

MANDATORY CSR IN INDIA: LESSONS FROM OTHER DEVELOPING COUNTERPARTS

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Abstract

Over the past few years, corporate social responsibility as a concept has been the focus of many deliberations and discussions. With the role of companies transitioning from mere profit-making enterprises to socially-responsible businesses, the importance of CSR has grown both academically and professionally. The present article aims to understand the need felt to introduce mandatory CSR in India and further predict the possibility of it being a success in at least augmenting the developmental efforts of our nation. This is done through a brief analysis of other developing countries which also seem to take a shift towards opting mandating corporate social responsibility for businesses as unlike the developed countries which hold the notion that CSR by its nature is voluntary. In the process, article also traces the legal journey of CSR in India and what does the term CSR comprises when we talk about it in Indian context. The article puts forward that the mandatory nature of CSR can be helpful only in presence of a strong accountable system both legally and publically. It is seen that the regulatory actions have helped increase the reporting of social, economic and development efforts undertaken by corporations, both nationally and globally. The impact of policy on upliftment and development of the marginalized is yet to be established as the CSR regimes across lack concrete steps for impact assessment of work done under CSR programmes. However, one can still be hopeful as the law is still in its nascent stage across all developing countries.

Keywords: Corporate Social Responsibility, Mandatory CSR, Developing countries, Impact, Social Development, Companies Act, 2013

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WHY INDIA NEEDED A MANDATORY CSR?

Corporate Social Responsibility (CSR) in India, having conceptual roots in ancient wisdom and evolving throughout the time span of modern history, saw a kick-start in its discourse after the Liberalization, Privatization and Globalization of Indian economy which in its fold brought various social, economic and environmental challenges. World Bank estimates that about 288.4 million people in India live on less than U.S. \$1.25 a day.¹ Poverty is further intertwined with illiteracy, gender inequality, and malnutrition. Vast environmental issues confront India, such as deforestation, loss of biodiversity, water pollution, air pollution, and the particular vulnerability of Indian populations to natural disasters, among others. In a country which has the highest concentration of people living below poverty-line, India has 90 billionaires and the number is expected to rise to 220 in next decade (in addition to 2.5 lakh millionaires which is likely to get doubled by 2023). This indicates the failure of the trickle-down effect in India.

With the poor remaining poorer and the corporates growing richer day by day, the significance of socially responsible behavior from companies becomes more pronounced. Many companies in India have been performing CSR activities but there still remains a huge gap to be filled.

It was only in the last decade that CSR, in India, has started been given express recognition by a regulatory and legal standpoint. The Indian Ministry of Corporate Affairs (MCA) made its first formal CSR-related efforts when it introduced the Voluntary Guidelines for Corporate Social Responsibility, 2009.² Since then, the Indian government has introduced several other efforts to address CSR concerns. The much discussed and awaited CSR provisions were notified by the Ministry of Corporate Affairs on February 27, 2014 giving effect to Section 135 of the new Companies Act dealing with CSR provision, Schedule VII³ and the Companies (Corporate Social Responsibility) Rules, 2014 (CSR Rules). India has apparently become the first country to have a legislation providing 2% mandatory CSR spending and disclosure for certain-sized companies.

The current approach towards mandatory CSR, continuously being shaped by laws and regulations, is driven by the belief⁴ that businesses and corporations reaping profits in the

¹ Poverty & Equity Data - Country Dashboard - India. (n.d.). Retrieved September 15, 2015, from World Bank, Poverty & Equity Data: <http://povertydata.worldbank.org/poverty/country/IND>

² CSR Voluntray Guidelines, 2009. (n.d.). Retrieved September 2, 2015, from Ministry of Corporate Affairs Website: http://www.mca.gov.in/Ministry/latestnews/CSR_Voluntary_Guidelines_24dec2009.pdf

³ Schedule VII deals with the activities which may be included by companies in their CSR policies

⁴ Then Minister of Corporate Affairs, Mr. Salman Khurshid, in proposing the Voluntary CSR Guidelines, 2009: *"We have seen the business sector generating wealth and value for the shareholders in the last sixty years, but simultaneously we also have the problems of poverty, unemployment, illiteracy, malnutrition etc. facing the nation. The corporate growth is sometimes seen as widening the gap between the India and Bharat through its income – skewing capability. This gap needs to be bridged. While the Government undertakes extensive developmental initiatives through a series of sectoral programmes, the business sector also needs to take the responsibility of exhibiting socially responsible business practices that ensures the distribution of wealth and well-being of the communities in which the business operates."*

society owe a responsibility to the very same society which, right now, suffers from wide income disparities and grave social problems. These entities, hence, should assist government in its developmental initiatives leading to equitable wealth distribution and inclusive growth.

Not just India, but many other developing countries have rejected the notion that CSR should be purely voluntary and have adopted the mandatory view of CSR. It is interesting to note that out of the top six countries having the largest share of global extreme poor (countries being India, Nigeria, China, Bangladesh, Congo and Indonesia⁵), four (India, Nigeria, China and Indonesia) have started mandating CSR in one way or the other.

PRE-2013 STATUS OF CSR IN INDIA AND THE BUILD-UP

Under the Companies Act of 1956, responsibility of companies was held to be only towards the shareholders. The High Courts in the different state jurisdictions noted that directors are agents of the companies and further the interests of the shareholders⁶ and private corporations are profit-making ventures of the shareholders.⁷ However, of late, the Indian Supreme Court called upon the legislature to safeguard the interests of the society at large by regulating the operation of the fraudulent companies functioning without any social responsibility.⁸ This goes on to show a transition in the judicial approach towards Corporate Responsibility from shareholder centric to stakeholder considerate. This shift has also pushed the government to issue guidelines facilitating and regulating interactions between corporate and society.

In the late 2009 MCA framed the groundbreaking *CSR Voluntary Guidelines*⁹ in what has been deemed to be the first concrete attempt to recognize CSR legally. In July 2011, the MCA issued the *National Voluntary Guidelines on Social, Environmental & Economic Responsibilities of Business (ESG Guidelines)*.¹⁰ They superseded the CSR Guidelines, 2009 in order to give way for more comprehensive guidelines.

To increase transparency and adoption of the ESG guidelines, in August 2012 SEBI issued a circular mandating that the top 100 listed companies based on market capitalization submit *Business Responsibility Reports (BRR)* regarding their ESG initiatives.¹¹ The BRRs were made to be submitted mandatorily as part of a company's annual report by inserting Clause

⁵ *Global Monitoring Report*. (n.d.). Retrieved August 28, 2015, from World Bank Web site: <http://www.worldbank.org/en/publication/global-monitoring-report/report-card>

⁶ *Dikshit and Co. Ltd. v. Mathura Prasad*, AIR 1925 All 71; *Albert Judah v. Rampada Gupta and Anr.*; AIR 1959 Cal 715

⁷ *Amarjit Singh v. Punjab National Bank and Others*, [1987] CompCas 153 (Delhi)

⁸ *K.K. Baskaran v. Secretary, State of Tamil Nadu*, AIR 2011 SC 1485

⁹ CSR Voluntary Guidelines, 2009, op. cit.

¹⁰ *National Voluntary Guidelines on Social, Environmental & Economic Responsibilities of Business*. (2011, July). Retrieved from Ministry of Corporate Affairs Web Site: http://www.mca.gov.in/Ministry/latestnews/National_Voluntary_Guidelines_2011_12jul2011.pdf

¹¹ *FAQs on Business Responsibility Reports*. (2013, May 10). Retrieved September 2015, from SEBI Web Site: http://www.sebi.gov.in/cms/sebi_data/attachdocs/1368184343037.pdf

55 in the Listing Agreement by SEBI.¹² SEBI also encouraged other listed companies to voluntarily disclose information on their ESG performance in the BRR format.

In April 2013, the new “Guidelines on Corporate Social Responsibility and Sustainability for Central Public Sector Enterprises” took effect (DPE Guidelines).¹³ These new guidelines viewed CSR as a core component of the work of public sector enterprises.

There were some commonalities between all these guidelines. CSR was seen as an activity beyond one-time charity and approach towards CSR was to take into account social, economic and environmental factors by the company. CSR for companies, irrespective of its size or sector, was seen as a voluntary act until the DPE guidelines came into force which made CSR mandatory for the Public Sector Undertakings.

AMENDMENT OF COMPANIES ACT

To keep in tune with the current economic realities and to redefine relationships between shareholders, stakeholders, company management and Board; an overhaul of the ages-old Companies Act, 1956 was sought starting with Companies Bill, 2008 which lapsed and got reintroduced as Companies Bill, 2009. The 2009 version of the Companies Bill did not include any provisions related to CSR. However, the 2009 version of the bill underwent extensive review by the Standing Committee of Parliament on Finance¹⁴ which included a discussion of the extent of CSR being undertaken by corporations and the need for a comprehensive CSR policy.

After a feedback period, on February 27, 2014 (Guidelines on CSR and Sustainability for Central Public Sector Enterprises, 2013), the MCA notified Section 135 of the Companies Act, 2013 and the CSR Rules, 2014 which came into effect from 1st April, 2014.¹⁵

Reflecting the controversial aspect of the provision, the then-secretary to the government at the MCA acknowledged that the MCA had taken a “considered view” in introducing the provision.¹⁶

¹² Vide circular no. CIR/CFD/DIL/8/2012 dated August 13, 2012

¹³ *Guidelines on CSR and Sustainability for Central Public Sector Enterprises*. (2013, April 1). Retrieved August 2015, from Department of Public Enterprises Web Site: http://www.dpemou.nic.in/MOUFiles/Revised_CSR_Guidelines.pdf (superseded Guidelines for Central Public Sector Enterprises, 2010 issued by Department of Public Enterprises)

¹⁴ Standing Committee on Finance. (2010). *The Companies Bill, 2009 - 21st Report*. Ministry of Corporate Affairs. 15th Lok Sabha. Retrieved August 2013 from National Foundation of Corporate Governance website: http://www.nfcgindia.org/pdf/21_Report_Companies_Bill-2009.pdf

¹⁵ *The Companies (Corporate Social Responsibility Policy) Rules, 2014*. (2014, February). Retrieved September 1, 2015, from Ministry of Corporate Affairs Web Site: http://mca.gov.in/Ministry/pdf/CompaniesActNotification2_2014.pdf

¹⁶ Standing Committee on Finance, op.cit., Para 9.43.

SALIENT CSR PROVISIONS

The CSR provision is applicable to companies, including foreign companies, with an annual turnover of INR 1,000 crore and more, or a net worth of INR 500 crore and more, or a net profit of INR 5 crore or more during any financial year. Companies that trigger any of the aforesaid conditions must spend at least two per cent (2%) of their average net profits made during the three immediately preceding financial years on CSR activities.

Although the Act mandates CSR disclosure, it does not mandate CSR spending per se. The unique comply-or-explain perspective envisioned by the Act means that a spending of 2% will be required, or its absence will be scrutinized.

- **CSR expenditure to exclude those incurred in the normal course of business**

Mandatory CSR as envisaged by the Act and Rules is in addition to the initiatives undertaken by corporations in their regular course of business. It is to be noted that “Shared value”¹⁷ concept has been ruled out from the ambit of CSR in India wherein the idea is to create economic value in a way that also creates value for the society by addressing its needs and challenges.

- **Scope of Activities Expanded**

Revised Schedule VII indicates an exhaustive list of CSR activities which can be undertaken by a company to fulfill its CSR obligations limiting a company’s autonomy to choose a CSR activity. The accompanying rules seemed to give some flexibility to companies to conduct CSR but on a careful scrutiny, no deviation was possible from Schedule VII. This was opposed by the companies. However, responding to stakeholder representations, the MCA issued June 2014 Circular. Crucially, the Circular explains that the items in Schedule VII are “broad-based and are intended to cover a wide range of activities.” For instance, the MCA clarified that “trauma care around highways in case of road accidents” would be considered CSR under “healthcare”.

- **Third party entities and Pooling of Resources permitted**

Companies belonging to the same group can set up a registered trust or a registered society or a company established under section 8 of the Act or engage such a third party, to undertake CSR activities. Companies can also join hands with other companies and pool resources to undertake CSR projects jointly, in such a manner that such companies can report separately on such projects. This is a positive development as it would allow groups and companies operating in an area to come together and undertake projects of a larger scale.

¹⁷ Porter, M. E., & Kramer, R. M. (2011, February). Creating Shared Value. *Harvard Business Review*

- **Tax Treatment**

Amount spent on CSR cannot be allowed as deduction under section 37 for computing the taxable income of the company as has been cleared by the CBDT circular. The circular states that the objective of CSR is to share burden of the Government in providing social services by companies having net worth/turnover/profit above a threshold. If such expenses are allowed as tax deduction, this would result in subsidizing of around one-third of such expenses by the Government by way of tax expenditure.¹⁸ In order to further provide certainty on this issue, said section 37 has been amended. However, the CSR expenditure which is of the nature described in section 30 to section 36 of the Income-tax Act shall be allowed as deduction under those sections subject to fulfillment of conditions, if any, specified therein.

- **Employees' contribution towards CSR**

Companies are permitted to train their employees and/or personnel of their implementing agencies to build CSR capabilities. Any expenditure incurred in providing such training up to a ceiling of 5% in one financial year is permitted under the CSR budget. Moreover, salaries paid by the companies to regular CSR staff as well as to volunteers of the companies (in proportion to company's time/hours spent specifically on CSR) can be factored into CSR project cost as part of the CSR expenditure.

- **Reporting**

It is mandatory for companies to disclose their CSR Policy, programs/projects undertaken and amount spent in their report and the CSR Rules provide for a separate format. The report containing details of such activities and CSR policies have to be made available on the company's website for informational purposes. If a company fails to meet its CSR obligation, the Board will have to specify reasons for non-compliance in its report. Failure to report on CSR obligation may have penal consequences for the company up to a maximum of INR 2.5 million.

Mandatory CSR reporting is a welcome regulation and is followed in many other countries. Such a regulation is motivated by the idea that increased disclosure can trigger additional stakeholder interest and pressure; as a result, the corporations covered by the regulation become more socially responsible.¹⁹

¹⁸ Vide CBDT Circular no. 01/2015 dated 21/01/2015, Ministry of Finance

¹⁹ Ionnou, I., & Serafeim, G. (2014, August 20). *The consequences of mandatory corporate sustainability reporting: Evidence from four countries*. Retrieved August 12, 2015, from Harvard Business School Web Site: http://www.hbs.edu/faculty/Publication%20Files/11-100_7f383b79-8dad-462d-90df-324e298acb49.pdf; Weil, D., Fung, A., Graham, M., & Fagotto, E. (2006). The effectiveness of regulatory disclosure. *Journal of Policy Analysis and Management*, 26(1):155-181; Jorgensen, A. V., Oyer, P., & Greenstone, M. (2006). Mandated disclosure, stock returns, and the 1964 Securities Acts Amendments. *Quarterly Journal of Economics*, 121(2): 399-460.

MANDATORY CSR POLICY IN OTHER DEVELOPING COUNTRIES

There are very few relevant national and international studies on the impact of CSR programs on community development or poverty reduction. Most of these impact assessment studies concentrate on CSR's impact on companies' reputation and profits. Another fact is that mandatory CSR as a policy has been very recently introduced in all these countries. Thus, it is not a ripe time to come to any conclusions about the failure or success of this model. What one can get is a perspective about what kind of challenges are these countries fraught with while implementing mandatory CSR and what potential CSR holds in assisting the development of these countries. Another issue lies in the ever contested debate of the definition of CSR and different nations defining CSR differently for mandating or regulating it. Although such contestation is not uncommon with social science concepts, it presents difficulties in theoretical, empirical and comparative analysis of CSR and its impact.

Indonesia, one of the first nations to take a mandatory CSR approach, enacted Limited Company Liability Act No. 40/2007 on the premise that companies exploiting natural resources have an added responsibility towards society thus mandating CSR for natural resources based companies. A company in this category is obligated to allocate funds for CSR implementation, and the allocated funds are considered corporate operational expense. Failure or neglecting this obligation carries with it sanctions.

The Nigerian government promulgated the NEITI Act 2007 which mandated due process and transparency in extractive revenues paid to and received by government as well as its application. Thus, the primary objectives were to promote transparency, responsible governance and accountability in the mineral industries and secondary objectives were to foster growth and reduce poverty. This was done through a system of audits. There were sanctions on breach of NEITI provisions against companies or their officials and government officials who give false information or report, render false statement or account, refuse or delay to render statements or account that result in loss of revenue to the federal government of Nigeria.

In China, the new company law that came into effect in 2006 explicitly recognized CSR.²⁰ Although, many opine that the wordings of the CSR provision in the new law is exhortatory rather than mandatory but still there seems to be a strong support for CSR by the government which can be seen in the way guidelines have been passed regulating CSR spending and disclosure.

As CSR gains traction in these countries, the regulation has helped make CSR reports accessible for public scrutiny, thus involving stakeholder engagement. However, the challenge is with respect to the impact or reforms, if any, created because of such regulation. In Nigeria, the government is yet to declare where it has invested the money, if any, realized

²⁰ Article 5 of Chinese Company Law, 2006 – *"In the course of doing business, a company must comply with laws and administrative regulations, conform to social morality and business ethics, act in good faith, subject itself to the government and the public supervision, and undertake social responsibility."*

from NEITI's activities. Indonesia lacks CSR standardization which is required in order to monitor and evaluate CSR programs. In China, the very enforceability of CSR is unclear, thus, leaving CSR activities relatively unchecked.

CONCLUSION AND WAY FORWARD

India is widely regarded as a country where CSR has played a key role in social development, much before it started globally. However, the involvement of the business community has always been concentrated among a few of the long established family-owned companies that contribute significantly towards social development. Till date, the idea does not seem to have penetrated into the numerous smaller family-owned and medium-sized enterprises in the country. Recent policy interventions by the Government have catalyzed the sector to some extent. In 2010-11, 336 firms had disclosed their donations and expenditure on community and environment related activities. This number rose to 1,470 in 2012-13 with 162 firms disclosing their environmental performance information.²¹ A combination of both regulatory and societal pressures has forced companies to take CSR more seriously than before. In fact, the board of companies is now directly responsible for effective utilization and reporting of CSR funds under the new Act.

A careful analysis of the mandatory CSR regulation and its social environment suggests that compulsory regulation can only be a good CSR tool when it is created in an enforceable and transparent process. Compulsory regulation is not alien to CSR but needs to be defined, coherent, specific, and practicable. Taking a lesson from these countries, India has taken a very cogent approach towards mandating CSR which will fructify if it gets strong civic accountability and strong enforcement of penalty against any breach.

As it comes out from the issues faced by our counterparts, impact assessment of the work done by corporations or government under the CSR model is crucial for understanding the contribution of this policy in development of the country, if any. It would be important to gauge the effectiveness of efforts being put by the corporation and its affiliates. It would also help in refining the model further by incorporating independent feedback from the direct beneficiaries of the program. Especially in cases where a social investment is made, calculation of SROI could give an insight into the effectiveness of the investment.

Apart from private sector, Government needs to revisit the policies in order to increase the effectiveness of the programs undertaken by the private sectors. In the decade to come, the Government should more clearly articulate the expectations from the private sector towards development activities so that they can put a concerted effort in a given direction. Moreover, the concept of shared value, which will eventually be of high interest for private sector, needs to be encouraged. The Indian corporations should be made aware of how they can tap economic value by creating social value through their CSR programs. This will change their

²¹ Bansal, Sangeeta & Rai, Shachi (2014), "An analysis of Corporate Social Responsibility in India", *Economic and Political Weekly*, Vol - XLIX No. 50

attitude towards CSR as being an opportunity rather than a liability. Only then can will they take the present CSR regime seriously and strive to make it better and more encompassing.

The CSR provisions in India are not free from legal predicaments and there are certain grey areas which require sober clarifications. One should be hopeful that this will come in time as the law is still in nascent stage of implementation. Over the next 10 years, India needs to move ahead from just CSR towards sustainability and ideally towards creating a shared value with an increased focus on the emerging needs of the country in the decade to come.