# The 2% CSR Mandate – an Unnecessary Imposition?

***Creating a strong business and building a better world are not conflicting goals - they are both essential ingredients for long-term success -Bill Ford***

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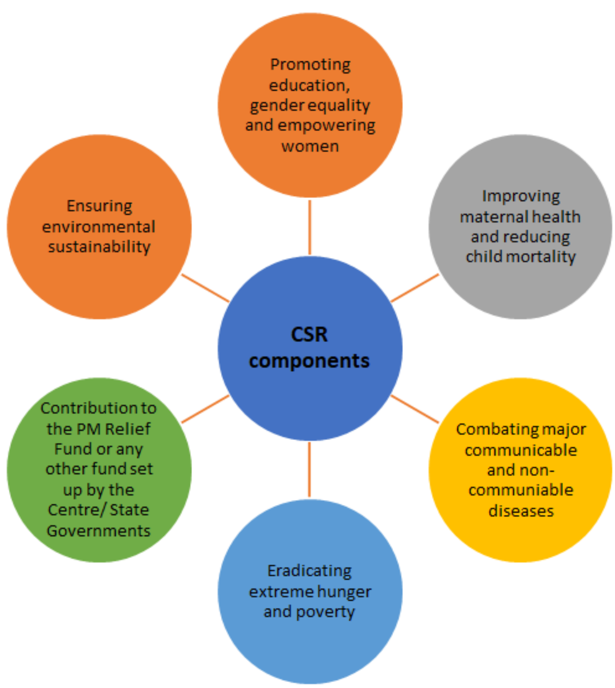
**Introduction and Overview**

United Nations Industrial Development Organization (UNIDO) defines “Corporate Social Responsibility (CSR) is a management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders.”[1] CSR is generally addressed as a notion where in a company strives to achieve a balance between the economic, social and environmental aspects while catering to the needs of the shareholders- the owners of the company.  revolves around the fact that a company should emphasize on the social and environmental repercussions of their business decisions, which tend to maximise economic returns. CSR is a wide-ranging term that includes contribution towards the environment, community involvement, philanthropy and charity, etc. In India as per the Section 135 of Companies Act 2013, the following companies are mandated to form a CSR committee and spend 2% of their average profits on CSR:

- Companies having a net worth of INR 500 crores and above
- Companies having a turnover of INR 1000 crores and above
- Companies making a net profit of INR 5 crores and above.

Some of the activities which can be performed by the company to meet its CSR obligations are:




Before the 2013 Companies Act mandate, the notion of CSR was based on a more informal setup mostly influenced by the large family philanthropists and dynastic charity, corporate trusts, family trusts, PPP (Private Public Partnerships) model, partnerships with the NGO and other social institutions etc (refer Image 1 below). The role of India as a state diversified during the post independent era- and discouraged firms to undertake social activities.[2] State failure to tackle issues like poverty and lower economic growth, widening disparities between the rich and the poor Indians led to diversion of corporate efforts to address social problems. The State began to think of innovative ways to draw up from the businesses. Opening of the Indian economy, rich-poor divide, state functioning inefficiencies marked the advent of a more formal setup for CSR in India.

| Time period | Economic currents | State role | Corporate CSR |
|---|---|---|---|
| **1850-1914** | Industrialisation | Colonial, extraction | Dynastic charity |
| **1914-1947** | Trade barriers for new industries | Colonial, exploitative | Support freedom struggle |
| **1947-1960** | Socialism, protectionism | Five year plans | Support new state; launch own rural initiatives |
| **1960-1990** | Heavy regulations | Licence raj; development failures | Corporate trusts |
| **1991-2013** | Liberalisation | Shrinking in production; expanding in social provision | Family trusts, private-public partnerships, NGO sponsorship |
| **2013-present** | Globalisation | Need to manage inequality; new reforms to liberalise further | Introduction of mandatory 2% rule |

Image 1 Source: https://www.gatewayhouse.in/a-brief-history-of-indian-csr/

Businesses in India over years have been contributing towards being better corporate citizens. Companies or groups like Tatas, Birla, JK, Reliance, Murugappa, TTK etc contributed for decades towards their social and environmental obligations much before there was any legal mandate. Technology companies and their founders e.g., HCL, Wipro, Infosys, TCS, Tech Mahindra etc. have made continued contribution towards their obligations to society. The quantum of such outlay is quite unprecedented and acutely generous. All these contributions were voluntary, focussed with measurable impact and often aligned to the industry, geography and ethos of these companies and their founders.

*Indian rules of CSR excludes all expenses made by a company towards its social and environmental obligations including those spend by the company voluntarily on making the company a responsible corporate citizen. CSR payments are made as an additional appropriation from profits after tax (as CSR spent is non tax deductible) towards causes enumerated by the government, which may not have any relevance to the business or its objectives.* Therefore, the debate rages as this additional outlay imposed on responsible businesses fair?

**CSR in different countries**

The notion of CSR is a rather subjective conception, in the sense that it varies from company to company and even country to country. As per the research paper titled- “Indian CSR- Is it different from Western?” authored by Dr. R Ramakrishnan, the dogma of CSR in India treats the primary and secondary stakeholders at the same level. Promotion of CSR is scattered unevenly and only taken up by a few major business players. The paper tested the null hypothesis – *“there are no differences between Indian CSR and Western CSR”*. Statistical testing led to rejection of the initial premise, concluding that there are differences between Indian CSR and Western CSR.

- The CSR perspective in India focuses on serving the less privileged sections of the society. “It’s a unique approach, combining both conventional philanthropy and careful strategy”.[3]
- CSR for the US companies is not a mandate. In the United States, the Bureau of Economic and Business Affairs has a CSR team to encourage the companies. However, US companies undertake CSR activities only in case of adequate tax breaks or as a result of consumer pressure to be categorised as an” ethical brand”.
- In UK, CSR as a part of Companies Act 2006 has coerced the businesses to consider the social, economic and environmental aspects, along with business promotion. The companies are also required to incorporate the disclosures as a part of their annual reviews.[4]

- In Europe, the CSR practices, lays its foundation on the fundamentals by United Global Compact, United Nations Guiding Principles on Business and Human Rights, ISO 26000 Guidance Standard on social responsibility and OECD guidelines for multinational enterprises.
- For Denmark, it is the Danish Financial Statement Act that directs the CSR disclosures (dependent on the company size) to be published as a part of their annual reports. The companies are required to state the absence of a CSR policy too. Certain law provisions mandated by the Danish government encourage the companies to cater towards the social wellbeing of the community.

***Evolution of CSR*: *A touch on different theories and model***

CSR in the world has progressed through manifold theories and models. The CSR definitions, theories and models were explored by many scholars - Reza Safarzad, Milton Friedman, James Brusseau, Archie Carroll, R. Edward Freeman, Elisabet Garriga and Domenec Mele, Maryna Saprykina, Yaroslav Kutov etc.[5] Some of the main theories in development of CSR are:

| The Caroll CSR theory by Archie Caroll | The Triple Bottom theory by John Elkington | The Stakeholder theory by Freeman and Reed |
|---|---|---|
| • Focusing on four main business reponsibilities- economic, legal, ethical and philanthropic. | • Highlighting the three dimensions of business - economic, social and environmental. | • Catering to the interests of various stakeholders of a business. |

There are various similarities as well as differences in these CSR theories. While some promote the subject of CSR, some postulate that the businesses should focus only on profit maximization.

As the concept of CSR proceeded over time the onus of social and communal development has shifted from the government to the business. Advancements in the process of CSR has led to a digression of the state's obligation towards the environment and people. Prior to development of CSR, there always has been a clear distinction between the state and business duties with no overlaps. It is the state that has been primarily responsible for addressing notions of poverty, inequality, welfare maximization etc. Catering to various stakeholders and considering the impact of operations on the ecosystem has been an inherent part of the business process-*then why the need for a mandatory spend out of the profits?* We attempt to categorize CSR as a boon or a bane using Friedman's doctrine.

**Friedman's CSR Doctrine**

- *Your money on yourself—spent wisely;*
- *Your money on others—spend wisely but challenging;*
- *People's money on yourself—little incentive to economise;*
- *People's money on other people— **the role of government and Corporate Social Responsibility programs.****

The liberal model of CSR (1970s-1990s) was captured by the macroeconomist Thomas Milton Friedman. As per the 1970 New York Times article - Friedman proposed ***There is one and only one social responsibility of business — to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud."***

As per Friedman's shareholder's theory the sole aim of the companies should be to focus on profit maximization and the welfare of the shareholders. Social activities conducted by the businesses distort economic freedom since the shareholders are unable to decide the utilization of their funds.[7] Friedman thus postulated that the corporations should focus on activities that leads to profit maximization. Activities including philanthropy and charity should be kept outside the business realms since these do not lead to a direct revenue generation. This implies activities undertaken by a good business should be *"economically feasible"* and not just *"ethically appropriate"*. Therefore, Friedman was fervently against the spend of funds on any activities for purposes other than shareholder's wealth maximization.

The shareholders can decide on matters regarding the social spend by themselves upon receiving the dividends. The force of free market capitalism will induce social welfare.

**Critical Assessment of Friedman's Theory**

Academically, Friedman's 1970 doctrine is established on a strong foundation claiming profit maximization as the sole aim of the business. But there is uncertainty regarding its application in the current business scenario. The theory postulates that free market capitalism persuades focus on societal causes. It's implementation however is not straightforward to a mixed economy model like India that works on the collaboration of free market forces and government intervention. While it is the role of the State and the government to work for the society, the businesses should also assist. It must be every company's moral obligation to compensate the environment, society and other components of the ecosystem for the disturbances caused as a result of the day-to-day business activities.

Nevertheless, irrespective of the turnover and size, CSR must not be a mandate for the company. As per Friedman, the decision to invest in social happenings , should rest with the shareholders of the company. Many critics claim the theory to have neglected community's role in the success of the business. The critics also argue that the goodwill of the company is significantly dependent on the society- often the end user of the business produce. However, there should be a clear distinction between responsibilities of the company towards its various stakeholders including customers and society *(business responsibilities and ethics)* and investment in social activities *(corporate social responsibility)*. The social responsibility of any business should be limited to the extent of serving the different business participants.

Moreso, checking the CSR box as a "*task done*" and investing an amount from the earned profits is not an indicative of the business's genuine intention to contribute towards social causes. Rohini Nilekani a philanthropist and wife of Nandan Nilekani (co-founder, Infosys) mentions in the 2014 research paper titled "*The Mandatory CSR in India*"[8] "*Ticking a CSR checklist or writing a cheque out of profits is a poor substitute for being a good corporate citizen because how companies make profits (ethically and legally) is more important than what they do with them (dividends or taxes). But mandatory CSR over and above taxation, forces companies to do the government's job. And trying to outsource the state's primary job is a bad idea. Companies should create jobs and pay taxes. It is unrealistic and unfair to expect them to focus beyond the immediacy of circumstances (survival and growth) that is the life of most small entrepreneurs.*" The company must focus in generating employment opportunities and paying taxes to the government. It's then the role of the state to spend the tax proceeds on social, environmental and related areas.

Azim Premji- chairman, Wipro engages in diverse philanthropic activities at a personal level but opposes the 2% mandate on CSR. He firmly believes that spending 2% of the company's profits is a huge proportion, especially in difficult times and for companies trying to expand.

*"I do not think we should have a legal mandate for companies to do CSR. Philanthropy or charity or contribution to society must come from within , and it cannot be mandated from outside." – Azim Premji*

**Is then CSR laws really necessary?**

As discussed, CSR as a business concept has evolved through multiple theories – The Carroll theory *(highlights business responsibilities- economic , legal , ethical and philanthropic)* ,The Triple Bottom Line Theory (*lists three dimensions of business performance -economic, social and environmental)* and The Stakeholder theories *(catering to the needs of various business stakeholders)* including Milton Friedman's doctrine. While some theories are supportive of CSR, others highlight profit maximization as the sole aim of the businesses.

There are various risks (environmental, physiological, social etc.) associated with business operations. A business is responsible to cater towards its various stakeholders including the environment and society. Its moral obligation towards the environment and society should be a part of the cost of doing business/ operations rather than a tax on earned profits. By its virtue, CSR is a redistribution of profits that belongs to the owners and shareholders of a company. A compulsory out-of-profit expenditure on social activities in disagreement with the shareholders cannot guarantee societal and communal development. CSR creates a departure of state's commitment from commissioning welfare maximizing activities. It is always the state that has primarily addressed the environmental and social notions. The welfare activities must be principally carried out by the government utilizing the tax proceeds. The government in collaboration with NGOs and other social institutions should strive to work for the society. The business should focus primarily on profit maximization and allied activities. Distortions caused in the daily course of business operations should be accounted for as a cost by the business and not a tax on its profits. While there is no straightforward categorization of CSR being labelled as a boon or bane, the 2% mandate can definitely be regarded as a burden on the company's profits, which is due to shareholders- retail, pension funds and other large and small ones who have invested capital and have taken risks. A mandatory diversion of 2 % returns from their capital towards social and other causes which falls in the realm of government's responsibilities is unfair to those who are taking risks with their monies.

*"Mandated CSR circumvents people's own plans and preferences, distorts the allocation of resources, and increases the likelihood of irresponsible decisions. Evidence that government policies will increase welfare and a compelling argument that proven benefits justify reductions in freedom are necessary in order to justify CSR mandates."*

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