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Legal development of corporate social responsibility in India

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Abstract: *The horizon of the development of a nation can expand if it promotes the ideology of welfare. Corporate entities today are conducting such social welfare schemes through CSR practices. Corporate Social Responsibility is not a new concept today. It was prevalent since ancient times but as a mandate was the yield of government's effort for the nation.*

This paper is in order to make an attempt to deal in depth the legal developments in CSR and New Companies Act, 2013, its utilization, various provisions laying out its benefits, drawbacks. According to this Act CSR Spending has been made compulsory for companies having certain amount of turnover. This 2% spending may help a company to attain goodwill along with the societal development or in other words promotion with a cause. This law had brought lots of benefits accompanied by certain loopholes such as no penal provisions in case of failure to spend surplus on such activities and so on. Such ethical initiatives should be promoted with holding a moral spirit.

Keywords: *Corporate social responsibility (CSR), companies Act 2013, CSR rules and reporting, CSR committee.*

1. INTRODUCTION

"Corporate social responsibility is a hard-edged business decision. Not because it is a nice thing to do or because people are forcing us to do it... because it is good for our business." Niall Fitzgerald Former CEO, Unilever.

India has a diversified culture. The welfare of citizens and nation is of paramount importance which is visible from the social initiatives taken by the corporate world and now by making the CSR spending mandatory. India is the first nation to enforce a regulation on corporate spending for society. Corporate social responsibility also called corporate conscience, corporate citizenship or responsible business is a form of corporate self-regulation1 integrated into a business model

As defined by the European Commission corporate social responsibility is, "a concept whereby companies decide voluntarily to contribute to a better society and a cleaner environment. A concept whereby companies integrate social and environment concerns in their business operations and in their interaction with their stakeholders on a voluntary basis."

Equal distribution of resources and wealth is fundamental for achieving strong social development. The enforcement of the CSR mandate under the Companies Act, 2013 is an attempt to supplement the government's efficacy of growth and to involve the Corporate World with the country's agenda of social welfare.

The constitutional structure of the country was laid with an objective of one man equals one vote, equals one value. However the socio-economic state of the nation still have a long way to go to match this ideology of free India. There is a constant debate of developmental growth versus welfare of the state. Our political scenario and our economic thinking are two opposite poles. The question arises is how we can seek balance between them. Our actions today will affect our future generations.

On one side, our nation is gaining the status of an economic entity in the world in the emerging globalization, on the other hand, it is still a developing country having number of people living in absolute poverty along with the children suffering from malnutrition. This picture of uneven distribution can be said to be one of the main cause of social unrest.

Government in this behalf has laid down the National Voluntary Guidelines for Social, Environmental and Economic Responsibilities of Business or the NVGs with the Business Responsibility Reports mandated by the SEBI the CSR clause within the Companies Act, 2013 are two such instances of the steps taken.

According to Indian Institute of Corporate Affairs, a minimum of 6,000 Indian companies will be required to undertake CSR projects in order to comply with the provisions of the Companies Act, 2013 with many companies undertaking these initiatives for the first time. Further, some estimates indicate that CSR commitments from companies can amount to as much as 20,000 crore INR.

Such combination of legal and social pressure indulge companies to pursue their CSR spending more ethically.A resilient and flourishing development sector is centre of India's desire for equitable and sustainable growth.

With the passage of the Companies Act, 2013 the mandate for corporate social responsibility (CSR) has been formally introduced to the dashboard of the Boards of Indian companies turning over a new leaf. The industrial strata had welcomed this mandate with open arms by giving their positive response to the reform measure undertaken by the government through thick and thin.

The practice of CSR is not new to companies in India. The Act undertake manifold companies from pillar to post. Also, it is a square deal giving rise to CSR spending. Building a nation spick and span, having a society maintaining equality in opportunity will not be an uphill task if considered as a collective responsibility.

Under the Companies Act, 2013, any company having a net worth of rupees 500 crore or more or a turnover of rupees 1,000 crore or more or a net profit of rupees 5 crore or more should mandatorily spend 2% of their net profits per fiscal on CSR activities. The rules came into effect from 1 April 2014.

India has the world's richest tradition of corporate social responsibility. Though the term CSR is comparatively new, the concept has its roots in ancient history. CSR has been informally practiced in ancient times in form of charity to the poor and disadvantaged. Indian scriptures have at several places mentioned the importance of sharing one's earning with the deprived section of society. We have a deep rooted culture of sharing and caring.Kautilya emphasized ethical practices and principles while conducting business. Religion also played a major role in promoting the concept of CSR. Merchants belonging to the Hindu religion gave alms, got temples and night shelters made for poor. Hindus followed Dharmada where the manufacturer or seller charged a specific amount from the purchaser which was used for charity. Islam had a law called Zakaat which ruled that a portion of one's earning must be shared with the poor in the form of donation. Similar to Islam's zakat, Sikhs followed what they called daashaant.

Hence, on the wholeCSR was in the air in India running parallel to the historical upliftment of India. CSR has evolved in phases like community engagement, socially responsible production, and socially responsible employee relations. Therefore, the history of Corporate Social responsibility in India can be broadly divided into four phases.

2. FOUR PHASES OF CSR

The first phase of CSR was driven by noble deeds of philanthropists and charity. Great impact can be seen of values, traditions, culture and religion along with industrialization. Up to 1850, donations for establishment of temples or religious institutions were given by the business classes. In case natural calamities they serve the poor and hungry. The approach changed with the emergence of colonial rule in 1850. In the Pre-independence era, the supporters of industrialization also supported significance of CSR. In 1900s, the industrial entities like Tata, Birla, Modi, Godrej, Bajaj and so on came out and took initiatives by creating various foundations, educational and healthcare institutions, and trusts for community development.

The second phase was the period of independence when the entrepreneurs were persuaded to show their diligence towards the welfare of the society. Mahatma Gandhi also advocated this allocation of wealth for the vulnerable section of society. The concept of trusteeship thus came into existence which supported the societal as well as economic growth of the nation. Gandhiji regarded the Indian industrial sector as “Temples of Modern India”. He intimidated them to build trusts for colleges, research and training institutes which also promotedrural development, women empowerment and education.

In the third phase from 1960-1980, CSR was influenced by Public sector undertakings in order to propagate the idea of equal distribution of wealth. The policy of industrial licensing, high taxes and restrictions on the private sector resulted in corporate wrongdoings. This led to enactment of legislation relating to corporate governance, labor and environmental issues. St PSUs were not very significant in case of gaining popularity. Hence there was a shifting of expectation from the public to the private sector with an industrious involvement in the socio-economic growth. In 1965, the academicians, politicians and businessmen set up a national workshop on CSR, where great stress was laid on social accountability and transparency.

In the fourth phase from 1980 onwards, Indian companies amalgamated CSR into a sustainable business strategy. With globalization and economic liberalization in 1990s, and partial withdrawal of controls and licensing systems thriving the economic growth of the country. This led to the increased impetus to the industrial growth, making it possible for the companies to contribute more towards social responsibility. Activity which began as charity was now being recognized as responsibility.

In present scenario, the new companies act was amended which mandates the corporate to spend 2% of their average net profits of the last three financial years towards CSR. This is applicable for companies with a turnover of 1000 Cr/ PAT of 5 Cr/ or net worth of 500 cr. The new bill replaced the Companies act 1956 and emphasizes carrying forward the agenda of Corporate Social Responsibility.

Tata group were among the first entity to initiate establishment of labour welfare practices, having eight-hour workday, free medical aid, Welfare department, paid leaves, Workers Provident Fund and Workmen’s Compensation, Maternity Benefit for ladies.

2008 Amendment Act to the Companies Act, 1956 – section 217 stated that the Directors’ Report should contain information on conservation of Energy.2009 Ministry of Corporate Affairs laid down National Voluntary Guidelines for CSR comprising following principles:

- Ethics, transparency and accountability while conducting and governing their business.
- Safe goods and services contributing sustainability during their whole business cycle.
- Well-being of all employees should be promoted.
- Businesses should respect the interests and responsive to all stakeholders.
- Businesses should respect and promote human rights.
- Businesses should respect, protect, and make efforts to restore the environment.
- Businesses, when engaged in influencing public and regulatory policy, should do so in a responsible manner.
- Businesses should support inclusive growth and equitable development.
- Businesses should engage with and provide value to their customers and consumers in a responsible manner.

2011, SEBI stated certain companies to report on Environment, Social and Governance initiatives taken by them.

The Companies Act, 2013 was enacted. The provisions of the CSR Act apply to all companies that have any one of the following in any financial year, Section 135 (1) of the Act 2013 makes it mandatory:

- Net worth of INR 500 crores or more
- Turnover of INR 1,000 crores or more
- Net profit of INR 5 crores or more

An average of the previous three financial years' PAT will be considered for calculating the 2% for CSR. CSR policy of a company should ensure that profit arising out of a CSR activity will not become part of business profits.CSR policy should specify that the CSR compilation will include the following: a) 2% of average net profit; b) any income arising of there; c) profit arising out of such activities. Average net profit shall be calculated according to Section 198.

Companies may amalgamate or form alliance with other corporate entities to take on CSR activities and any disbursement sustained on such efforts will qualify for reckoning CSR spending. Under Section 135 (1) CSR a committee shall be formed consisting 3 directors, out of which one will be independent. This CSR Committee will formulate CSR policies and also recommend these to Board accompanied with the CSR expenditure. It will monitor CSR Policy.

Section 135 (3) (a) lays down the list of CSR activities given in Schedule VII such as ending hunger & poverty, promoting public health, good educational structure, promoting gender equality and upliftment of women, fundraising for cultural activities and arts, combating HIV, AIDS, malaria and other diseases, contributing to prime minister relief fund or any other welfare fund, to initiate Social business projects, empowerment of backward classes, minorities and women, such other matters as may be prescribed.

CSR Rules 2014 were effective from 01.04.2014.Rule 2 (c) states that definition of CSR not limited to Schedule VII while Rule 8 says CSR Report shall contain particulars as per Annexure. Rule 4 (2) provides that CSR through Registered Society or Trust or a section 8 company is permitted.

There was no specific definition of CSR in 2013. Schedule is reference and Company may decide as applicable as per advice of the CSR Committee. Thus flexibility is there. Government of Indiathrough Notification dated 12.04.2013 issued 'Guidelines on CSR and sustainability of Central Public Centre Enterprises', with effect from 01.04.2014. General Circular No. 21/2014 on CSR dated 18.06.2014, giving clarification on interpretation of section 135 read with Schedule VII.

3. CORPORATE SOCIAL RESPONSIBILITY REPORTING

So far as reporting is concerned Section 135 (5) Proviso states that the report under section 134 (3) (o) requires the reason for not spending CSR whereas Rule 2 (c) widen the horizon of definition of CSR mentioning that it is not limited to Schedule VII. Global Reporting Initiative (GRI) has also given place in this law.

However, the Sustainability Reporting Guidelines were introduced in 2006. New dimension of reporting dynamics. It will be a separate report from the Annual reporting alluring cost and time. CSR reporting divulge to investors and stakeholders on company's future sustainability. CSR is an alternative form of reporting enlightening long term corporate approach and future directions.

CSR report will shed light on the sustainable development enduring aspirations of today, without compromising the future. CSR can be said as a fragment of sustainability. Hence, proper reporting is required. This should also provide information relating to economic, social and environmental execution.

Reporting shall include social and environmental outcomes along with financial aspects of a company considering the entire view of companies' affairs, risk management along with scrutiny of investors. There should be inclusion of protection of human rights, safety at workplace, employees relationship, partnership relations, relations with customers and local communities, long terms potential of the company, long term goals and value, sustainability directives, strategic reporting of business prospects. It should highlight the connectivity between overall strategy to be carried out in business by the reporting Company and sustainability measures.

Companies falling under the provision of Section 135 (1) of the Act,a prescribed format for reporting has been laid down, the details of their CSR initiatives should be given in the director's report and on the company's website. In case the company had not spent for promoting CSR activities it has to give reason for the same in the Report under section 134 (3) (o) for not spending on CSR.

Whether penalty under 134 (8) will be considered non-compliance of 135 is still debatable. In case of failure to do so no provision for penalty in form of fine or imprisonment is not given. Furthermore, if a company has failed to spend 2% of the average net profit, the reason for doing so should be mentioned in the annual board report. It can be seen that too much of stress has been given to reporting. So far as the aspect of taxation is concerned initially there was no clarity on this behalf, however, it is now clear that CSR expenditure will be taxable. Some activities are exempted from tax.

4. BENEFITS

It will portray a good public image as people will feel that companies indulged in charity works is better than others. Reduction in scrutiny will create transparency promoting long term goodwill of the company. Companies will gain faith of people and value creation will be there as corporate success and social welfare go hand in hand. Fair practices keeping in mind about labour, community, environment will be nurtured. Having beneficial human resource with retention will make task easier. There is no doubt that it will be helpful in securing reputation initialising proper risk management techniques as the management will be more aware of and understand non-financial risks. Brand building and brand differentiation will be now given priority. Facilitate competitiveness through escalating stakeholder as well as investor's relationships. Better communication with third parties will enhance harmonious atmosphere. Sustainability factors will be rapidly understood as significant indicators for long term performance in corporate world. Credibility will be there.

5. DRAWBACKS

Critics always trigger out the question that what is the rationale behind involvement in CSR activities. Sometimes this may amount to distract the attention of society from harmful business activities to cite an epitome of McDonald's case of associating with Ronald McDonald House as CSR even being accused for promoting poor eating habits. Controversial industries engaged in the business of tobacco and liquor may eclipsed under CSR.

Furthermore, the Act contains no penal provision in case if a company fails to spend the mentioned amount on CSR activities. However, the Board will state explanation with reasons for noncompliance in its report. The inception limit of Rs.5 crores net profit for pertinence of CSR requirements in comparison, to be on the lower side with regard to net worth and turnover inceptions of Rs.500 crores and Rs.1, 000crores respectively. The aftermath of this can be that companies will be getting covered under the sphere of CSR even when they do not have net worth/ turnover criteria.

There is no clarity whether a company requires to create a provision in its financial statements for the amount which it has not spent if it fails to spend 2% on CSR activities in a particular year. No details has been given in relation to the activities which will be exempted from coming under the roof of taxation policy.

Section 135 relates to the linking of a company's profit-making with the development of local areas.10 Companies are required to spend 2% of their average net profits from the preceding three years and focus on local areas around which they operate. This is an absurd proposition as it will increase inter-state disparities in social indicators. For instance, states like Gujarat, Maharashtra and Andhra Pradesh (as also Odisha in 2013), with their large number of industrial units, are likely to see greater social development on account of higher CSR spend by the private sector.

In case if a company witness losses then what will done for the development initiatives continuation. Whereas, during recession times, when the need for CSR expenditure is of paramount importance may be highest among in jeopardy groups, such spending may actually become unavailable.

The rules in the Companies Act-2013 would make it difficult for companies to pursue strategic CSR aligned to business strategy as any outlay traced back to financial profits may distinguished from CSR. Possibility can be there that companies will prefer more on activities prescribed under the Act for CSR spending having lower social impact rather than the burning issues causing social disparities such as inter-regional inequality or particular social stigmas.

Bringing social change or desire to do something for society is an inherited feeling making it a compulsion will definitely affect its depth and originality. Same is the scenario with corporate world. True yearn for social change and efforts in this direction may outweigh the adversity promoting unity in diversity and equality. While this has created an opportunity to increase the scope of companies laying down a wide platform and enjoying this rollercoaster.

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