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The Mandatory CSR in India : A Boon or Bane

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ABSTRACT *The Companies Act, 2013 has commenced a new regime in the Indian corporate world. Harmonizing with the international norms, fraud reduction measures, new government powers, and accountability provisions are all important new facets of the act, however, the CSR provisions in the act are the most innovative, and these set India apart from other Asian countries. The act requires targeted companies to spend 2 percent of their net profit on CSR activities, to make changes within its board of directors, and to formulate and publicly disclose an official policy on its CSR activities. This paper is an attempt to clearly bring out the major concepts and provisions of the act with respect to CSR, and present a summarized analysis based on the "arguments for" and "arguments against" corporate social responsibility, determining whether making CSR mandatory shall turn out to be a boon or bane for India's economy.*

INTRODUCTION

Corporate Social Responsibility (CSR) refers to the way the businesses should be managed to bring an overall positive impact on the communities, cultures, societies and environments in which they operate. The fundamentals of CSR rest on the fact that not only public policy but even corporates should be responsible enough to address social issues. As said by the United Nations and the European Commission, Corporate Social Responsibility (CSR) leads to triple bottom-line: profits, protection of environment and fight for social justice. Thus, CSR is "the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large.

In a country like India, companies have no shortage of CSR opportunities or issue areas to address, as the needs in India are immense. A 2011 study by the Oxford Poverty and Human Development Initiative estimated that approximately 650 million people, or fifty-three percent of India's population, live in poverty. In 2010, the World Bank estimated that about 400 million people in India live on less than U.S. $1.25 a day. Poverty is also intertwined with illiteracy, gender inequality, and disease. Vast environmental issues confront India, such as deforestation, illegal wildlife trading, loss of biodiversity, water pollution, air pollution, and the particular vulnerability of Indian populations to natural disasters, among other issues. In spite of economic boom, India only spends 0.6% of its GDP, which accounts to about $5 billion on corporate oriented social welfare. In comparison, America spends about 2% of its GDP, equivalent to $300 billion. Income disparity in India has doubled in last 2 decades. In a country which has the highest concentration of people living below poverty-line, according to Forbes, India has 55 billionaires and the number is expected to rise to 220 in next decade (in addition to 125,000 millionaires). This clearly 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 corporates involvement in the process of equitable and sustainable development becomes more pronounced. Though many companies, in India, have been performing the CSR activities for some time, however, there still remains a huge gap to be filled. Thus, there is a need of collective effort by all resourceful companies and not a few of them. Therefore, the Government of India in Companies Act, 2013 makes it mandatory for the "capable" companies to contribute towards social development activities. The major provisions for the same can be read as follows:

1. The "2 per cent" requirement

The act requires that companies set up a CSR board committee, which must consist of at least three directors, one of whom must be independent. That committee must ensure that the company spends "at least 2 per cent of the average net profits of the company made during the three immediately preceding financial years" on "CSR" activities. If the company fails to spend this amount on CSR, the board must disclose why in its annual report.

2. The qualifying "capable" companies

The requirement will apply to any company that is incorporated in India, whether it is domestic or a subsidiary of a foreign company, and which has (1) net worth of Rs. 5 billion or more, (2) turnover of Rs. 10 billion or more, or (3) net profit of Rs. 50 million or more during any of the previous three financial years. This means that about 8,000 companies will spend a combined total of up to Rs.150 billion annually on CSR activities.

3. Accountability and enforcement

The board committee is responsible for reviewing, approving, and validating the company's investments in CSR. Prior to each annual meeting, the board must submit a report that includes details about the CSR initiatives undertaken during the previous financial year. The board's independent director helps ensure the credibility of this process. However, the act does not provide any guidance on what constitutes acceptable reasons for which a company may avoid spending 2 per cent on CSR.

4. Recommended activities for CSR investment

Schedule VII of the Companies Bill, requires the CSR policy created by the CSR Committee to involve at least one of the following focus areas:

Eradicating extreme hunger and poverty
Promotion of education
Promoting gender equality and empowering women
Reducing child mortality and improving maternal health
Combating HIV, AIDS, malaria and other diseases
Ensuring environmental sustainability
Employment-enhancing vocational skills

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Social business projects
Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central government.

While a company is not subject to liability for failing to spend on CSR, a company and its officers are subject to liability for not explaining such a failure in the annual report of the board of directors.

BOON OR BANE
Ever since the passing of the new act, there has been a heavy debate on whether this will have positive or negative implications for India. A summarized analysis of both sides - positive impact (Arguments For) and negative impact (Arguments Against) - is presented below:

ARGUMENTS FOR:
In a country such as India, where one-third of the population is illiterate, two-thirds lack access to proper sanitation, and 400 million people still live on less than US$2 a day, the passage of the Companies Act should be hailed as a positive step forward in ensuring that business contributes to equitable and sustainable economic development.

According to the global philanthropic advising firm, Kordant philanthropic advisors, companies should not view the CSR Clause as an onerous reporting requirement—i.e., a necessary cost of doing business in India. Instead, they should utilize the two percent amount of the CSR Clause as an opportunity to effect positive impact in the communities where they work and in the communities they affect. These concerns are not mutually exclusive to enhancing a company's brand value and market equity through CRS activities. Indeed, some companies feel CSR is simply the right thing to do and already give beyond the tentative requirements of the CSR Clause. Regardless of company's giving ethos, if done strategically, spending under the CSR Clause can develop business goodwill with shareholders, consumers, the Indian government, Indian citizens, and the international public at large.

Professors Tom Lyon, Professor of Sustainable Science and director of the Erb Institute for Global Sustainable Enterprise refutes the idea that markets and governments alone can shape responsible corporate behavior; he makes the case that CSR is essential in the real world of business. He says CSR to companies implies do well by doing good. Many large multinationals establish what's called a global common standard. They use the same technology in every country around the world. That often serves two functions. Take Dow Chemical moving into China or Brazil. They're using top-quality, American technology that's probably better than what most domestic firms are using in those countries. It serves to elevate the expectations for technology in those countries. It may create a strategic advantage for Dow as it moves into Brazil because it forces the other guys to raise their costs and meet its requirements, but it's doing well by doing good...There are lots of examples of companies that have reduced their greenhouse gas emissions substantially and made money in the process.

Dr Savithri Subramanian, Human Resource Manager in an MNC says - when CSR initiatives are taken in the area of education and awareness, the companies effectively contribute to the growth of the very middle class that serves as its consumer base. Further, many of these companies aim to expand their consumer base from urban to rural areas even in quite remote locations. Thus, in both these respects it makes good business sense to undertake CSR. Undertaking CSR initiatives will also earn goodwill from the company's consumer base which will ultimately benefit the company. Undertaking CSR builds a positive image of the company in the public benefiting it in its interaction with the government, investors and business partners. Therefore, in the long term business stands to gain in financial terms by undertaking CSR initiatives. There is no doubt either that the country as a whole and the needy and disadvantaged sections in particular will gain when companies get involved in social welfare and development. This is because companies are resourceful partners to have in terms of finances, knowledge base, technical know-how and human resources. In the end, one can conclude that CSR would prove a win-win situation for both sides.

ARGUMENTS AGAINST
A number of arguments have been put against the making the companies invest in CSR activities:

Aneel G. Karnani, Associate Professor of Strategy, PhD, Harvard University, says the idea that companies have a responsibility to act in the public interest — and will profit from doing so — is fundamentally flawed. CSR is either irrelevant or ineffective and dangerous. Firms only can be expected to embrace CSR when the market naturally marries profits to social interests, or when government regulation forces such a union. It's not realistic to expect companies, who have a fiduciary responsibility to their shareholders, to sacrifice profits for the sake of social welfare.

Dr Karnani further opines that not only is mandatory CSR not effective, it's dangerous. When there is a conflict between business and social interests, CSR serves the purpose of greenwashing. Companies say they do things, but they don't actually do very much. This is much worse. Dr Karnani is of the opinion that said we should de-emphasize CSR, so that we can focus on the real conflict and the real issues.

Rohini Nilekani, a philanthropist and wife of Nandan Nilekani, says - Every life form has its role and purpose. It is dysfunctional for steel or aluminum companies to run schools or hospitals. Ticking a CSR checklist or writing a cheque out of profits is a poor substitute for being a good corporate citizen because how companies make profits (ethically and legally) is more important than what they do with them (dividends or taxes). But mandatory CSR over and above taxation, forces companies to do the government's job. And trying to outsource the state's primary job is a bad idea. Companies should create jobs and pay taxes. It is unrealistic and unfair to expect them to focus beyond the immediacy of circumstances (survival and growth) that is the life of most small entrepreneurs.

Wipro Chairman, Azim Premji, may have personally contributed enormous sums to community development, but he opposes the mandated spending of 2 per cent of a company's profits on corporate social responsibility (CSR) related activities, as envisaged in the new Companies Bill. Speaking at the All-India Management Association's (AIMA) 40th Management Convention in New Delhi on Thursday, he said: "My worry is the stipulation should not become a tax at a later stage ... Spending two per cent on CSR is a lot, especially for companies that are trying to scale up in these difficult times. It must not be imposed."

SUMMARIZED ANALYSIS
The 2% CSR provision of the Companies Act, 2013 will have a cascading effect on Indian economy. However, the effect, both positive and negative, can only be speculated and not proved. The negatives of the 2% CSR policy come from the classical economic thought framed by Milton Friedman in his New York Times piece "The Social Responsibility of Business Is To Increase Its Profits". According to this view, CSR is bad for economy and it increases inefficiency by forcing business to divert from the main objective of profit making to social welfare. Friedman equates CSR as "taxing" which deprives the investors of mobilizing the economy. India's 2% CSR policy is an example of government mandated intervention which will lead to wastage in the economy. In real sense, it will not have any social benefits.

On the other hand, the pro-2% CSR economic argument depicts a different set of reasoning. This policy only brings India

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at par with other advanced liberalized economies such as the US in terms of India's charitable giving which is expected to be an optimal 2% of GDP (after the implementation of this CSR provision). With increased deregulation, capitalization and privatization in India, human welfare and environmental standards are being drawn down. India is winning the "race to the bottom" and failing to improve standard of living for its population. Therefore, it is smart to mandate CSR in order to reduce such inefficiencies in the economy. Via 2% CSR, there will be more human capital developed (education, healthcare, training, etc.) in the economy which will have long term ripple effect on Indian economy to accelerate production of goods and services. Moreover, through CSR spending in energy, environment and R&D other factors of production will be more efficiently utilized. This will in turn boost capital generation and thereby boost the economy in the long run. By not increasing taxes and allowing companies to invest in their own CSR programs, the government is actually increasing efficiencies in the economy. Businesses in terms of their technical, local and information capabilities are in a unique position to better provide social goods than the government.

CONCLUSION

The mandated 2% CSR investment in the new Indian Companies Bill is a novel solution to India's social problems. It may not be perfect but it is a product out of necessity for economic justice in India. Corporations in India have failed to take the responsibility for the real cost of their functioning. Many often pollute the environment and run away from human hazards that they invent. 2% CSR policy envisions a system in which each industry would contribute in a manner apt with their expertise. Chemical and oil companies might take environmental and safety initiatives and technology companies might take tech-education initiatives. Thus, in a nutshell, this new policy may turn out to be a boon for both the corporates and the society, propelling India towards the path of equitable and sustainable growth.

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