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# CORPORATE SOCIAL RESPONSIBILITY AND CORPORATE GOVERNANCE IN INDIA

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***Abstract:*** *There is considerable overlap in the concepts of Corporate Governance and Corporate Social Responsibility (CSR). In addition to financial results, the other aspects of corporate performance like social and environmental outcomes are becoming equally important for both the concepts.*

*In corporate governance, companies are expected to promote ethical practices, maintain fairness and transparency and ensure accountability in all the dealings with all stakeholders. The similar concerns are being covered in CSR debate also. The discussion involves all the stakeholders covering employees and shareholders who are internal to the organization to customers and society which are outside the organizations.*

*Through this act, the Government has tried to bring good governance in the corporate sector especially for CSR activities. It ensures accountability by mandating the constitution of a committee for it. Transparency has been brought out by specifying the activities and by categorizing the companies coming under this act. But, there is a problem in implementation as well as in measuring the activities prescribed in the Act for the CSR. It raises the age old question of effectiveness and efficiency issue of any developmental activities.*

***Keywords:*** *Corporate Social Responsibility, Good Governance, India.*

## 1. INTRODUCTION

The role of government in social sector has been diminishing with the increasing trend of privatization and liberalization. It has increased the importance of concepts like corporate social responsibility and good governance.Globalization has affected the

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functioning of the organizations.Organizations have expanded their operational area as well as their operational issues got affected. An important trend could be seen in termsof increasing focus on short term gains by the organizations. It has resulted in dominant focus on shareholders (Körner, 2005). But, when we talk about good governance, it includes promotion of ethical practices, maintaining fairness and transparency and ensuring accountability towards all stakeholders. Similar, concerns are part of the CSR debate; when it comes to CSR from stakeholder's perspective, it includes internal stakeholders like employees and shareholders as well as external stakeholders like customers and society at large.

Information and communication technology has played important role in linking, corporate social responsibility and good governance. There is easy availability of information and instantaneous connectivity between large numbers of individuals. The technology has inevitably brought about transparency in the business environment. As a consequence there is pressure on the business from the stakeholders for incorporating their opinion regarding corporate responsibilities towards society and also towards ensuring accountability (Fernandez-Feijoo, Romero, and Ruiz, 2014; Jo and Harjoto, 2014).

The Indian government also has recognized the importance of CSR, and it is first time in the world that these activities have been made mandatory. The Company Act, 2013, directs companies having certain level of profit/turnover to spend 2 per cent of the net profit on the prescribed activities. Through this paper, attempt would be made to understand the debate between corporate governance and CSR as well as its implication in the Indian context. Section 2 deals with literature review followed by Section 3 which deals with corporate social responsibility in Indian context with reference to Company Law 2013.The last section deals with discussions and conclusions.

## 2. LITERATURE REVIEW

### Corporate Social Responsibility

Corporate Social Responsibility (CSR) includes everystakeholder. There are economic, legal, ethical, and philanthropic responsibilities of the organization and priority has to be former to latter (Carroll, 1991). It also perhaps goes on the lines of stakeholders involved, including employee, family of employee, customers, community in which organization is working, society at large, and environment.

The benefits of CSR can be felt at both macro as well as micro level. Environmental and social benefits would be part of macro level, whereas improved financials, better relationship with customers and shareholders would be micro level benefits. There is shift in implementation of CSR which can be sensed from genuine philanthropy to taking the benefits out of CSR in terms of a more compliant workforce, the smoother granting of planning permission, more amenable customers, or in the jargon of today's corporate affairs manager ''gaining a license to operate'' or ''reputational assurance'' (Frankental, 2001). CSR might have different motives like instrumental motives, relational motives, and moral motives being driven by self-interest, concern for status, and concern for larger groups respectively (Aguilera *et al.*, 2006).

Governance structure impacts organizations CSR activities. The large share of institutional investors in the ownership structure makes many organizations myopic and tends to reduce investment in CSR activities. Investors with short term orientation might not go for CSR investments as it results are not immediate whereas; investors with long term orientation might go for these investments. In addition, when organizations are performing well and have access to resources, they tend to invest more in CSR activities (Arora and Dharwadkar, 2011). After Enron, concepts of corporate governance have started giving more focus towards ethics, accountability, disclosure, and reporting. Simultaneously, CSR movement has also forced management to consider corporate governance as a tool to think about broader ethical issues. CSR has progressed with the organizations balancing act of shareholders goals and its impact on externalities on other stakeholders (Gill, 2008).

Although both of these concepts have evolved parallel, their origins are different. Corporate governance has its origin from internal stakeholders like shareholder, whereas CSR has originated from external stakeholders (Fassin and Rossem, 2009). Both concepts are interrelated and there are increasing overlap happening in discussions (Jamali, et. Al, 2008). There are researchers having opinion that CSR is part of corporate governance and extended model of it (Sacconi, 2006; Aguilera *et al.*, 2006).

## Good Governance

In literature, the terms governance and good governance are interchangeably used. Bad governance is regarded as one of the basic causes of malfunctioning of an organization. The governance is a process of decision making as well that of implementation of decisions. It deals with formal and informal actors along with formal and informal structures involved in the process.TheUnited Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) mention eight major characteristics of good governance. (Table 1) It describes good governance as participatory, consensus oriented, accountable, transparent, responsive, effective and efficient, equitable and inclusive and follows the rule of law. It is expected to assure minimization of corruption and responsiveness to the present and future requirements of society.

John Graham, Bruce Amos and Tim Plumptre (2003) mention five good governance principles based on United Nations Development Program (UNDP) "Governance and Sustainable Human Development, 1997" as under:

**Table 1**
**Good governance criteria suggested by UNESAP**

| *Sr. No.* | *Characteristics* | *Description* |
|---|---|---|
| 1. | Participatory | It implies participation by men and women both. It further indicates that concerns of most vulnerable in the society are considered. |
| 2. | Consensus oriented | There are several players and different groups in an organization, representing different viewpoints orinterests. In order to arrive at broad consensus their reconciliation is required be done in the best interest of organization. |
| 3. | Accountability | The organizationshould be accountable to all their stakeholders internal as well as external..Transparency and rule of law are prerequisites for enforcement of accountability. |
| 4. | Transparency | This means decision making as well as implementation of decisions as per rules and regulations. It requires that information is freely available to all concerned. |
| 5. | Responsiveness | It means processes should address the issues concerning all stakeholders within a reasonable time frame. |
| 6. | Equity and Inclusiveness | Equity implies fairness or justice. Inclusiveness implies that excluded section of society should feel that they have a stake and are having opportunity in improving their wellbeing. |
| 7. | Effectiveness and Efficiency | The organizations should produce results that meet the needs of society while utilizing the resources in the best possible manner. It also means sustainable use of natural resources and protection of environment. |
| 8. | Rule of law | It means existence of fair legal frameworks and its impartial enforcement. |

*Source:* United Nations Economic and Social Commission for Asia and the Pacific

1. Legitimacy and Voice based on participation and consensus.
2. Direction
3. Performance based on responsiveness, efficiency
4. Accountability and Transparency
5. Fairness based on equity and law.

These principles are same as suggested by UNESAP except the principle of Direction. It refers to strategic vision of leaders and the public based on broad and long-term perspective on good governance and human development, along with a sense of what is needed for such development.

## 3. CORPORATE SOCIAL RESPONSIBILITY IN INDIAN CONTEXT

Traditionally CSR has been seen as voluntary activity, but institutional theory suggests to include it in wider field of economic governance relating with market, regulation etc. (Brammer, 2012). In India the government is facing severe budgetary constraints in financing public services and infrastructure where as many business organizations are in a position to address these issues. Thishas attracted the attention of Indian government and they have taken different measures in this direction. The Company Act, 2013 stipulates provisions regarding the CSR in the Indian context and perhaps for the first time in the world, it has been made legal responsibility of the business. The Act covers all companies in India meeting any one or more of the following conditions:

1. Turnover ≥ INR10 bn
2. Networth ≥ NR 5 bn
3. Net Profit ≥ INR 50 mn.

The CSR contribution is required to be 2 percent of average net profit before tax for last three financial years. Contributions to be made towards causes listed under Schedule VII of the Act. (Annexure 1)Transparency has been brought out by specifying the activities and by categorizing the companies coming under this act.

The Act has also introduced various provisions regarding enforcement and accountability regarding CSR provisions.The clause 49 has provided for mandatory CSR committee consisting of three directors and for induction of independent director on the boards of listed companies and selected unlisted companies to oversee the corporate governance. These provisions are applicable from 1$^{st}$ April 2014. The Act specifically lays down the responsibility of the committee as under:

1. Formulation CSR policy;
2. Recommendation of CSR activities;
3. Monitoring CSR expenditure

The objective of this clause is to make the working of the corporates more accountable and transparent thus making the corporate governance framework more effective.

Through this act, the Government has tried to bring good governance in the corporate sector especially for CSR activities.It ensures accountability by mandating the constitution of a committee for it. The framework for accountability has been further strengthened through provision for penalties for noncompliance. In case of failure to spend, reasons are required to be disclosed. There is also provision of penalties for violation as shown in Table 2 below:

**Table 2**
**Penalty stipulated for violation of C.S.R. provisions**

| *Responsibility* | *Penalty* |
|---|---|
| Company: | Fine between INR 50,000 – 2,500,000 |
| Officer in default: | Imprisonment upto 3 years and/or Fine between INR 50,000 to INR 2,500,000 |

*Source:* Companies Act 2013

In addition to transparency and accountability the act has brought in responsiveness, equity and inclusiveness, effectiveness and efficiency and rule of rule of law in respect of CSR. By stipulating reasonable time frame, responsiveness has been introduced. Equity and inclusiveness has been taken care of by specifying activities for excluded section of society and by mandating supervisory frame work at the apex level of the organization. The monitoring frame work will also ensure effectiveness and efficiency in decision making and implementation. The penal provisions stipulated will further reinforce the frame work for good governance. The provisions of the act are consistent with the principle of direction stipulated in UNDP good governance principles, being based on strategic vision for long term development. The activities specified in in schedule VII of companies' act 2013 are based on sense of what is needed for the same.

## 4. DISCUSSION AND CONCLUSIONS

As mentioned above, it is perhaps for the first time in the world that CSR has been made legally binding for the corporate sector to address the social, environmental and health issues plaguing the society. The bill however ignores other stakeholders of the company, and focuses onlyon the society. But, CSR also involves many others including employees, customers, owners, suppliers etc. and one shouldn't be focused on one stakeholder at the expense of others. The Act needs to be improvedwith respect to the content as far as its inclusiveness and participatory approach is concerned.

In addition, there is a problem in implementation as well as in measuring the activities prescribed in the Act for the CSR. When it comes to implementation, organizations who are supposed to spend the money on CSR activities have no capability to do so and are dependent on third sector organizations. But, third sector organizations also lack management capability matching the requirements of this scale. It raises the need to build up management capability of the third sector. In the present situation, organizations may take an easy way out to deal with the situation, and might donate the money to the third sector organizations without considering the capability to implement it effectively. It raises the age old question of effectiveness and efficiency issue of any developmental activities.

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## ANNEXURE 1

## CSR Activities Specified in Schedule VII of Companies Act 2013

(i) eradicating hunger, poverty and malnutrition, promoting preventive health care and sanitation and making available safe drinking water;

(ii) promoting education, including special education and employment enhancing vocation skillsespecially among children, women, elderly, and the differently abled and livelihood enhancement projects;

(iii) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;

(iv) ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water;

(v) protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional handicrafts;

(vi) measures for the benefit of armed forces veterans, war widows and their dependents;

(vii) training to promote rural sports, nationally recognized sports, Paralympic sports and Olympic sports;

(viii) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Caste, the Scheduled Tribes, other backward classes, minorities and women;

(ix) contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government; and

(x) rural development projects.

*Source:* Companies Act 2013