Voluntary vs. Mandatory CSR

Ms. Amee Ishwarbhai Dave
Temporary Assistant Professor, Department of Accounting and Financial Management, Faculty of Commerce
The Maharaja Sayajirao University of Baroda, Gujarat, India
Email - ameedave16@gmail.com

Abstract: *As Indian corporate are constantly striving to be more efficient in the competitive global business scenario, they need to become equally proactive, accountable and socially Responsible to their immediate environments. In India CSR is in a very much primary stage. Seeing to the government of India's most desirable step towards Social welfare through economic reforms and involving well economic corporate performers by introducing a Provision of mandatory 2% CSR spending of Net Profit on August 29, 2013 through companies act 2013. keeping this provision in mind researcher has tried to analyze Comparatively & critically old provision of Voluntary disclosure and CSR spending with New Mandatory 2% CSR Spending. And title the Paper as "Voluntary V/s Mandatory CSR" This paper will discuss the evolution of the concept of Corporate Social Responsibility and how important this is for the economy and society, alike. The pros and cons of mandating CSR initiatives for the inclusive development of the society. The problems and issues involved in the Rules issued by the Government would be discussed in detail as well as current status of Indian corporate in compliance provisions of CSR would also be highlighted. An attempt will be made to offer suggestions as to how these inadequacies (as believed to be by few companies) can be countered effectively so that the law is followed in its true letter and spirit.*

Key Words: *Corporate social responsibility, Companies Act 2013, CSR Committee, CSR Rules.*

1. INTRODUCTION:

The term "Corporate Social Responsibility (CSR)" can be referred as corporate initiative to assess and take responsibility for the company's effects on the environment and impact on social welfare. The term generally applies to companies efforts that go beyond what may be required by regulators or environmental protection groups[1].

The industrial families of the 19th century such as Tata, Godrej, Bajaj, Birla, were strongly inclined towards economic as well as social considerations. However it has been observed that their efforts towards social as well as industrial development were not only driven by selfless and religious motives but also influenced by caste groups and political objectives. Hence Corporate Social Responsibility is not a new concept in India, however, the Ministry of Corporate Affairs, Government of India has recently notified the Section 135 of the Companies Act, 2013 along with Companies (Corporate Social Responsibility Policy) Rules, 2014 "hereinafter CSR Rules" and other notifications related thereto which makes it mandatory (with effect from 1st April, 2014) for certain companies who fulfill the criteria as mentioned under Sub Section 1 of Section 135 to comply with the provisions relevant to Corporate Social Responsibility. Seeing to the time bound needed and desirable changes made by Ministry of Corporate affairs under Corporate Governance rules by targeting CSR Spending of Corporatist Paper is appropriately titled as "Voluntary V/s Mandatory CSR"

Moreover, while proposing the Corporate Social Responsibility Rules under Section 135 of the Companies Act, 2013, the Chairman of the CSR Committee mentioned the Guiding Principle as follows: *"CSR is the process by which an organization thinks about and evolves its relationships with stakeholders for the common good, and demonstrates its commitment in this regard by adoption of appropriate business processes and strategies. Thus CSR is not charity or mere donations. CSR is a way of conducting business, by which corporate entities visibly contribute to the social good. Socially responsible companies do not limit themselves to using resources to engage in activities that increase only their profits. They use CSR to integrate economic, environmental and social objectives with the company's operations and growth ."*

Corporate social responsibility is one such niche area of corporate behavior & governance that needs to get aggressively addressed & implemented tactfully in the organizations. At the same time CSR is one effective tool that synergizes the efforts of corporate & the social sector agencies towards sustainable growth & development of the societal objectives at large.

2. OBJECTIVES:

2.1 To analyze comparatively & critically old provision of Voluntary disclosure and CSR spending with New Mandatory 2% CSR Spending

2.2 To find pros and cons of mandating CSR initiatives for the inclusive development of the society.
2.3 To know the problems and issues involved in the Rules issued by the Government.
2.4 To see current status of Indian corporate in compliance provisions of CSR

3. RESEARCH METHODOLOGY:

The research under study is analytical in nature .The data used for research is secondary data analysis. The data source is related Journals, Magazines, Articles on CSR and News Papers columns on CSR.

4. Voluntary CSR V/s Mandatory CSR:

The question is should CSR be adopted by firms as a corporate strategy for voluntary use or should CSR be a legally binding legislation. Whether CSR remains voluntary or CSR becomes Mandatory, the role of government in CSR is not deniable. Governments can stimulate voluntary CSR through preferential treatments, permits, monitoring, and subsidies or deregulation (Glachant et al. 2002).González, Cuesta & Martinez (2004) and Dentchev et al. (2015) have extensively summarized and analyzed the literature on this debate and concluded that there is a strong case for a mandatory approach to CSR and governments use a combination of both voluntary and mandatory laws to achieve their public policy goals. The group of voluntary CSR enthusiasts claim that voluntary CSR initiatives support improving economic performance one or the other way by increasing market value (Aupperele, Carroll & Hatfield 1985, Griffin & Mahon 1997, McWilliams & Siegel 2000, Simpson & Kohers 2002), reducing economic risks(Moore 2001, Orlitzky & Benjamin 2001) and helps to create value for individuals (Backhaus, Stone & Heiner 2002, Turban & Greening 1997). Whereas the supporters of mandatory CSR argue that legislation is mean to measure the self-regulatory Performance of the firms (Lückerath-Rovers & De Bos 2011) and increase the interaction of stakeholders, which impacts the policymaking process (Mathis 2007). Additionally, the argument continues that legislation cannot solve the Issues of corruption, social norms and injustice, and issues related to integrity .Because of different countries may view an integrity issue in diverse manners or Traditions (Lindgreen 2004).The proponents of voluntary CSR advocate that there is no need for government to involve in CSR activities as the market offers enough motivation for firms to get involved in CSR initiatives (González, Cuesta & Martinez 2004). Eden (1997) found that self-regulation standards and systems are also invariably not entirely capable of fulfilling all the need for CSR since a variety of players and a variety of agendas are involved. Also, different players may have their preferred solutions. These weaknesses of a voluntary global framework for self-regulation help to support the case for mandatory CSR (Leighton, Roht- Arriaza & Zarszky 2002). Leighton, Roht-Arriaza & Zarszky (2002) and Doane (2003) mention that there is a risk of using CSR as a PR tool or a corporate strategy tool instead of the purpose of sustainable development. As there are very limited occasions where researchers could make a real case for mandatory CSR, most of the literature on the topic is based on assumptions or speculations. **It is an excellent opportunity now that Indian government has taken a significant step towards mandatory CSR. This can be a great case to study for all the governments and provides them an opportunity to learn from both achievements and drawbacks of this new legislation** (Sarna, 2016)

Voluntary V/s Mandatory CSR:

Promote, not impose
CSR is deeply connected with values, not with laws. Values cannot be forced, they can be promoted, taught or awaken. Besides, who is going to define what CSR is? Is it going to be the government?
Where there is law, there is fraud
If someone is forced to do something, there will always be a temptation to skip the rules. Sometimes fraud cannot be discovered so easily. However, if a company decides not to be socially responsible, it's more likely that its stakeholders will end up unveiling it and punishing its behavior.
Forget political issues
If law forces CSR, political and partisan interests will probably interfere. Who wants to leave CSR in the hands of political fights?
CSR as soft power tool
I am fully convinced that a soft CSR approach (voluntary CSR plus public promotion) is far more effective than a hard CSR approach (mandatory regulation). Soft power is in the very soul of corporate sustainability.
Convictions, not impositions
Voluntary CSR is connected to convictions and commitment. It's something that comes from inside the company, with a desire to change things and create value. It has a psychological explanation: Mandatory CSR is imposed from outside the company and it may not be perceived as own.

CSR for competitiveness

Companies have to be able to decide which way they want to go in order to improve their competitiveness. Voluntary CSR is one of the ways. In the end I am convinced that socially responsible companies will be more competitive than those who are not.

As I wrote earlier, I do think that there should be a certain public CSR regulation. However, this should promote CSR, not force it. Of course, we need to have minimum standards, a certain framework that set the rules of the game. But we already have it. This set of standards has been created by the industry itself or by international organizations. It is not a task of the government to create new standards, but to support the ones that are already availed. To create the most effective method for reporting companies to compare their results, from year to year and among themselves, there is need for a single reporting system and criteria that apply to all. But does that mean sustainability reporting should be mandatory, with rules laid down by a government agency, for example? (https://www.globalreporting.org/Pages/default.aspx, 2011) Corporate Social Responsibility is a voluntary initiative. It begins where the law ends and is entirely motivated by the desire to maintain competitiveness and maximize the effectiveness of management and company resources. It is not dictated by laws, but rather by the requirements of society and consumers. Its effectiveness is precisely because it is voluntary. Sustainability reporting is an initiative which comes from the business; it comes from the inside, not from outside - from governments. So is it right to formalize and oblige such a voluntary initiative? And if so, why? May be we should first answer the question of whether we need all companies to be socially responsible, so that the world is wholly changed, or should just large corporations be at the heart of change? And if sustainable reporting is valid for all, than what will the core indicators be, and will they be the same for different companies? The reporting of sustainable development by companies should and will become mandatory. But formulating a law should be an initiative of the business itself. It will be more efficient and will not be a burden on companies' management, as they themselves would have expressed understanding its benefits. The business sector now realizes that its future is truly sustainable development, and will require increased reporting.

5. PROBLEMS AND ISSUES RELATED TO MANDATORY CSR RULES:

A bare reading of the new CSR rules may indicate simplicity and reader-friendliness. But close analysis of the fine print leaves ample room for ambiguity at various places.

While the Companies Act prescribes a specific method for computing net profits and the CSR contribution,

- **The CSR rules take a step backwards in carving out exclusions from the net profit** so calculated. Most shockingly, one of the exclusions provides that the profits of a branch of an Indian company located outside India cannot be merged into the profits of the parent company for the purpose of computing the two per cent contribution. **This exclusion goes against the very mandate of Section 135 and is, to that extent, ultra vires.**
- **Major contradiction in the rules in respect of the meaning of the words 'corporate social responsibility'.** The Companies Act, 2013, defines CSR activities to mean an identified set of activities set out in the separate schedule to the Act. However, a reading of the definition in the rules indicates that the list of CSR activities provided in the rules (which also includes the schedule activities) is only illustrative and not exhaustive.
- At the same time, an overall reading of the **rules strongly suggests that the scheduled activities alone will be considered for the purpose of CSR**. Whether or not social activities falling outside the purview of the schedule form a part of CSR activities still remains doubtful.
- Another aspect of ambiguity in the new law that was expected to be corrected through the rules was the **'local area preference' for CSR Spending**. The Act provides that a company should give preference to the local area in which it operates for CSR spending. How would this work if a company has more than one operational office in the same city, or even otherwise? Is the location of a factory, as opposed to the corporate office, the target of preference?

  The CSR rules have rightly excluded contributions directly or indirectly made to a political party from the scope of CSR activity. But, what about contributions made to institutions affiliated with one or more politicians or those located in a constituency represented by a politician who has some form of regulatory supervision or leverage over that company? What about activities/institutions being run under the trusteeship or office of a politician?
- **Another aspect of the rules that may be abused is the carve-out made in respect of CSR activities undertaken 'only' for the benefit of the employees and their families.** Could the intent of the legislation have been to mean activities undertaken 'primarily' to benefit the employees? If a company undertakes a project primarily but not exclusively benefiting its employees, should that be considered CSR activity?

  While the new rules are well-meaning, there is definitely room for further clarity and certainty. The last thing anyone wants is a select group of people with vested interests benefiting from this noble legislative initiative.

- **How to manage the total burden?** Like any other person, companies also pay various taxes to the government in one form or the other. Direct taxes particularly are a major tax directly borne by the companies which account for around 1/3rd of their profits every year. Apart from this, companies also pay wealth tax of 1% of their taxable net wealth. In one view the corporate responsibility should end there, it is for the government now to use the money collected efficiently.
- **How to spend in case of loss making company?**
How to calculate average profits in different situations, for instance in case a company has a loss year what will the formula for calculation of average profit in such a case.
- **What about other activities?-** Activities as like providing electricity and other basic facilities, superstition eradication, pollution control, Dam building, Irrigation, adult education etc. are out of purview of the schedule VII
- **How to determine Rural Area?** The reference for the rural area is not mentioned in the company act. It is confused one on the point where to be conducting this activity?
- **What will be tax benefit from CSR activity?** The present provision for the same was depended on voluntary CSR, but now it is mandatory CSR, hence tax benefits for the same is not cleared.
- **In which time the quantum is to be spent?** Once it is not mentioned in the act. Suppose if a company wants to undertake a large project which can consume more than one or two years, under this situation it is not mentioned in the Act that what will be time limit for spending of present quantum?
- **What is report format?** It is mentioned in the Act, the reasons of the non-spending of the amount on CSR is to be mentioned in the report. But the format of the report is not provided in the act also?
- **What will action if not spend?** There are no provision or any penalty mentioned in the Act, if any company fail to spent that amount on CSR activities
- **Why only Company? Why not other business?** A very basic question is that why only Company has to spend? There are lot of other form of business i.e. Partnership firm, sole trader, Co- operation firm etc. They should contribute for CSR. (Datkhile, 2014)

6. SUGGESTIONS ON ISSUES:

The minimum limit of 2 % should be reduced according to the earning ability of the company. Exemption for loss making company from last two years should be made for the given till the recovery of loss. Government should declare priority needs of every region. It will include actual need of the situation. Hence activities which are not mentioned in Schedule VII but required will be covered automatically. The whole region of the country or any area of the country should be place of activity to be conducted the CSR. Only rural area or area where company located is not sufficient. CSR should cover any region of India. Unfortunately, the sheer amounts of money that must now be spent on CSR in India have increased substantially the dangers of violating U.S. and U.K. law, and we expect that there will be close scrutiny of companies' CSR payments by United States and U.K. authorities. Because of these risks, foreign companies with operations in India should seek the advice of counsel in structuring the CSR programs and establishing internal controls.

7. CURRENT STATUS OF CSR COMPLIANCE:

(Scape, 2015)**2015:** The CSR study of 2015 finds that many companies have scaled up operations in CSR and are looking at it as a priority. Mahindra and Mahindra leads the pack. Compared to the previous study it has jumped two ranks. There are four Tata group companies in the top 10 list. GAIL replaces SAIL in the public sector honors; while Bharat Petroleum joins the top ten list. Interestingly no foreign players make it to the top 10 list. Interestingly, Jubiliant Life sciences, a healthcare company has entered the top ten list.

CSR scores

Manufacturing companies, on an average, score far better than service companies. This difference is attributable to higher sustainability scores indicating that these issues are more important for the manufacturing sector.

Public sector companies perform somewhat similar to private companies. Again, sustainability is the primary cause for the difference.

Companies are reasonably strong on governance, weak in disclosure, weak on stakeholder based CSR and, surprisingly, weak on sustainability. At least a third of all companies fail to beat the half way mark on all the fronts.

CSR spend

We also studied spending patterns on CSR. We find that only 18 % of the companies studied are currently complying with the 2% norm. Current CSR spend of 147 companies out of Top 214 companies is Rs 4281 cr during 2013-14. Data for 67 companies is not available hence it is excluded from this study. Presently only 27 corporate are complying with these norms with a spending of 2% or more. Most of corporate are not meeting with the proposed 2% CSR norm

– the average CSR spend as a percentage of PAT for 147 companies is 1.28%. Further 45 companies are spending between 1% and 2% of their PAT. Rest 75 companies have a CSR spend of less than 1% of their PAT.

Spread + Spend = CSR Matrix

To illustrate progress versus expectations, company performance results have been categorised across four quadrants - Pace setters, smart utilisers, starting out and low efficiency.

Pace Setters

These are companies that spend relatively large amounts on CSR and have relatively high CSR scores. 49 companies fall in this category.

Starting out

These companies spend relatively less on CSR and also have lower CSR scores. 50 companies fall in this category.

Smart Utilizers

These companies spend relatively less on CSR but have higher scores or CSR. 20 companies fall in this category.

Low Efficiency

These companies spend a relatively larger amount on CSR but have relatively low CSR scores. 28 companies fall in this category.

Materiality and focus: Last years' (2014) study was in the context of the introduction of mandatory spending on CSR brought on by the Companies Act 2013. The focus of the companies has now shifted from anticipating the change and trying to understand the ramifications of the change to implementing the change. This is in the early stages. Hence, this, year companies need to shift their focus from anticipating to implementing.

With CSR moving from sidelines to being an integral part of a company's strategy, companies increasingly need to figure out what they should focus on. Here the concept of materiality comes to our rescue. So what is materiality?

Material issues are those that have a direct or indirect impact on an organization's ability to create, preserve or erode economic, environmental and social value for itself, its stakeholders and society at large.

2014 study revealed that most companies talk about a company's success in implementing CSR activities. Some though also talk about things that may have no context to CSR or sustainability. The 2015 study took an in depth view of the relevant issues for each industry and then evaluated them Materiality issues are mostly context and industry specific. Across industries materiality issues would include waste disposal, bio-diversity, energy efficiency, responsible procurement, carbon emission, water, employee diversity, gender equality among many others. But others such as employee motivation strategies, gathering customer feedback or product launches have no place in sustainability reporting.

8. CONCLUSION:

The New Act's CSR requirements will increase the costs of doing business in India and add to existing administrative and reporting burden with facing no of challenges and issues. No doubt Mandatory CSR is in Current wave with some favorable outcomes especially for those corporate not involved in social welfare activities, but the term Corporate Social Responsibility means responsibility towards the society and which comes from within not to be forced.

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