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# **CORPORATE SOCIAL RESPONSIBILITY IN INDIA A CONTRAST AND DEVELOPMENT**

AUTHORED BY - NABIL RAZA

## **Acknowledgement**

This paper delves into the underlying theories and real-world research regarding the rationale behind Corporate Social Responsibility (CSR). It examines the potential consequences of enforced CSR as per the recently enacted Companies Act of 2013 in India. This analysis encompasses firm incentives, expected reactions from companies subject to this law, implications for the availability of resources and the provision of social benefits, and the prospects and hurdles associated with implementing mandated CSR.

To shed light on these matters, empirical insights are drawn from the study of voluntary CSR practices within a sample of 500 prominent companies listed on the Bombay Stock Exchange, spanning the period from 2003 to 2011, which predates the new regulation. The central argument of this paper posits that despite the potential economic burdens that mandated CSR may entail, the provisions of the new Act have been carefully crafted to strike a balance between the interests of corporations and their shareholders, as well as those of society and its stakeholders. Nevertheless, the effective resolution of implementation challenges will ultimately determine the extent to which the objectives of the new regulations are achieved.

## **INTRODUCTION:**

Indian corporations, akin to their counterparts in other nations, have a longstanding tradition of engaging in social endeavors that transcend the immediate financial objectives of the corporate world. However, since the late 1990s, Corporate Social Responsibility (CSR) activities have increasingly come under scrutiny from both policymakers and stakeholders in corporations. This heightened focus on governance issues led to the formal initiation of CSR emphasis in India.

The journey towards formalized CSR in India commenced with the issuance of the Corporate Social Responsibility Voluntary Guidelines in 2009 by the Ministry of Corporate Affairs (MCA, 2009). This eventually culminated in the enactment of Section 135 of the Companies Act in 2013 (MCA, 2013), mandating CSR spending and disclosure for specific categories of companies. Notably, while CSR issues gained prominence globally, India became the pioneer in making CSR activities obligatory for large, profitable companies through legislation. In other countries, CSR endeavors by corporations mostly remained voluntary, with only a few nations mandating corporate disclosure of such activities. Consequently, Section 135 in India has stirred a wide spectrum of opinions among policymakers, corporations, industry associations, social sector organizations, and academics. On one side, mandatory CSR has been hailed in policy circles as a “historic opportunity” and a potential “game changer” for India. Advocates envision a collaborative effort between corporations, government, and civil society to facilitate “national regeneration” through sustainable development. Unconventional as it may appear, some argue that, for a developing nation like India, mandatory CSR might serve as a tool to navigate a “middle path” between a liberal and a regulatory state, thereby balancing economic growth with social stability. On the flip side, critics of mandatory CSR, primarily represented by corporations and business associations, contend that mandating CSR activities essentially transfers government social responsibilities onto the private sector and forces businesses to bear the brunt of governmental shortcomings. Moreover, when these activities lack clear definition, mandatory CSR could create perverse incentives for corporations to mask their efforts to meet obligatory requirements or seek loopholes to evade legal compliance.

Given the contrasting perspectives surrounding mandatory CSR, the objective of this paper is to critically examine the implications of Section 135 and the accompanying Rules, as notified by the Ministry of Corporate Affairs in 2014 (MCA, 2014a). Fundamental and Central Inquiry:

The overarching question at the heart of this study revolves around the potential of mandated Corporate Social Responsibility (CSR) to address the welfare disparity in a developing nation like India. To be specific, this paper undertakes an in-depth analysis of the implications of Section 135 of the Companies Act, 2013, on various facets. These facets include firm incentives, the expected responses of corporations falling under the purview of this section, its impact on the availability of resources and the delivery of social benefits, and, lastly, the prospects and challenges entailed in the implementation of mandatory CSR expenditure under the prescribed Rules. To shed light on these

complex issues, empirical insights are derived from the examination of CSR practices among a sample of 500 major companies listed on the Bombay Stock Exchange during the period from 2003 to 2011. This timeframe precedes the enactment of Section 135.

### **Structural Overview of the Paper:**

The paper follows a structured outline for comprehensive exploration. Section 2 lays the foundation by elucidating the key provisions of mandatory CSR as stipulated under Section 135 of the Companies Act, 2013. Section 3 provides a panoramic view of the existing theoretical and empirical literature pertaining to the rationale behind CSR. Section 4 delves into various regulatory approaches and identifies the potential costs and benefits associated with mandated CSR.

To provide context for the issue of mandatory CSR, Section 5 conducts an empirical analysis of the voluntary CSR initiatives undertaken by the top 500 listed companies in India during the period spanning from 2003 to 2011, which precedes the enactment of Section 135. Finally, Section 6 serves as the concluding segment of the paper, assessing the prospects and challenges entailed in the implementation of mandatory CSR in India.

### **2. CSR(The Legal Framework) :**

The initial formal attempt by the Government of India to address the CSR issue was the issuance of the Corporate Social Responsibility Voluntary Guidelines in 2009 by the Ministry of Corporate Affairs (MCA, 2009). Before this, the significance of CSR had been discussed in the context of corporate governance reforms, as seen in the Report of the Task Force on Corporate Excellence by the Ministry of Corporate Affairs in 2000 (MCA, 2000). While this report made a compelling business case for CSR and underscored the societal benefits it could yield, the discussion remained advisory in nature, lacking actionable points.

It was in the 2009 Voluntary Guidelines that the fundamental elements of a CSR policy were delineated. These elements included care for all stakeholders, ethical conduct, adherence to workers' rights and well-being, respect for human rights, environmental responsibility, and activities aimed at promoting social inclusivity and development. The Guidelines explicitly differentiated between philanthropic activities and CSR endeavors, emphasizing the voluntary nature of CSR initiatives that extend beyond any statutory or legal obligations.

### **Transition to Mandatory CSR Regulation:**

The progression from voluntary CSR initiatives to regulated requirements began with the issuance of the National Voluntary Guidelines of Social, Environmental & Economic Responsibilities of Business in 2011, also issued by the Ministry of Corporate Affairs (MCA, 2011). These guidelines, crafted based on input from significant stakeholders nationwide, delineated nine principles for responsible corporate conduct aimed at fostering inclusive economic growth at the national level. Similar to the 2009 Guidelines, the 2011 Guidelines operated on a voluntary basis, encouraging corporations to adopt all nine principles and report their adherence under an “apply-or-explain” principle. Interestingly, unlike the 2009 Guidelines, the 2011 version did not propose earmarking a specific portion of profits after tax or any other parameter for CSR activities.

The transition from voluntary CSR practices to a regulated framework took a pivotal turn when the Securities Exchange Board of India (SEBI) mandated, as part of Clause 55 of the Listing Agreement, that the top 100 listed companies must disclose their CSR activities in the Business Responsibility Reports (BR Reports) accompanying their Annual Reports. SEBI viewed this move as serving the broader goal of public disclosure and as a step towards integrating social responsibility with corporate governance.

The most ambitious endeavor in the realm of mandated CSR for corporations unfolded with the introduction of Section 135 of the Companies Act in 2013 (MCA, 2013). As mentioned earlier, Section 135 marked a significant departure as it made both CSR spending and reporting obligatory for the first time in India, placing CSR activities firmly within the purview of corporate law. Precisely, Section 135 requires companies with a net worth of rupees five hundred crore or more, a turnover of rupees one thousand crore or more, or a net profit of rupees five crore or more to (i) establish a CSR Committee comprising at least three directors (including one independent director), and (ii) allocate, under the guidance of the CSR Committee, at least two percent of the average net profits made during the preceding three financial years toward the fulfillment of their Corporate Social Responsibility Policy.

While Section 135 firmly stipulates the quantum of CSR spending and reporting, it maintains flexibility in terms of the choice of CSR activities for companies. Instead of rigidly defining CSR

boundaries, the law broadly outlines a scope of social responsibility in Annexure VII of the Act, comprising a list of activities that corporations may potentially undertake, granting them the discretion to decide. As for compliance with Section 135, the law adopts a “comply-or-explain” approach, without explicit penalties for non-compliance.

Following the passage of the Act, the Ministry of Corporate Affairs notified the Rules related to CSR on February 27, 2014. These Rules specify activities on which companies may expend the earmarked CSR funds. To prevent self-serving expenditure, the Rules clarify that CSR activities benefiting only the company’s employees and their families will not qualify as CSR spending. However, companies are permitted to enhance the CSR capacities of their employees through reputable institutions, with the caveat that such spending does not exceed five percent of the total CSR expenditure for that financial year. The Rules under Section 135 came into effect on April 1, 2014.

### **India’s Leadership in Mandated CSR:**

With the implementation of Section 135 of the Companies Act, 2013, India achieved a notable milestone, as observed in the Report on the Standing Committee on Finance (LSS, 2010) by the Ministry of Corporate Affairs. India became the first country to incorporate CSR provisions into Company Law and make CSR expenditure mandatory for corporations based on predefined criteria. In contrast, in most other parts of the world, CSR remains a voluntary endeavor at the discretion of corporations. The extent of mandatory requirements typically revolves around the compulsory reporting of CSR activities undertaken by corporations, although this is not uniformly practiced across all countries. In certain nations like Sweden, Norway, the Netherlands, Denmark, France, Australia, and China, either government regulations, stock exchange regulations, or a combination of both necessitate corporate disclosure of CSR activities through sustainability reporting. The distinguishing aspect of Section 135 is that it not only mandates the reporting of CSR activities but also requires corporations to engage in CSR activities in the first place.

### **3. The Rationale Behind Corporate Social Responsibility:**

In any discussion about CSR, it is crucial to grasp why corporations should assume social responsibility in the first instance. Why not exclusively pursue the maximization of shareholder value and leave the pursuit of social development to other entities? Understanding the Essence of CSR.

The inquiry into the essence of Corporate Social Responsibility (CSR) extends to comprehending the basis for CSR, particularly within the framework of Section 135, and the economic underpinnings of mandated CSR. The question of “why CSR” can be dissected into three subsidiary inquiries: What is CSR? What rationalizes CSR? What justifies mandated CSR?

### **Defining CSR:**

The quandary regarding the relevance of CSR within corporate activities is intricately tied to defining the scope of CSR for a corporation. A review of existing CSR literature reveals a divergence of opinions and ambiguity concerning the elements constituting socially responsible behavior by corporations. It is imperative to establish a consensus on the definition of CSR, first from the standpoint of the entity responsible for CSR (i.e., the corporation), second from the viewpoint of the entity affected by CSR (i.e., society at large), and finally from the perspective of the entity seeking to bridge the gap between the firm and society (i.e., the regulator). In any national context, discussions about the extent of CSR regulation should, at the very least, commence with an agreement among these three entities regarding the essence of CSR.

The definition of CSR has evolved over time, with sample definitions from academic literature and international agencies, CSR has been conceptualized along a spectrum of corporate behaviors. On one end, it encompasses shareholder profit maximization within the framework of established rules, as proposed by Friedman in 1970. On the opposite end, it represents an all-encompassing objective that harmonizes economic, social, and environmental goals to serve the interests of shareholders and stakeholders, as defined by UNIDO, the World Bank, and the World Business Council for Sustainable Development (WBCSD).

Central to most of these definitions is the notion that CSR is fundamentally a voluntary endeavor, serving as a conduit between the corporation and society. The corporation’s objective shifts from merely maximizing shareholder interests (the shareholder primacy perspective) to considering the interests of all its stakeholders. This concept closely aligns with the emphasis on reconciling economic objectives with social and environmental goals, potentially compelling corporations to embrace a broader sense of responsibility.

### **CSR and Its Scope:**

The concept of Corporate Social Responsibility (CSR) encompasses a wide spectrum of activities, from ethical and moral conduct to actions that go beyond regulatory and legal obligations, all of which contribute to social welfare. It entails recognizing that a corporation's economic activities should align with societal concerns. This perspective considers the relationship between business and society, emphasizing the moral and ethical responsibility of businesses to make positive contributions beyond mere legal compliance.

Early proponents of CSR, like Bowen (1953), argued that private corporations should be evaluated based on their tangible contributions to the general welfare. This includes fostering higher living standards, promoting economic progress and security, and contributing to the overall betterment of society. Such contributions were viewed as essential for the survival of the free enterprise system. Steiner (1971) extended this argument, asserting that businesses, while primarily economic entities, should also strive to achieve social goals, with responsibilities increasing in tandem with the size of the business. This perspective ultimately evolved into the stakeholder view, positing that a corporation's objectives should extend beyond profit maximization for shareholders and encompass all stakeholders, including the broader society (Freeman, 1984).

While moral and ethical considerations underpin much of the societal argument for CSR, economic arguments have also been put forth both in favor of and against CSR. The most prominent critique comes from Friedman (1970), who contended that profit-maximizing firms should refrain from engaging in CSR, as diverting funds to create social good at the expense of shareholder returns would be akin to "theft." According to Friedman, CSR would lead to allocative inefficiencies and social losses. Conversely, a body of theoretical research has provided an economic rationale for the social role of private firms in providing public goods through CSR. For instance, Besley and Ghatak (2007) argued that CSR resembles the private provision of public goods, potentially leading to Pareto improvements. They suggest that CSR by private-for-profit firms can be efficient, especially when government provision of public goods is suboptimal.

### **Rationale for CSR in Developing Countries:**

The rationale for CSR takes a distinct form in developing countries, considering their unique socio-economic challenges. In these contexts, social, environmental, and sustainability issues are often more acute, particularly in regions affected by globalization, economic growth, investments, and expanding economic activity (Visser, 2007). As noted by Amaeshi et al. (2006), CSR in low-income countries predominantly focuses on socio-economic issues such as poverty alleviation, healthcare provision, education promotion, and infrastructure development. This contrasts with CSR priorities in Western countries, which often revolve around business ethics, fair trade, green marketing, climate change, and socially responsible investments.

In India, CSR aligns with socio-economic activities aimed at fulfilling the nation's development goals, without necessarily sacrificing corporate economic objectives. The role of corporations in development is seen as complementary to that of the government, rather than antagonistic.

### **The Rationale of CSR:**

Understanding the drivers of CSR in developing countries and the basis for imposing mandatory CSR in India requires examining the pros and cons of socially responsible activities from both societal and corporate perspectives, as well as recognizing the need for regulatory oversight.

### **CSR and Social Welfare:**

At the societal level, there is a growing recognition that a corporation's economic activities should be intertwined with societal well-being. CSR discussions often revolve around the moral and ethical obligation of businesses to contribute positively to society, extending beyond mere legal compliance. Early advocates like Bowen (1953) argued that private corporations should be evaluated based on their tangible contributions to the general welfare, such as raising living standards and promoting economic progress. Steiner (1971) echoed this sentiment, asserting that businesses should aim to achieve social goals in addition to economic objectives, particularly as they grow in size. This perspective eventually evolved into the stakeholder view, which emphasizes that a corporation's purpose should encompass the interests of all stakeholders, including society at large.

While moral and ethical considerations form the bedrock of the societal argument for CSR, economic arguments have also been made, both for and against CSR. Friedman (1970) famously argued against CSR, claiming that it would be socially irresponsible for profit-maximizing firms to engage in activities that detract from shareholder returns. However, others, like Besley and Ghatak (2007), have provided theoretical support for the economic rationale of CSR as a form of private provision of public goods, particularly in cases where government provision is lacking.

In the context of developing countries like India, CSR takes on a broader role that goes beyond standard arguments. Here, the focus extends to the role that CSR can play in achieving developmental objectives, including poverty reduction and inclusive growth. The perspective shifts from Friedman's view, and instead, emphasizes the social role of corporations in development in tandem with the government. CSR is seen as a means to supplement or substitute for government resources and delivery mechanisms, particularly in areas where governments may be weak, corrupt, under-resourced, or lacking institutional capacity (Visser, 2008; Blowfield and Frynas, 2005; Matten and Moon, 2008). These arguments align with the conclusions drawn by Besley and Ghatak, suggesting that CSR can be efficient when government provision of public goods is suboptimal.

### **CSR and the Corporation:**

Examining the rationale for Corporate Social Responsibility (CSR) from the perspective of a corporation reveals two distinct motivations: "performance-driven" and "stakeholder-oriented" (Basu and Palazzo, 2008, as cited in van der Wees, 2009).

#### **1. Performance-Driven CSR:**

Performance-driven CSR is a strategic approach where corporations engage in CSR activities with a profit motive in mind. These firms believe that their corporate social performance will ultimately translate into improved financial performance over the long term. Essentially, this aligns with the "business case" for CSR, where CSR expenditures are fully consistent with the objective of maximizing shareholder wealth, with no inherent trade-off between shareholder interests and social responsibility. This perspective operates under the premise that "smart companies" proactively integrate CSR into mainstream business practices, employee engagement, and view it as a competitive advantage (Davies, 2002). In other words, CSR is an investment that yields returns.

## **2. Stakeholder-Oriented CSR:**

Stakeholder-oriented CSR arises from the corporation's desire to serve the interests of all stakeholders beyond just shareholders. While the shareholder primacy view predominantly emphasizes profit motives, the stakeholder perspective seeks to reconcile the social and economic goals of an organization, driven by a moral imperative to benefit society at large (van der Wees, 2009). Often, a corporation's motivation to prioritize stakeholder interests through CSR activities stems from external pressures exerted by various stakeholders (Frynas, 2005). However, it's important to note that stakeholder-oriented CSR activities may involve a trade-off with profit maximization, sometimes requiring corporations to "sacrifice corporate profits in the public interest," as referred to by Elhauge (2005).

Critics of the stakeholder perspective argue that maximizing stakeholder value is inconsistent with the efficient operation of a company. The multiplicity of objectives that the stakeholder theory proposes can distort managerial incentives, as it becomes unclear what managers should prioritize when there isn't a single, well-defined objective to maximize.

### **Determining Stakeholder Weights and Regulatory Approaches:**

A critical concern emerges when considering stakeholder-oriented CSR: how to assign weights to the various objectives of different types of stakeholders, and who should be responsible for this determination? In the absence of a clear-cut economic rationale for such an exercise, responsible behavior towards stakeholders can inadvertently lead managers to act irresponsibly. Managers may strategically use stakeholder value maximization and CSR engagement as a façade for personal gains. The issue of assigning weights to stakeholders and objectives remains complex and largely unresolved. It raises questions about the transparency and fairness of such assignments and whether they should be determined by the corporation, regulatory bodies, or other entities. Without a standardized framework, this aspect of CSR remains open to interpretation and manipulation.

### **Additional Dimensions of CSR Motivation in Developing Countries:**

In developing countries like India, firm-level motivations to engage in CSR take on additional dimensions. Globalization has increased the importance of accessing international markets, potentially driving firms in these countries to align with globally accepted CSR norms. This alignment

is particularly relevant concerning environmental standards, where firms may seek to signal their compliance through sustainability performance reporting and adherence to CSR codes (Visser, 2005). The presence of multinational companies with international exposure also exerts pressure on local firms to comply with various sustainability reporting and CSR code requirements, including ethical trading initiatives, fair trade practices, and product labeling.

### **Regulatory Approaches to CSR:**

The regulatory approaches to CSR involve the extent to which governments influence CSR behavior in two key aspects: reporting of CSR activities and the amount of spending on CSR activities. This leads to three types of regulatory regimes:

1. Voluntary reporting and voluntary spending.
2. Mandatory reporting but voluntary spending.
3. Mandatory reporting and mandatory spending.

Debates on CSR policy often revolve around whether CSR reporting should be voluntary or mandatory, i.e., whether firms should be legally required to report their CSR activities. In contrast, the discussion of voluntary versus mandatory spending is less common, primarily because CSR activities, regardless of their nature, tend to be voluntary in most countries (Box 1).

### **Mandating CSR Disclosure:**

The issue of mandating CSR disclosure revolves around whether corporations should be legally obligated to report and disclose their CSR activities or if this decision should be left to the discretion of the corporation. The debate over mandatory CSR reporting gained prominence in recent years following the global financial and economic crises.

### **The Shift Toward Mandatory CSR Reporting:**

The transition from a “hands-off” approach to more stringent CSR regulation has been driven by various factors, including the global financial and economic crises, corporate misconduct, failures, and growing environmental sustainability concerns. These developments created a “trust deficit” between corporations and their stakeholders (KPMG-UNEP, 2010). Consequently, CSR governance

has evolved to impose greater mandatory disclosure requirements regarding how corporations' CSR activities impact different stakeholders and the broader community.

The economic rationale for mandatory CSR disclosure, compared to voluntary reporting, is not immediately obvious. If CSR activities are primarily driven by strategic considerations or the desire to serve stakeholders, it should be in the firm's self-interest to voluntarily disclose its CSR activities. In essence, if engaging in CSR is financially beneficial, it should also be advantageous to disclose these activities. Corporate responsibility reporting is considered to have become an essential business practice because corporations increasingly recognize that CSR reporting positively affects financial value. Failure to report can negatively impact competitiveness, costs, and potential business opportunities. Therefore, when all firms voluntarily report their CSR activities, mandating CSR reporting may only add regulatory burden without generating additional information (Lin, 2010). Moreover, mandatory CSR reporting could lead to uninformative and biased information, potentially undermining corporate accountability (Hess and Dunfee, 2007). From a public policy perspective, the need for mandatory reporting arises when corporations do not view CSR as immediately financially rewarding, yet it is perceived as beneficial at the societal level. In such cases, mandatory reporting can stimulate a positive CSR response, whereas voluntary reporting could theoretically result in minimal CSR efforts. Mandatory reporting can also reduce information asymmetries, especially in emerging markets with imperfect capital markets, and enhance corporate accountability (Hung et al., 2013). Additionally, in countries with weak institutions and enforcement mechanisms, mandatory CSR reporting can address societal issues that are not adequately addressed by existing laws and regulations. The growing support for mandatory CSR disclosure, despite criticisms, is evident in the increasing number of governments and stock exchanges mandating CSR disclosures through laws and regulations while still maintaining the voluntary nature of CSR activities.

### **The Shift Toward Mandatory CSR Reporting in India:**

The transition from voluntary to mandatory CSR reporting is particularly notable in India. Prior to 2012, the disclosure of CSR activities in the country was purely voluntary, supported by reporting frameworks provided by the government through the issuance of the Voluntary Guidelines in 2009 and 2011. However, since 2012, it has become increasingly mandatory, starting with the Securities and Exchange Board requiring the top 100 companies to file Business Responsibility Reports and

culminating in the Companies Act of 2013, which mandates CSR reporting for a larger set of listed and non-listed companies under Section 135.

### **Mandating CSR Spending:**

The prevailing definitions of CSR in the literature and underlying CSR theories largely portray CSR as a voluntary endeavor. In this perspective, corporations determine their optimal CSR actions as part of their business strategy, influenced by market pressures from consumers, investors, stakeholders, and civil society organizations. In such a scenario, the government's role is generally limited to endorsing, facilitating, and partnering with socially responsible corporate behaviour through policy instruments like tax exemptions for CSR activities, award schemes, information dissemination, training, and the promotion of CSR best practices through voluntary guidelines and certification systems.

Economists and policy analysts have typically been cautious about mandating companies to allocate resources to CSR activities. Economic efficiency suggests that CSR should remain voluntary, with companies engaging in it when the perceived benefits outweigh the opportunity costs

## **Mandatory CSR: Prospects and Challenges**

The empirical analysis in the previous section demonstrates that even prior to the enactment of mandatory CSR under Section 135 of the Companies Act 2013, Indian corporations had progressively embraced the notion of social responsibility. This is evident through the substantial increase in the proportion of companies reporting their CSR activities over the years. Importantly, this upward trajectory occurred in a regime where both CSR spending and reporting were voluntary. It signifies a compelling business case for companies to engage in social responsibility. This is further corroborated by preliminary evidence suggesting a positive relationship between CSR and firm performance, as gauged by Return on Assets (ROA) and market value. Much like the overwhelming body of evidence from developed countries, the analysis of India's top 500 companies suggests that the market values a firm's social engagement positively. Given these findings, it is crucial to assess the prospects and challenges associated with Section 135 in the foreseeable future.

## The Prospects

Mandated CSR garners both support and opposition. Proponents argue that a corporation's objectives should extend beyond mere profits and shareholders, encompassing social welfare and all stakeholders. Opponents, on the other hand, contend that corporations have a well-defined role of maximizing shareholder value and, therefore, CSR should be market-driven and left to their discretion. This debate revolves around normative issues that are challenging to resolve. Any economic policy typically results in winners and losers, and a "good" policy strives to balance gains against losses.

While the new provisions outlined in Section 135 are expected to significantly boost CSR spending by Indian companies compared to their previous levels, it is essential to recognize that mandated CSR might impose certain economic costs on these companies and their shareholders. Consequently, Section 135 incorporates various flexibilities to mitigate these costs, ensuring that CSR spending does not disproportionately harm companies and their shareholders while substantially enhancing net social welfare.

A comprehensive assessment of the arguments for and against mandated CSR suggests that the new CSR regulations introduced under Section 135 are conceptually robust and well-structured. Firstly, under the current rules, CSR expenditure is derived from profits, which circumvents the challenge of managing multiple objectives inherent in stakeholder theory. Companies still maintain shareholder value maximization as a primary objective, with the option to allocate two percent of their profits toward CSR activities post hoc. Therefore, these CSR stipulations do not distort economic objectives, as is often the case with stakeholder optimization.

Secondly, the requirement of two percent of Profit After Tax (PAT) does not impose a significant demand on corporate resources. For instance, considering the median PAT and turnover of the top 500 companies (Table 1), the 2 percent rule would necessitate a modest CSR spending of Rs. 4.65 crore relative to a turnover of Rs. 9687 crore. Even when extended to all listed companies under the CSR rule, a company with median PAT would only need to allocate Rs. 55 lakh annually as of 2012 (Table 7). These figures cast doubt on the likelihood of CSR spending leading to a substantial loss of competitive advantage, whether domestically or internationally. In fact, if there is a business case for

CSR, supported by empirical evidence, international companies may be engaging in CSR to gain, rather than lose, competitive advantages.

Thirdly, the CSR regulations follow a “comply or explain” approach rather than a strict “comply or else” approach, allowing companies to assess the opportunity cost of CSR. Smaller companies, falling below specified thresholds, are exempt from CSR, recognizing their potentially high opportunity cost of internal capital. Furthermore, companies that deem the 2 percent CSR spending not in their best interest may spend less or provide an acceptable explanation to the regulator. This approach, as articulated by the Ministry, emphasizes disclosure of CSR activities in the public domain, creating social expectations and, consequently, generating more CSR spending compared to voluntary spending with mandated reporting.

Fourthly, companies lacking expertise or core competency in CSR-related projects may appoint reputable trusts or donate the specified amount to the Prime Minister’s Relief Fund. It is noteworthy that many companies had voluntarily undertaken CSR, some exceeding 6 percent of their PAT, even before the regulations were enforced. These companies likely assessed that the benefits of CSR outweighed the costs, indicating that CSR aligned with their core competencies.

Lastly, concerns that mandated CSR might reduce spending by companies voluntarily exceeding the two percent threshold can be addressed. While there is merit in this argument, it is equally plausible that CSR spending by these firms could increase to maintain the signaling value of CSR. The ultimate impact becomes an empirical question. Moreover, incumbent firms can enhance the signaling value of CSR through better project selection and more efficient delivery compared to newcomers.

Despite these arguments, economists may still view mandated CSR provisions under Section 135 as an implicit corporate tax. However, a key distinction is that the current CSR provisions function as a centralized tax with decentralized utilization through project implementation by private parties. Explicit taxation lacks the assurance that funds collected by the government will be allocated to CSR; the implicit tax, in contrast, grants companies control over the targeted disbursement of their funds, offering stronger incentives for informed choices.

## Challenges Arising from Mandated CSR Implementation

While recognizing the potential benefits of Section 135 in strengthening the relationship between businesses and society in India, several challenges and issues are likely to emerge during the implementation of the new CSR rules. Addressing these challenges requires the establishment of appropriate mechanisms.

1. **Resource Allocation:** One concern is the potential generation of excessive funds under the new CSR Rules, posing challenges for companies in identifying and sustaining suitable projects. Companies are required to allocate 2 percent of their net profits annually, creating management challenges in searching for, selecting, and implementing projects, as well as monitoring ongoing CSR activities. These challenges could accumulate in terms of scale and scope over time. An analysis of BSE listed companies suggests that applying the present CSR criteria to these companies in 2012 would have resulted in an estimated CSR spending of Rs. 8343.9 crore based on their net profit figures for that year. Extrapolating to FY 2015, including unlisted companies, this amount could exceed Rs. 10,000 crore annually. While these figures may seem relatively small in comparison to government spending on social programs, they are substantial at the company level. For instance, the median firm with a turnover of Rs. 33 crore would have to identify and manage CSR projects worth Rs. 55 lakhs annually. Larger companies like Reliance and ONGC would need to spend over Rs. 400 crore each year. Companies may require dedicated centers for identifying, implementing, and monitoring projects or handling numerous smaller projects, incurring additional costs. The government must be vigilant to prevent promoters from channeling funds through CSR into organizations they have an interest in. Effective monitoring and legislative provisions are essential.
2. **Reclassification of Expenditure :** Another issue pertains to the treatment of expenditures that companies may already be incurring. Can expenses for educational institutions or hospitals beyond legal requirements be classified as CSR under Section 135? Will this be permitted if such facilities are accessible to non-employees as well? Questions have arisen about whether certain types of expenditure qualify as CSR expenses. In response, the Ministry of Corporate Affairs issued a circular specifying that CSR activities must relate to Schedule VII of the Act

and be interpreted liberally. The circular lists specific expenditures that count as CSR and those that do not. Further explanations and clarifications may be necessary.

3. **Coordination of CSR Projects:** Coordinating CSR projects across companies in the same region to avoid duplication and overinvestment in similar projects is a challenge. The Rules recommend that companies prioritize local areas for CSR spending. An analysis of CSR activities by large listed companies in 2011 indicates that companies typically engage in a limited number of activities, such as education, health, sanitation, women empowerment, and material and financial aid. Pooling resources for large-scale projects like hospitals and schools may be more efficient for smaller companies. Formal partnerships or consortiums can enhance coordination among companies in a particular region.
4. **Geographical Imbalance:** Mandated annual CSR expenditure could unintentionally lead to the concentration of social welfare programs in regions with larger and better-performing corporations. High CSR spending by such companies might disproportionately benefit certain regions or states while leaving others with limited corporate sector activity lagging behind. To prevent such unintended consequences at the macro level, a coordinating agency at the central or state level could harmonize CSR spending to ensure equitable development.

## Conclusion

In conclusion, India's new CSR provisions should not be viewed as the government shifting its responsibility to the private sector. The estimated annual CSR spending by corporates, in the context of total government social sector spending, amounts to just around two percent of what listed companies would have spent under Section 135. These provisions should be seen as an effort by the government to engage the corporate sector in complementing broader societal development goals. The flexibility provided to companies in choosing and monitoring projects is likely to promote efficiency and effectiveness in project implementation without conflicting significantly with the primary objective of shareholder value maximization. These rules strike a balance between social and economic incentives, and it is hoped that the corporate sector will willingly contribute to the nation's inclusive growth under these provisions.<sup>i</sup>

Reinhardt et al. (2008) observe that given a “bewildering” array of CSR definitions and conceptualizations in the Literature, the challenge is to identify a “consistent and sensible definition

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