

MAKING CORPORATE SOCIAL RESPONSIBILITY MANDATORY

IN INDIA - PROSPECTS AND PROBLEMS

DIVYA MEHTA & MONICA AGGARWAL

Assistant Professor, Department of Commerce, Dyal Singh College, University of Delhi, New Delhi, India

Assistant Professor, Department of Commerce, Ram Lal Anand (Evening) College, University of Delhi,
New Delhi, India

ABSTRACT

With the new companies Act, 2013 specifying the legislative provisions for making CSR mandatory, India becomes the first country to take this move. Though, the concept of corporate social responsibility is much talked about over nearly seven decades, there is lack of clarity in terms of both its definition and implementation. This subjectivity about CSR and absence of legal backing leads to ambiguity which raises a lot of unanswered questions. India by making CSR mandatory attempts to resolve these subjectivities by clarifying how much to spend, who has to spend and where to spend for CSR. This being a pioneering move will be bundled with lot of repercussions. Thus, this paper attempts to throw some light on the problems and prospects of making CSR mandatory in India.

KEYWORDS: Companies Act, 2013, Mandatory CSR, India, Problems, Prospects

INTRODUCTION

The revamping of the Companies Bill in the Rajya Sabha on August 8, 2013 leading to the formation of Companies Act, 2013, has ushered a new regulatory stance towards corporate social responsibility in India. The concept of Corporate Social Responsibility (CSR) is not new to India. Business involvement in social welfare and development has been a tradition in India and its evolution from charity towards individuals or philanthropic activities to Corporate Social Responsibility can be seen in the business sector over the years. No doubt, the Indian business' have traditionally been socially responsible, but to ensure a win-win situation both for the initiators of CSR (companies) and beneficiaries of CSR (various stakeholders of the company). India has taken a step towards regularising , standardising and making CSR mandatory. This being a very exceptional move as making CSR mandatory is not only first time in India but also in the world. The implementation of this Act will be with effect from April, 2014. Being initiated for the very first time, making CSR mandatory brings with it a lot of inquisitiveness regarding what problems could the companies face in its actual implementation and as to what benefits it will fetch. The current paper attempts to decipher the problems and prospects of implementing new Companies Act, 2013 with respect to CSR.

The remainder of the paper is organised as follows. Section I of the paper presents the provisions relating to CSR in Companies Act 2013. Section II and III highlights the prospects and problems arising out of new CSR provisions in the Companies Act 2013. Section IV concludes the paper.

SECTION I: PROVISIONS OF CSR IN COMPANIES ACT, 2013

With this new development towards mandating CSR, India has become the first country in the world to make CSR mandatory. The Bill, which is now enacted into law, lays down mandatory requirements with regards to CSR for companies with a particular financial strength. The provisions relating to CSR are covered in Section 135 of the Companies Act, 2013, and Schedule VII of the Act lists out the activities that may be undertaken under the ambit of CSR. Relevant extracts from the Companies Act, 2013, applicable to corporate social responsibility are stated below:

Section 135

According to Section 135 of the Companies Act 2013, every company having a turnover of Rs. 1000 crore or more, or a net worth of Rs. 500 crore or more, or a profit of Rs. 5 crore or more during any financial year shall:

- Spend in every financial year, at least two per cent of the average net profits (net profits are defined in Section 198) of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy.
- Constitute a Corporate Social Responsibility Committee of the Board (CSRC) consisting of three or more directors, out of which at least one director shall be an independent director.

Duties of Corporate Social Responsibility Committee of the Board (CSRC)

The Corporate Social Responsibility Committee shall

- Formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;
- Recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and
- Monitor the Corporate Social Responsibility Policy of the company from time to time.

Duties of the Board (CSRC)

The Board of every company shall, -

- After taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed;
- The Board's report shall disclose the composition of the Corporate Social Responsibility Committee;
- Ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company;
- Ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy;
- If overall spend falls short of the 2% threshold, the Board will need to provide reasons for non-compliance in the

Directors Report to the shareholders.

Section 135 also provides that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities.

Schedule VII of Companies' Act 2013 - Activities Covered Under CSR

Schedule VII of the companies' act, 2013 lists out the various activities that come under the ambit of CSR policy activities. The specified activities are as under:

- Eradicating extreme hunger and poverty;
- Promotion of education;
- Promoting gender equality and empowering women;
- Reducing child mortality and improving maternal health;
- Combating human immunodeficiency virus (HIV), acquired immune deficiency syndrome (AIDS), malaria and other diseases;
- Ensuring environmental sustainability;
- Employment enhancing vocational skills;
- Social business projects;
- Contribution to the Prime Minister's National Relief Fund, Central or State Government Fund for socio-economic development and relief, welfare of SC/ST/OBC, minorities and women; and
- Such other matters as may be prescribed

(Source: Companies Act 2013)

The act clearly demarcates CSR from charity and does not position it as a 'moral responsibility' for companies. Charities and donations are outside the purview of CSR and are separately taken care of in section 181. The purpose appears to be on employing standard business principles to develop and roll-out CSR strategies and programs, so as to optimise resources and maximise impact. By requiring CSR policy formulation and monitoring to be governed by a Corporate Responsibility Committee (CSRC), the act ensures that CSR becomes a Board level agenda and is therefore viewed strategically.

According to Sachin Pilot, corporate affairs minister, "CSR should be viewed as something that you are doing - whether through cash or kind, or man-hours, or anything else - to bring smiles to the people's faces and not for your EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortisation)," (Source : Economic times, 10 september, 2013). The ministry of corporate affairs (MCA), released draft rules for the Companies Act, 2013 on september 9, 2013. MCA has asked corporate houses to set up a corpus, which will have 2% of the average net profits for the preceding three years as the seed capital. Every year, any income earned on the corpus and surplus arising out of CSR activities will be added to increase the size of the kitty and ensure that companies don't add these earnings to their bottomlines. The rules require that "CSR activities may generally be conducted as projects or programmes (that do not

include normal business activities)." The draft rules also specify that only activities that are not exclusively for the benefit of employees of the company or their family members will be considered as CSR activities. In other words, if a company provides elementary education for children of its plantation workers, such expenditure would not be eligible CSR spend.

Section 198

According to section 198 of the companies act, 2013, companies while calculating net profit should make the following deductions:

- all the usual working charges;
- directors' remuneration;
- bonus or commission paid or payable to any member of the company's staff, or to any engineer, technician or person employed or engaged by the company, whether on a whole-time or on a part-time basis;
- any tax notified by the Central Government as being in the nature of a tax on excess or abnormal profits;
- any tax on business profits imposed for special reasons or in special circumstances and notified by the Central Government in this behalf;
- interest on debentures issued by the company;
- interest on mortgages executed by the company and on loans and advances secured by a charge on its fixed or floating assets;
- interest on unsecured loans and advances;
- expenses on repairs, whether to immovable or to movable property, provided the repairs are not of a capital nature;
- outgoings inclusive of contributions made under section 181;
- depreciation to the extent specified in section 123;
- the excess of expenditure over income, which had arisen in computing the net profits in accordance with this section in any year which begins at or after the commencement of this Act, in so far as such excess has not been deducted in any subsequent year preceding the year in respect of which the net profits have to be ascertained;
- any compensation or damages to be paid in virtue of any legal liability including a liability arising from a breach of contract;
- any sum paid by way of insurance against the risk of meeting any liability such as is referred to in clause (m);
- Debts considered bad and written off or adjusted during the year of account.

In making the computation aforesaid, the following sums shall not be deducted, namely:—

- income-tax and super-tax payable by the company under the Income-tax Act, 1961, or any other tax on the income of the company not falling under clauses (d) and (e) of the above deductions;

- any compensation, damages or payments made voluntarily, that is to say, otherwise than in virtue of a liability such as is referred to in clause (m) of the above deductions;
- loss of a capital nature including loss on sale of the undertaking or any of the undertakings of the company or of any part thereof not including any excess of the written-down value of any asset which is sold, discarded, demolished or destroyed over its sale proceeds or its scrap value;
- any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value.

Section 181

According to this section, the Board of Directors of a company may contribute to a bona fide charitable and other funds provided that prior permission of the company in general meeting shall be required for such contribution in case any amount the aggregate of which, in any financial year, exceed five per cent of its average net profits for the three immediately preceding financial years.

SECTION II: PROSPECTS OF CSR MANDATORY REGIME

The law mandating CSR may appear to be a burden and a drain on the profits of the company. But in reality, it is the way we look at it. If we look at the glass half- full instead of half empty then we would be able to appreciate the initiatives of Government of India towards making CSR mandatory. Incorporating CSR automatically helps the companies to tackle some of the stringent challenges faced by them such as employee turnover, government support, customer loyalty, competitive advantage and so on. Companies undertaking CSR can reduce unforeseen risks arising out of employee turmoil, customer dissatisfaction, competitive pressures etc. Thus, the new CSR policy opens up the doors towards more responsible and sustainable Indian companies.

Following are the perceived merits of mandating CSR:

- **CSR in True Sense**

Companies Act, 2013 not only lays down the quantum of amount to be spent on CSR but also gives the avenues for spending it. Thus, by mentioning the areas as to where all such expenditure is to be expended brings some uniformity amongst the corporate and also the questions as to whether CSR is an eyewash is also waived off.

- **Compliance Based: Law And Regulatory Standards**

The Companies Act, 2013 will make Indian companies to consciously work towards that objective, as it requires a prescribed class of companies to spend a portion of their profits on CSR activities. By making CSR mandatory, a lot of inconsistencies in this respect will be eliminated. Everything now will be compliance based.

- **Limited Integration with Corporate Decision Making and Processes**

By making it altogether a separate concern for the companies, CSR relating issues will now be handled by a separate team of experts. The strategic corporate decisions of the company will not be affected by the CSR related decisions.

- **Reputation Management**

As now more companies will come under the CSR spending bracket, new companies which were earlier not actively involved in CSR activities will now have to do it compulsorily. This will bring an add on benefit to the company in terms of goodwill enhancement as such a company will now be viewed as a pro CSR company, even though it is a forced move.

- **New Customers and Markets**

In an attempt to fulfill the CSR spending requirements on the avenues specified in Schedule VII of the Companies Act, 2013, the companies will enter into new areas and markets which were untapped earlier and eventually it may become a new business destination for the companies.

- **Sustainable Competitive Advantage**

Social Responsibility strategies are associated with competitive advantage such as attracting valuable employees as well as enhancing the company image and reputation. The formulation of social strategies influence the opportunities, resources, skills, corporation merits, industry structure and stakeholders which directly or indirectly helps company gain competitive advantage.

- **CSR Disclosure an Opportunity**

Disclosure in Companies board report can be perceived as an opportunity by the companies to showcase their efforts towards society at large besides focusing on maximization of shareholders wealth. This will bring companies a notable response from various stakeholders in form of governmental support, customer satisfaction, employee retention etc.

SECTION III: PROBLEMS WITH CSR MANDATORY REGIME

With the implementation of the new companies act, 2013, CSR becomes mandatory in India. The practical implementation of this compulsory 2% spent on CSR has a lot of lacunas. Few of them are mentioned below:

- **Encroachment on the Duty of the State**

The Constitution of India through the Directive Principles of State Policy & Preamble tries to set up a welfare state. Directive principles contained in Part IV of the constitution of India are concerned with the welfare of the citizen. Thus according to the constitution, welfare is prerogative of the state and imposing it on companies is actually encroachment into the arena of working of state. Furthermore, taxes are already levied on the individuals and corporates which in turn should be used for the societal concerns. Taxes could have been increased in the name of social development activities but it should have been the task of the state only.

- **Lack of Knowledge and Expertise of Companies**

Another issue is regarding the lack of knowledge and expertise of the companies towards societal development and needs. Endeavours by the companies towards CSR may not be fruitful as they won't be aware of the priority requirements of the society as well as the initiatives of other companies simultaneously. Thus such efforts may be lopsided.

- **Flawed Workable Model**

While making CSR mandatory, the law is silent on certain issues and which have practical implications. Such issues need clarifications. The act does not mention whether such spent on CSR will be treated as expense or an appropriation of profit. Another aspect is that there is no mention of tax implications of such CSR spent. There is inherent vagueness associated with model as no instructions are in place regarding the implementation of such model.

- **CSR May Lose Its Sanctity**

The very purpose of undertaking CSR initiatives by the companies was to willingly do something for the society at large. Now, by making it mandatory, the CSR sounds as a burden on the companies and in its fulfillment the willingness to serve the will be lost. If CSR is considered as a burden or yet another expense by the corporates then the very obvious reason for which such expenditure is incurred stands defeated. The focus of the companies may shift from the quality of spend to the quantity of the spend.

- **Regulatory Penalties**

As now CSR is no more voluntary and is a legislative requirement, therefore the companies have to abide the repercussions of non-compliance. Now the companies have to bear the brunt of being penalised for non- fulfillments of the minimum 2% spent on CSR. Thus, the companies are affected on two fronts, one compulsorily spending 2% on CSR and second, facing the burden of penalty for non-compliance as well.

- **Need For Separate Department with Deliverables**

Companies now have to set up an altogether new department focusing on CSR of the company. This department will be responsible for making a corpus of funds to be spent on CSR in accordance with the Companies Act, 2013 and then deciding upon the avenues for this spent in tandem with the Schedule VII of the companies act, 2013. This will be an add on burden in terms of expenditure of setting the department, recruiting new employees or re-skilling of existing teams and establishment of processes.

- **Burden for the Companies on Border Line**

There may be reluctance in compliance, especially in case of companies which are not profitable, but fall under the designated category due to triggering net worth or turnover criteria.

Additional Expenditure on Companies

In addition to the compulsory spending on CSR according to Section 135 of the Companies Act, 2013, companies will also have to allocate a part of their budget in meeting the reporting requirements which will not be counted as a CSR expenditure.

SECTION IV: CONCLUSIONS

CSR holds a very important place in the development scenario of the world today and can pose as a tool for sustainable development. As CSR is a dynamic and ever evolving concept it has many definitions and interpretations. CSR may be defined as various activities undertaken by the firm reflecting its responsiveness towards various stakeholders such as employees, customers, society at large etc. Corporate Social Responsibility is a “bridge” to integrate and synthesize the

different interests of society and corporations.

The benefits of CSR are not short term and are larger in scale. Customers have also acceptance towards companies which are responsible and have ethical business practices. CSR should not be perceived as an expenditure by the company rather it is an investment which fetches return in intangible form. These intangible benefits may include enhanced corporate image and reputation, ability to retain existing employees and attract new ones, increased customer loyalty etc. These benefits, not direct in nature and extending to longer term are often overlooked and immediate profit enhancement comes to the forefront.

There is often a curiosity as to whether CSR is pro company or not. Whilst profit may be the end goal for any business, but companies being the part of the society have the responsibility to give back to the society in the most sustainable way.

According to global survey by Ernst & Young, 94 % of companies believe the development of a CSR strategy can deliver real business benefits, research found that company CSR programs influence 70 % of all consumer purchasing decisions. There are more than 1,200 Indian listed companies who have reported profits for the last financial year. The total aggregate profits reported by these companies for the last financial year is Rs 4, 31,167 crore.

Keeping in view the benefits of CSR, the Government of India has mandated the Indian Companies of specific financial strength to spend at least 2% of their average net profits towards CSR activities.

It is the first time in the history of corporate social responsibility that a country has seriously considered mandating spending by large companies on social upliftment activities.

Therefore mandatory CSR may seem like a burden, but it will only urge us to broaden our horizon and strengthen our sustainability. It is the era of accountability where companies need to act responsibly. Accepting this shift would help us better prepare for the changes that will nurture and strengthen corporate India. Hence, it is suggested that CSR is adopted by the companies as a long term strategy instead of merely a legal obligation. On the international stage, India will be at the forefront of CSR law. We expect India to be a testing ground for CSR laws of this kind in future years.

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