CSR AND THE COMPANIES ACT 2013 *

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There are some abbreviations like IT, NREGA and RTI which have become so well known that people forget what the original stood for. CSR is one such. It has become a buzzword but not everyone knows what it stands for, or the full implications of the concept.

So what is CSR?

Corporate social responsibility goes beyond the contribution of a certain portion of the company's profit to projects of benefit to the community. It is a far wider concept. It implies a continuing commitment by business to behave ethically, to contribute to sustainable economic and social development of all its stakeholders, not just its shareholders, but also its employees, the government, suppliers, consumers, the local community and society at large, and to protect the environment. Instead of being concerned only with the bottom line of profits, it must be conscious of the triple bottom line or commitment to people, planet and profit.

CSR also implies that the process of making profit is as important as the use of the profits. A company must do no harm to people through its processes and operations i.e., it must minimize the negative impacts and maximise the positive ones by engaging in initiatives to promote the progress of society.

Earlier, business first calculated its profits regardless of the cost to society of its operations and then gave some of it to society in the form of charity or philanthropy. But today CSR implies that social expenditure – the amount spent on environmental preservation, ensuring consumer satisfaction, employee welfare or ensuring human rights has to be built into the cost of doing business, same as any other business expense. What remains after this is done is the 'responsible profit' of business.

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Thus CSR must incorporate the following elements: community development, environmental management and improvements at the workplace, including the product, consumer services and human resource development.

Why CSR

You might say all this is very well, but why should companies be socially responsible? In answer let me tell you a Mulla Nasruddin story.

Mulla Nasruddin was a Persian folk hero who was known for his wit and wisdom. One day he was walking along a deserted road when he saw a troop of horsemen come by. Thinking they might capture him and sell him off as a slave or that he might be forced to join the army, Nasruddin bolted, climbed a wall into a graveyard and lay down in an open grave.

Puzzled at his strange behaviour, the men who were honest travellers, followed him and found him cowering and shaking with fright.

"What are you doing in that grave?", asked one of them."We saw you run away. Can we help you?"

"Just because you can ask a question does not mean that there is a straightforward answer to it",said the Mulla. "It all depends on your viewpoint. But if you must know, I am here because of you and you are here because of me."

So here we have the answer: interdependence. We are all interdependent.

We tend to forget that business and society cannot exist or flourish without each other. Society is dependent on business to create wealth and business is dependent on society for license to operate, to provide the labour as well as the customers, among other things. If society fares poorly, business too does badly, and vice versa. Therefore business has an obligation to society which goes beyond making profits in self-interest.

If a company can align self-interest with needs of society then we can have a winwin situation for both. To illustrate: an IT firm can engage in spreading digital literacy, a toothpaste manufacturer can promote dental hygiene which in turn will increase the sale of toothpaste; banks can undertake programmes of financial inclusion and so on.

This has also been called creating shared value or CSV. It means creating economic value while contributing to meaningful and sustained social impact at scale. For instance, HUL offers a free radio on demand service to villages in Bihar who otherwise do not get even the FM radio. The radio's lone channel is called Kan Khajura Tesan. Any mobile phone user can give a missed call to a specific number and will immediately get a return call that will play the channel for 15 minutes. Besides entertainment programmes, the station also plays HUL's ads,so that their sales go up and the mobile users get free entertainment.

Second example: the Godrej group has pioneered Chotukool, a small, low cost fridge for rural areas which works on batteries, because typically there is no power in villages. The Tata Nano, the small cheap car meant for lower income families is another such example; WIPRO has designed cheap healthcare products using digital technology, and so on.

Evolution of Concept

Because the Companies Act 2013 is a culmination of developments in theory and practice over several centuries, I would like to dwell briefly on some of the landmarks along the way because it will help us understand where the Act is coming from.

As I have pointed out in my book 'Business and Community - The story of Indian Corporate Social Responsibility', the idea of CSR is neither a totally new idea, nor is it an alien import into India. Though called by different names at different times, it has evolved gradually to its present form, in the context of India's own political, cultural and socio economic history and government policies. There have always been business leaders who were keenly aware of the business and community interdependence and, therefore,contributed not only financially to society but also took a leading role in social transformation. Charity or philanthropy and even non-monetary social responsibility was a considered business strategy, though not called CSR. Even before the advent of modern capitalism, traditional business communities like the Marwaris, the Chettiars, and the Jains, used to set aside a part of the business income for both religious charity, such as building temples, feeding the poor and financing local festivals, and for secular causes such as helping the community in times of drought or floods, or for building wells or rest houses, schools, or planting trees, building ghats and so on.

It gave them higher visibility and status in society, contributed to their image as trustworthy citizens and added to their credit worthiness. It helped them build goodwill and social capital. And, all of these helped in business expansion.

After the commencement of industrialisation, Jamsetji Tata, Ranchodlal Chotalal, Jamnalal Bajaj, GD Birla, JRD Tata, Kasturbhai Lalbhai, to name only a few, were not only India's leading business men but also played an active role in society, helping to shape it to their vision of a good society and progressive nation. They were as active in the freedom struggle, in social reform and institution building as they were in setting up big business dynasties which continue to flourish even today. Jamsetjee Tata set an example to the business community not only in setting up a trust to provide scholarships for deserving students to study abroad, but in instituting progressive employee welfare measures in Tata Steel, like shorter working hours, minimum wages, and good working conditions long before the government legislation.

For his part, Jamnalal Bajaj, the founder of the Bajaj group and a devout Gandhian had said:

"We should.... look to the interests of the province, region or society in the midst of which we earn our living and, whenever necessary, we should serve it with all our heart". "We should never fail to spend at least a portion of our incomes on the social, economic and educational development of the province where we live."

Social Irresponsibility and Reaction

Licensing policies and the Inspector Raj, amongst other factors, made business socially irresponsible and the several scams which surfaced then, such as the Mundhra scandal, led to a very poor image of business in the public mind. This was a far cry from the past when the influence of Gandhiji and his later disciples, Vinoba Bhaveand JP Narayan on business leaders like Kasturbhai Lalbhai, JRD Tata, and Ramakrishna Bajaj had resulted in their working to make the business community more responsible. Witness Ramakrishna Bajaj's statement: "the business community is an essential ingredient of our democratic society and it has a duty not only to create wealth but also to promote the ethical and social goals of the community. Unless it fulfils both these functions and there by plays its due role as a responsible section, it will not be able to ensure its own survival."

First Articulation of CSR

The first international conference on social responsibilities of business held at IIC in 1965 is a landmark in the development of CSR in India. It led to the Declaration of Social Responsibility of Business which recommended justice and fair play, development of all constituents from owners to consumers and utilization of surplus for other social causes. In 1979 the first ever social audit was carried out by Tata Steel, which led them to amend the articles of association of the company by adding a clause to the effect that"the company shall be mindful of its social and moral responsibilities to the consumers, employees, shareholders, and the local community". It put the creed which had been espoused by Jamsetjee Tata at the centre of corporate consciousness, viz. whatever comes from the community must go back to the community.

The government too played an active role in years past in making business contribute to society, sometimes encouraging business through tax concessions and award of titles such as Rai Bahadur, and sometimes by wielding the stick.

Now in the last 2-3 decades of the 20^{th} century, industry began to accept social responsibility as part of the management of industry itself, though it was still confined to a few top businesses. Corporate giving was also extended to more grassroots, mainstream concerns and to rural areas. There was a diversification in the causes supported such as afforestation, science education for the people, preservation of monuments, women's rights and consumer education. But there were deficits:

The Deficits

Though many had accepted the idea of CSR and moved to implement it, only a small fraction of the whole sector was engaged. While the PSUs were almost all engaged in CSR activities because of government directions, followed by MNCs, private Indian companies lagged behind.

Much of what was being done was still cheque book philanthropy. And the emphasis was still on "activities" like building schools or running clinics or promoting employment or skill development, rather than on responsible behaviour. Human rights, fighting corruption, or building an ethical supply chain were low on the agendas.

Whatever was being done was non-strategic, ad hoc, and CEO driven, without a stated policy which was known within and outside the companies .It was also limited to when times were good. Finally there was no metrics, nor monitoring of the outcomes or impact.

The Immediate Context of the Act

CSR received a stimulus after globalization opened up India to competition and better business practices. A technological revolution, economic reforms and other factors scripted India's growth story and led to the second wave of wealth creation. Ideological changes gave a greater role to the market and the private sector. As the tally of India's billionaires climbed, (presently over 60, I am told) it increased both business willingness and ability to give.

At the same time, rapid economic growth had bypassed the poor, and increased inequalities between the rich and poor with over 836 m. living on less than ₹ 20 a day. Ranking on all human development indices such as literacy, child and maternal health, housing and sanitation, was low and the achievement of the UN Millennium Development Goals [2000] or MDGs seemed a distant goal.

Climate change, environmental degradation, and the idea of sustainable and inclusive development brought new issues for business to take on board such as energy efficiency, conservation of natural resources, disposal of toxic and e-waste, and so on.

With a more dynamic civil society, there was a growing consciousness of human rights, and particularly the rights of dalits, tribals and women. Businesses began to come into conflict with civil society on a number of issues. For instance, Pepsi and Coke faced confrontation with the CSE over pollution of water sources; local populations and environmental groups were in conflict with business over R& R for those displaced by the SEZs and new industrial plants, like Singur and over the exploitation of natural resources as in the case of the Vedanta and Posco plants.

The trust deficit due to several developments such as the Union Carbide disaster in Bhopal, the Satyam and the 2 G scams, brought disrepute to unregulated capitalism, and focused attention on corporate governance, irresponsible social behaviour and crony capitalism.

Since it was given greater freedoms and had been the principal beneficiary of globalization and reforms, the government and the public expected that business would share the gains of growth with the rest of society and contribute more to national development.

Taken together these factors led to demands for reform of business attitudes and practices for more equitable use of business wealth and for responsible business behaviour.

It was becoming clearer by the day that if business was to avoid conflict with government and society, acceptance of the wider idea of CSR was absolutely inevitable. The stage was thus set for some kind of regulatory intervention by government.

Prelude to the Act

One of the first moves was the development of the 'National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business' by the Ministry of Corporate Affairs, Government of India, in July 2011. These guidelines contain comprehensive principles, 9 in all, to be adopted by companies as part of their business practices: For instance,principle 1 states that businesses should conduct themselves with ethics, transparency and accountability.; principle 2 states that business should provide goods and services that are safe and contribute to sustainability; that it should promote the wellbeing of all employees, that businesses should respect the interests of all stakeholders, especially the disadvantaged and marginalised, pay attention to human rights, the environment etc.

A reporting format was also developed requiring certain specified disclosures, demonstrating the steps taken by companies to implement the said principles.

Later it was decided by SEBI to mandate inclusion of Business Responsibility Reports ("BR reports") as part of the Annual Reports for the top 100 listed entities based on market capitalization at BSE and NSE. The Sebi reporting requirement was made applicable with effect from the financial year ending on or after December 31, 2012.

These developments are as important in the efforts to bring transparency and accountability into the business sector as the introduction of mandatory CSR.

Companies Act of 2013.

While the Act as a whole is devoted to bringing about more accountability and transparency in business operations through better corporate governance, Section 135 is meant exclusively to promote social responsibility among business, and because of its mandatory provision of financial contributions for the purpose, has received disproportionate attention to the exclusion of the other sections of the act, which are designed to reform business practice as a whole.

Clause 135 makes it mandatory for every company, having a net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year to constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.

(1) The Board's report under sub-section (2) of section 134 has to disclose the composition of this Corporate Social Responsibility Committee.

(3) The Committee has to:

- formulate and recommend to the Board, a CSR 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 policy from time to time.

The Board of the company has to:

- approve the CSR Policy and disclose its contents in its report and also place it on the company's website.
- ensure that the activities mentioned in the policy are actually 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 the policy.

Also the company must give preference to the local area and areas around where it operates, for spending the amount earmarked for CSR activities:

If the company fails to spend such amount, the Board shall, in its report specify the reasons for not spending the amount. But both the Act and the recently notified rules are silent on what will happen if the explanation is not accepted. Will the penalties in Clause 134 apply?

Activities which may be considered CSR activities are mentioned in Schedule VII of the Act which has been amended following the notification of the rules,to expand the categories of CSR activities.

They are very broad categories and give latitude to boards. Boards can add if they can justify but only within the broad framework of the Act and Rules. They cannot decide what CSR is outside the rules.

The approved activities include those relating to eradicating hunger and poverty; promotion of education,promoting gender equality, reducing child and maternal health and so on. Activities to support sports, welfare of army widows and shelters for women are some additional activities approved. Donating directly to the PM's Relief Fund is allowed, but not to CM's Funds.

Rules exclude political funding from CSR spend. Also excluded are donations to political parties.

A clarification which is provided by an official dealing with the Act is that all activities must be in the form of projects, with stated goals, timelines, budgets, expected outcomes etc. Mere donating to an entity is not allowed. The rules also clarify that companies can spend only upto 5% of the total CSR expenditure on manpower in a single financial year. This includes their own staff as well as those of outside implementing agencies.

Tax deductibility of CSR spends remains unclear. It depends on the authority of the Ministry of Finance.

Other changes notified in the Rules are:

- CSR spends can be pooled by several different companies for a particular project or for creating a fund for a particular project, e.g. an education fund. But each company must report separately.
- Definition of net profit will not include dividend income received from other Indian companies, nor profits from overseas branches.
- If companies do not have independent directors it need not specially appoint them for CSR. Also if there are only two directors on the board of a company, it would suffice for the CSR committee.
- Rules also apply to foreign companies operating in India but not to companies' foreign branches.
- In case companies are unable to spend the CSR budget they have to provide reasons and disclose the same. Rules stipulate listing of projects

/ programmes,as also monitoring process for such programmes.

The essence of Clause 135 can be summed up as:

- Forming the CSR committee
- Spending the CSR budget
- Moving from peripheral involvement to passionate involvement of top management
- From ad hoc CSR expenditure to planned strategic investment
- From a single bottom line culture focused on profit to a triple bottom line focus and
- From a standalone CSR function to one where CSR is internalized and accepted by all in the company.

Penalties

The penalties for non-compliance with any section of the Act are given in Clause 134. (1) They include a fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default can be punished with imprisonment for a term which may extend to three years or with fine not less than fifty thousand rupees and which may extend to five lakh rupees, or with both.

Issues raised by the Act

In many ways the Companies Act is a path breaking legislation. It has brought CSR into the centre of corporate consciousness and introduced systems and procedure where none existed before. It has provided a path to be followed.

Also some of the changes recommended by the Act are sound from the point of view of governance as well as social responsibility such as those regarding independent directors and having women on the Board. Studies by Harvard Business School and others have found that companies with women board members contribute significantly more charitable funds on average than those without women members;

that they bring more diverse perspectives on fairness and distribution of resources to donation decisions which in turn broaden a company's commitment to CSR; they also develop more quality CSR initiatives.

However, I regret the use of compulsion for promoting CSR. Charity has to come willingly and from within. But unfortunately, it is also true that in India unless there is some compulsion the desired transformation or compliance does not take place. Though CSR has a long history, it has remained limited to a few top progressive companies, many of them multinationals, who follow the example at home. The large bulk of Indian businesses were not doing anything at all for society.

But again the Act limits itself to the largest companies and does not require the same of SMEs who are often some of the worst offenders especially in regard to the environment and labour welfare.

My second area of discomfort is the emphasis on monetary contributions. Paying a sum of 2% of its profits cannot, by itself, make acompany a good social citizen. As explained earlier, the concept of CSR is not limited to monetary contributions to social projects or causes but implies a 360 degree effort to make business responsible and ethical. How a company makes its profits is as important as whether and how much it gives out of its surplus. It is not enough for a company to make 2% or even more contributions to community projects if it acts irresponsibly in other areas of business such as the environment or by short-changing consumers, suppliers, labour, or shareholders. Unless the other sections of the Act dealing with transparency and accountability and good governance are implemented as rigorously, all that will happen is that government will receive a helping hand to do what many see as its prime responsibility – to provide social development to its citizens.

To make an impact on society CSR must articulate a moral vision of development, one that includes all sections of society, which means sustainable use of common goods, which adheres to concepts of democracy, peaceful coexistence and social justice. Can mandating CSR make business accept lower profits in the greater interest of equitable distribution? No.

A law cannot by itself promote the normative values underlying it. It is for the business leadership, not government, to articulate a moral philosophy for their own profession and carry their fraternity with them through example, as many of the greats of Indian business had done in the past.

Further, once such concepts are legislated upon, one would have to add further provisions to protect such legislation. Besides, no matter how comprehensive rules and regulations are, there will always be grey areas as to what is CSR and the government will have to consider each case on merit. Besides, rules are ineffective unless they are monitored regularly to ensure compliance. Who will monitor compliance? That is not clear. Government or another independent agency?

I also worry that in order to meet legal requirements; it is likely to lead companies to unproductive allocation of resources. In the initial years there is likely to be some confusion as to whether a particular activity can be considered CSR or not.

Companies will pay lip service to the law and show all kinds of expenditure as CSR expenditure, paving the way to more dishonesty. For CSR as a mandatory approach to work there must be proper procedures and a transparent system of accounting in place to spot window dressing.

The amounts to be spent are so big (at approximately ₹.30,000-40,000 crs), that the real issue will be how to spend wisely – on activities and projects that will add real value to society and bring progress and not for the sake of spending. Even where there is no attempt at window dressing, companies may not have the bandwidth to devise imaginative projects which meet real felt needs and so might opt for routine health and education projects. It would skew allocation of resources towards too much attention to one need and not enough for transformative changes such as political and social reform, ensuring human rights and the like, the need for which is less obvious, but nevertheless necessary for progress.

So far there is no mention of a mechanism for coordination of several companies' efforts in a given field or geographical area.

Companies are looking to NGOs to partner them in doing social development, but this is not going to be simple. For one, both companies and NGOs come from different ecosystems, their values, attitudes, styles of work, are different. Thirdly, even with the best will in the world, companies may not be able to give much money to NGOs because there may be no credible NGOs in their territory, or they may not have the requisite absorptive capacity. Not all NGOs have the competencies to use large amounts of money productively and efficiently.

- Successful partnerships between NGOs and companies will therefore require several ancillary measures such as organizational brokering to bring NGOs and companies together to understand each other and to remove the trust deficit;
- competency building in NGOs,
- building database of companies, with NGOs classified according to their core competencies, CSR interests, amounts available for CSR and contact details,
- putting in place a mechanism for communication with local communities either directly or through panchayats .This will be particularly important for those companies whose operations hinge on exploitation of natural resources and land acquisition.

More clarity is also required on what is to be done with the unspent amounts. It has been clarified that surpluses from CSR activities cannot be added to business income. That presumably means that they must go into CSR budgets. But there are surpluses which arise from creating shared value and are properly part of business income. Is a company to be denied the extra profits that accrue by greater sales of dental products because of a campaign for dental health?

Future Challenges

To implement Section 35 successfully may need redefining business strategy, accounting and disclosure practices, employee engagement practices, engagement with investors and the like. It may also bring newer imperatives for it in terms of collaboration and engagement with critically important social actors viz. the civil society, the government,the large middle and small scale industrial sector, the media and the people of the country.

It will further involve orienting of not only committee members but also all staff, many of whom may be unfamiliar with the concept.

A monitoring and evaluation framework will also need to be put in place.

To conclude, before judging the Act harshly it must be remembered that it is essentially a work in progress. Many things will need to change as experience is gathered in its implementation.

Given the radical nature of Section 35, the government will have to facilitate the process of learning by disseminating knowledge, being open to changes suggested by companies and devising an incentive system to encourage more companies to be responsible citizens.

But finally, it is the business leadership which will have to rise to the challenge and lead by example. I would urge all those who have to implement the Act to be guided by their hearts rather than their heads, to feel that what they have been asked to do is what they want to do and then do it with passion and sincerity.

Examples of CSR by some companies:

ONGC

Main focus areas:

- Education including vocational courses, health care.
- Entrepreneurship – self-help and livelihood generation.
- Infrastructure support near operational sites.
- Environment protection and ecological conservation.
- Promotion of heritage- sites, monuments protection.
- Some projects:

- Girl child education for economically deprived girls.
- Grooming environment leaders through environment education, partnering with TERI. (Soldiers of the Earth project – Ashadeep now supports around 15,000 girls).
- Green Cremation project.
- Project Saraswati to explore water sources in deserts of Rajasthan.
- Asmita Project to promote consciousness of India's monumental heritage in partnership with Surabhi Foundation and TERI- production of 13 films on India's cultural heritage.

NTPC

Activities:

- o Infrastructure, including providing roads, drains, drinking water, sanitation around plants.
- o Education and health.

Banks

Standard Chartered.

Focus on financial inclusion, environment protection, global health,poverty alleviation, women empowerment.

Partnership model in seeing is Believing Initiative, to focusing on curable blindness.

Bajaj Auto

Activities- schools, management and ITI institutes, speciality hospital; health care development; development of infrastructure in their model villages.

MNCs

Microsoft

Community Technology Skills Programme called Project Jyoti, launched in 2004.

Trained 2.5 lakh people in 20 states.

Focus on unemployed youth, marginalized women, and rural communities.

Goal IT skills training and basic computer literacy.

Mahindra and Mahindra

Nanhi Kali Foundation and Nanhi Kali projects for girl children.

Also, Mahindra Pride School for livelihood training for socially disadvantaged youth.

Mid-Day meal kitchen in Jaipur district.

Environment initiatives – tree plantation, bio diversity Park.

Life Line Express – Hospital Train.

Nokia Siemens Network

Internet kiosks established in rural areas to help producers with marketing information on agri extension via mobiles.

Blind taught how to transcribe instructions from an engineer and doctor in the field who receive instructions by phone and then fill in report cards.

Kanoria Chemicals

Education – High school at Renukoot; support to 4 village schools nearby.

Watershed management -65 check dams;

Livelihood promotion – skills development; health – medical camps, prevention of female foeticide; 128 houses exclusively for contract workers, fly ash used in building material.

Examples of CSV

WIPRO Technologies proposes to address social needs through its regular business operations, viz. leveraging technology for the masses. It has identified healthcare, education and energy products as sectors for creating new low cost products within the reach of the masses as well as those small enough to be used conveniently, such as an electrocardiogram necklace, tablet computer aimed at the education sector and cameras for use in hospitals and in mining and retail.

Novartis India, Vaatsalya, General Electric, and Water Health India are other companies in healthcare and sanitation who, recognizing health challenges as business opportunities, are creating shared value by extending access to medicine to rural areas, developing innovative medical devices tailored to low-income populations and improving sanitary conditions as well as access to clean drinking water for the under served.

In agriculture, companies such as Jain Irrigation Systems Limited, IKSL (IFFCO Kisan Sanchar Limited), eFarm and the Gujarat Cooperative Milk Marketing Federation, Ltd. (also known as Amul) are seizing opportunities to create economic and social value by increasing agricultural productivity, creating fair and transparent markets and collectivizing small and marginal farmers.

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