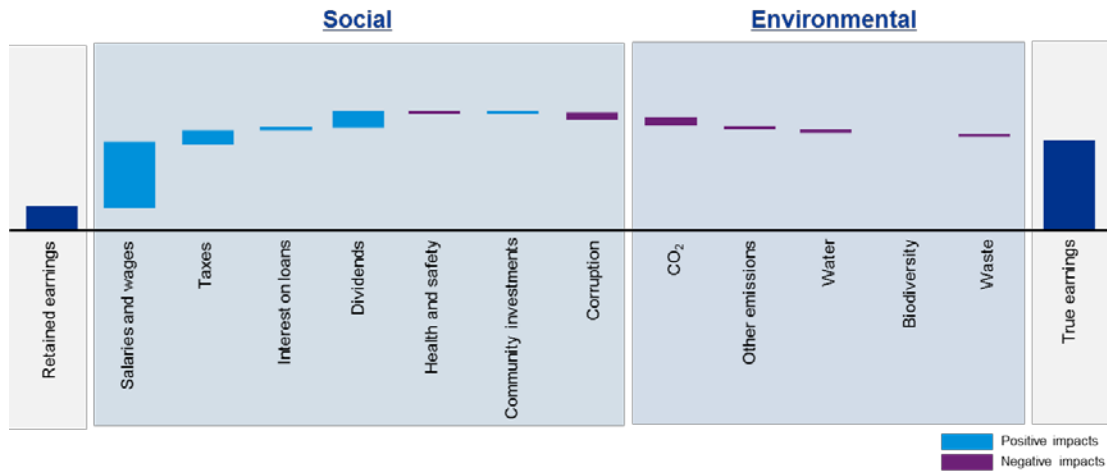
### **(3) Methods of monetary valuation of externalities**

In estimating the value of externalities, we have consulted the Redefining Value project advocated by the World Business Council for Sustainable Development (WBCSD). We calculated the amount in principle by multiplying the actual value of multiple items (health and safety, emissions, etc.) that impact our business activities by their respective conversion factors. As to “the economic losses of corruption,” which is a part of externalities, however, we calculated indirectly by multiplying such cash expenditures as salaries and wages and taxes of countries where we mainly operate by the GDP loss factors of corresponding countries. This is because measuring the actual impact of “corruption” caused by our business activities is not feasible.

These actual values are those of the Kao Group for that particular fiscal year, while conversion factors have been taken from various reference materials. When conversion factors diverged, we picked the highest figure to obtain the maximum value.

The estimated value has been converted to Japanese yen based on the exchange rate as of FY2017 year-end.

### 3 Monetary Valuation Results



(Vertical axis unit: Japanese yen)

Kao Group's residual value that takes into account externalities exceeds our retained earnings (after-tax profit minus dividends). This means that the combined value of the positive impacts we generate on our stakeholders exceeds the combined value of the negative impacts.

The top three externalities that comprise the total value of the positive impacts are salaries and wages, taxes to the government, and dividends to shareholders. Among them, dividends to shareholders are a component of Economic Value Added (EVA), which represents the "real profit" that reflects the cost of invested capital, a key management indicator for the Kao Group. We will further increase our positive impacts by generating a steady cash flow through EVA and providing stable and continuous dividends toward 40% target payout ratio.

The top three externalities that comprise the total negative-impact value are CO<sub>2</sub> (Scope 1 and Scope 2), corruption, and water. The Kao Group will maximize benefits to stakeholders by reducing our negative impacts, and thus, contributing to the soundness of society.

In comparison with the monetary valuation results of the Kao Group's business activities in FY2016, it was revealed that the residual value generated in FY2017 exceeded that of FY2016.

### 4 Recognition of Future Challenges

#### (1) Expansion of the scope of data collection

This document, as explained on the second page, encompasses the sets of data from Kao

Corporation, a consolidated subsidiary of Kao Corporation and its equity-method affiliates.

The nature of Kao Group's operations is that we must reduce environmental impacts associated with our products, such as the use of water and packaging materials, to maximize benefits to stakeholders. For this reason, we will expand the scope of data collection in the future to include the entire supply chain.

## **(2) Expansion of externalities with positive impacts**

This document lists five externalities that contribute to the total positive impact: salaries and wages to employees, taxes to the government, interest payments to creditors, dividends to shareholders, and contributions to society through community development.

The Kao Group strives for the wholehearted satisfaction and enrichment of the lives of people globally and to contribute to the sustainability of the world, with products and brands of excellent value that are created from the consumer's and customer's perspective. This commitment is embraced by all members of the Kao Group as we work together with passion to share joy with consumers and customers in our core domains of cleanliness, beauty, health and chemicals. We will maintain our efforts to establish a method to calculate the positive impact that our products have on consumers and customers.

## **(3) Examining interrelations between externalities and EVA**

EVA represents the "real profit" after the cost of invested capital and is a key management indicator for the Kao Group. We believe that continuous increases in EVA will also lead to our corporate value improvements, benefiting not only our shareholders but also the rest of our stakeholders in the long-run.

In this document, the externalities such as salaries and wages to employees, taxes to the government, and interest payments to creditors, are defined as value providers; i.e. they contribute to the positive value for maintaining the health of the society while they are expenses by EVA definition. Consequently, the Group's residual value is verified by including the externalities that are not included in EVA. We aim to maximize our value for all stakeholders through EVA management, by reducing adverse environmental and social impacts attributed to Kao Group's business activities.

## **5 References**

This document has adopted as a framework the Redefining Value project advocated by the World Business Council for Sustainable Development (WBCSD). In calculating externalities with respect to the environment and society, we used the references below.

- Technical support document: technical update of the social cost of carbon for regulatory impact analysis, EPA, 2015
- Costs of air pollution from European industrial facilities 2008–2012 - an updated assessment, European Environment Agency, 2014
- Natural Capital at Risk: The Top 100 externalities of business, TruCost, 2013
- TEEB, climate issues update, Pavan Sukhdev, Joshua bishop, et al, 2009
- Environmental impacts and costs of solid waste: a comparison of landfill and incineration, Ari Rabl, Joseph V. Spadaro, Assaad Zoughaib, 2008
- The Cost of Work-related Injury and Illness for Australian Employers, Workers and the Community: 2012–13, Safe Work Australia, 2015
- Global costs and benefits of drinking-water supply and sanitation interventions to reach the MDG target and universal coverage, WHO, 2012
- Comparable Estimates of Returns to Schooling Around the World, Claudio E. Montenegro and Harry Anthony Patrinos. World Bank Policy Research Working Paper, 2014
- Corruption Perceptions Index 2016, Transparency.org, 2017