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Rapidly Transforming into the New, Strong and Agile Kao



To our stakeholders

The world today continues to experience great turmoil. Rising geopolitical tensions are fueling divisions among people, the pandemic is still with us, and environmental problems are increasing in severity. On the other hand, economic activities are necessary for people to continue living their lives. There have been long-running debates on how to balance human life and the economy, the environment and the economy,

and so on. It is incumbent upon us to find this balance in the world in the 21st century. We have set our vision as “protecting future lives” in light of the tumultuous times that we are in, and have designated life, everyday lives and ecology as three areas where we will contribute to society. In the face of urgent environmental problems and complex social challenges associated with population aging and growing burden of health care expenses, Kao is more committed than ever to enabling healthy and sustainable everyday lifestyles.

Turbulent first year of the Kao Group Mid-term Plan 2025 (K25)

We kicked off K25, the new Kao Group Mid-term Plan, in FY2021. The strategic approach for K25 consists of the following three parts with a focus on the year 2030.

They are: (1) Become an essential company in a sustainable world, (2) Transform to build robust business through investment and (3) Maximize the power and potential of employees. In addition, we must achieve business transformation to a high-revenue-earning business model in this tough business environment. From the starting year of K25, financial performance for FY2021 should and could have been stronger. While external factors including the prolonged COVID-19 pandemic and hikes in raw material prices are certainly present, it is also a fact that we under-invested in parts of our business that



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needed more support. This is not an issue that has suddenly emerged, and it signifies that we must further increase the speed of our corporate reforms.

Our awareness of the issues

After peaking in 2018, three factors have contributed to a sharp decline in our Economic Value Added (EVA®) result.

The first is our delay in moving away from mass marketing in Japan. In the past, we have enjoyed best-in-market loyalty from consumers in many categories by leveraging our distinctive technologies and mass production capabilities. However, consumer needs are diversifying, and in some areas the speed and quality of our manufacturing has not kept pace with these expectations.

The second factor is the collapse in inbound demand for disposable baby diapers, which accounted for a large share of our sales. Our category leader Japanese-made *Merries* had become so popular in Japan that consumers could not even find them in stock. The combination of being out of stock, with the emergence of local Chinese products, resulted in declining levels of our brand name recognition. It is fair to say that our delay in changing our business model in anticipation of those developments significantly impacted our EVA.

The third factor is the contraction in the cosmetics market driven by the COVID-19 pandemic. Makeup products account for an especially large share of our sales, and the contraction in demand severely impacted

our business performance. We had advanced reforms through 2019 to transform the Cosmetics Business into a high-profit business, and as such the overall business impact was magnified because of the investment in business model transformation already underway.

Dual-track reforms to revitalize existing business and create new business

Since last year, we have been implementing dual-track reforms using the concepts of Reborn Kao, which aims to revitalize existing business, and Another Kao, which aims to create future focused new business. Just as the phrase implies, Reborn Kao is about reinforcing our current business with dynamic investments and fortifying our brand strategy, while Another Kao focuses on themes that we have not done, or have not been able to do, in the past. In order to deliver the dual-track approach, we have reset our innovation agenda and mobilized the team to ensure new business investments are highly leveraged against our current business competencies, capabilities and technologies. Optimizing synergies between our existing and new businesses to deliver maximum value is core to how we will lead the way forward. Our goal in this is stated in our Commitment to the Future.

Reborn Kao: Major reforms in manufacturing and marketing

The immediate priority to deliver on the Reborn Kao plan is to implement a series of significant

manufacturing and marketing reforms.

We will be making dynamic investments in category leading brands and deliver a dramatic shift in our approach to marketing. Marketing investment will be focused on creating strong ties with consumers and accelerate our rapid shift to loyalty and retention based relationship marketing. We need to have distinctive products that offer functional value to do this. Also important is offering value that touches consumers on an emotional level and has the power to make consumers want to tell other people about the products. New digital experiences, technology advancements and opportunities to maximize personalization are all key to success.

Integrated into these priorities is the advancement of our ESG agenda, we will accelerate our proposals for ESG-driven *Yoki-Monozukuri*, which we define as “maximum value with minimum waste,” to contribute to a circular society. In products designed for the future, it is important that the various types of value they provide to consumers is long-lasting and strongly satisfying while minimizing the energy, substances and labor required to make them.

Next, regarding globalization, we will distinguish ourselves in the global marketplace and avoid fierce competition of product and price, by ensuring we offer “only one” value to our customers. To compliment this, we are moving toward local production and consumption model, grounded in local value, cost performance and manufacturing.

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In the Americas, Europe, the Middle East and Africa (AEMEA), our goal is to become the No. 1 brand in the target categories. In the salon hair color field for example, we have strengthened our global presence and success through distinctive and innovative product. In the body skin care field in AEMEA, we are rolling out products that set us apart from other companies.

In the Chemical business, we already enjoy market leadership driven by unique and high performing products. Our focus is on driving forward and integrating ESG-based innovation to distinguish them even further.

Reborn Kao: Significant reform for high-profit businesses

We are also aiming to make a major pivot to a high-profit business. To clarify our investment policy, we separated our business into three domains last year: Stable Earnings, Growth Drivers and Business Transformation. Stable Earnings relies on high margin category leading businesses where we lead in the industry. In Growth Drivers domain, we will accelerate our global growth through targeted investment and Business Transformation efforts will be focused on delivering increased profitability. We are currently pressing ahead with these reforms.

In addition to these efforts will be a focus on purpose-driven brand management in our Consumer Products Business. We will design our distinctive brands to create synergies built around their brand

purpose and leverage the authenticity and performance of our portfolio of brands to deliver growth.

Last year, we saw growth in brands and business that digitized early. These were primarily in cosmetics and men's facial cleanser in Japan, professional hair care in Europe, and body skin care in the Americas. We delivered new innovation in disposable baby diapers in China to positively support newborn development.

These diapers are resistant to swelling after urination, so they do not interfere with babies' walking gait. Also, parents can use smartphones to monitor the development of their baby's earliest walking movements, and we launched a service that provides advice based on the stage of a baby's individual development. The diapers have been positively received in the market, and we are proceeding with local production. These are some of the ways in which we have moved the "yardstick" used to measure value with consumers, and evidence that we are increasing the value experienced by customers.

Another Kao: Create new businesses

Specific measures for Another Kao, which aims to create new business models, commenced in 2022. This business model mobilizes our deep expertise in monitoring technologies and allows us to deliver precise and customizable solutions. Generally speaking, for issues where the cause is clear, precise and effective product design is possible. There are many

cases, however, where the cause is unclear, and often the solutions that are provided then need to be highly generalized. This then results in a sharp drop in the value that is experienced. Kao is well advanced in developing platforms to analyze causal relationships from easily obtainable data such as with sebum RNA monitoring and walking motion monitoring. This enables us to offer more precise and targeted solutions. These monitoring solutions are not done solely by Kao; anyone can use them and improve their applicability.

We have also started utilization of the Virtual Human Body Generative Model this year, which can be versatily applied to meet needs by estimating correlations even when causes are not identified. This model is able to utilize wide-ranging attributes that by their nature have been difficult to connect as input data, and is able to return estimated values for a number of requests. It can thus be utilized in cooperation with partners in many different industries and fields, and this year we have started a large number of collaborative projects. Preferred Networks, Inc., a company with some of the most advanced deep-learning technology in the world, was involved in the development of this model, which utilizes our unique data set.

We are also deploying solutions in industrial fields based on Precision Monitoring in areas such as adjuvants (agriculture) and infrastructure (roads). These are a few of the advancements we are making to advance new business development in alignment with our ESG-driven *Yaki-Monozukuri* commitment.

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People's energy is our driving force

The Kao Way, our Corporate Philosophy, was created in 2004 and established part of our company culture and core DNA in order to spread our valued spirit passed down from our predecessors to all employees. Employees have put the Kao Way into practice as the cornerstone and the starting point of everything we do.

In the midst of transformation, it is vital that our employees question the status quo. As part of this, in 2021 we revised three points in our philosophy that we need to achieve going forward. The first is

establishing our new Mission of "As one, we create a Kirei life for all—providing care and enrichment for the life of all people and the planet." Then we updated our Vision "To be closest to the individual and beyond their expectation," and finally we added "We act with courage" to our Principles.

The updated Kao Way was developed with input and ideas from employees all around the world. Our commitment to our core values of Integrity as the only choice, *Yoki-Monozukuri* in plan and action, and Innovation for today and tomorrow have not changed.

In parallel with these updates, we implemented an OKR (Objectives and Key Results) system. We are already experiencing positive changes as employees are encouraged to set higher and more challenging goals.

In conclusion

As we declared last year, we will transform our manufacturing from an approach driven by consumption to one where resources are circulated. This represents a transition from a linear economic model based on units and volumes to a circular economy based on quality and human connections. It is a more just and sustainable business model for all, poised for success as we remain focused on serving fundamental human needs while solving for complex environmental and social problems. We expect to enact business reforms in FY2022 amid the challenging global business environment. We view the current turbulence as an opportunity to reform and, are fully committed to transform rapidly into the new, stronger and more agile Kao.



Representative Director
President and Chief Executive Officer

Evolution of the future-oriented Kao Way

