CSR Mandate: An opportunity to build a Sustainable Organization

Nupur Pavan Bang
Associate Director, Thomas Schmidheiny Centre for Family Enterprise
Indian School of Business

A study by the Thomas Schmidheiny Centre for Family Enterprise, using data from Prime Database, found that nearly 50 percent of the companies mandated to spend 2% of their average net profits on CSR activities failed to comply with the requirement. But why? After all, "Giving back" has been a part of the Indian culture. Many religious texts and practices actively promote the practice of giving.

All top religions practiced in India, as per the Census of India 2011, advocate giving as an essential tenet of life. For example, the "zakat" or the "sadqa" in Islam, the practice of "tithe" followed by the Jews and the Christians, "dana" in Hindus, Jains, Sikhs, and Buddhists, and "Yatha Ahu Vairyo", that is, "He who gives assistance to the poor acknowledges the kingdom of God."

Examples of business houses or business leaders establishing educational institutions, places of worship, hospitals, and engaging in preserving art and culture are many in India. This naturally percolated to the organizations as well that engaged in a broad spectrum of philanthropic activities, especially for the communities that they operated in and around. Examples include the GMR group supporting causes like education, healthcare and empowerment, and livelihood through the GMR Varalakshmi Foundation, the Ambuja Cement Foundation, which has programs on Water, Skills, Agriculture, Health, Women, and Education, and the Infosys Foundation that aims to support underprivileged sections of society, create opportunities and strive towards a more equitable society.

However, almost half of the companies failed to spend the prescribed amount. This was puzzling. Therefore, this article delves into the reasons for the lack of adoption of CSR in letter and in spirit by the firms in India.

Challenges

Simply, lack of time and ideas: CSR was limited to certain large firms earlier. When the Act was enacted, many relatively smaller firms that became eligible and needed to comply with the CSR requirement did not have the time, bandwidth, idea, or initiative to do this. They are on a growth path that creates a daily firefighting situation at the operational level. CSR is seen as a distraction or an unnecessary forced activity to them.

Limited immediate downside of non-compliance: Prior to 2021, the government's stand on non-compliance was "comply or explain". However, from 2021 onwards, the stand has changed to "comply or be penalized". The maximum penalty amount is Rs10 million, and a small penalty for the company's officers. The penalty may not seem too large for a company in the growth phase. However, as "comply or be penalized" gets operationalized, the compliance is bound to improve in letter, at least.

Cap on Expenses: Per a circular from the Ministry of Corporate Affairs, the maximum permissible limit for administrative overheads is five percent of the total CSR expenditure of the company for the financial year. With this cap in place, attracting and retaining experienced, passionate, and skilled people to manage projects may be challenging. Further, many smaller firms that meet the criteria and are required to comply may not be able to put an appropriate infrastructure in place for sustained efforts in one direction with such a cap. They would thus choose to comply in letter by donating to another foundation or the government funds but will not be able to align their long-term corporate strategy with their CSR activities.

Discontinuity in Passion: Traditionally, philanthropy was carried out based on the individual or family's beliefs. In a professionalized environment, identifying causes, continuity of CSR activities, and impact assessment become challenging. Many schools or hospitals earlier had a place of pride in a city when they were managed by passionate founders. They are now run down for lack of funds or interest. This can be overcome by institutionalizing CSR activities. Institutionalizing CSR activities will separate the giving from the individual, ensure that the activities continue beyond the person, and guarantee long-term support to the beneficiaries.

Lack of Long-term Vision: In addition to continuity in passion, it is also noticeable that State Owned Enterprises that have a mandate of social welfare, family-owned businesses that look at legacy building and are driven by the vision of a family, and MNCs which are more conscious of sustainability goals, comply better to the CSR mandate when compared to widely owned non-family firms. They have been restrained in their spending. It indicates that continuity in long-term vision and institutional values may be an issue in such firms. Professional managers may not have the will to drive social welfare activities proactively. The short-term horizons of non-promoter shareholders in these companies could drive the priorities towards economic returns at the expense of long-term social investments.

Opacity: Many of the company-owned foundations are run by family members of the promoters. This casts aspersions on the usage of funds in a few cases. It raises the question of whether the family benefits at the cost of other stakeholders of the company. As a result, companies will have to professionalize their efforts and contend with implementing greater transparency and monitoring mechanisms to lend greater credibility to their social initiatives.

Every Drop Counts

It needs to be clear that CSR funds are minuscule compared to the welfare schemes run by the Government of India. In FY 2020-21, the CSR-eligible companies have spent a cumulative CSR amount of Rs 24,865.46 crore. Thus, the foundations need to engage more with the government and facilitate a more significant impact.

Further, with emphasis on the company to decide on areas of spending, there could be an oversupply or undersupply of funds and, as a result, inefficient social outcome of the CSR law. This article is not advocating for the government to get involved in the selection of projects or areas of spend. However, need assessment and impact assessment are necessary conditions for CSR spending to have the desired impact.

Also, the 2 percent defined spend might have created a disincentive for companies who were spending more than the prescribed limit. Promoters have an uphill battle convincing shareholders of the long-term strategic value, especially in cases where promoter shareholding is not concentrated. Nevertheless, with emphasis on ESG and Sustainability and investors becoming conscious about the footprints of companies in the lives of people and the planet, the companies must go all out to do their best

Conclusion

When the Companies Act 2013 mandated the companies registered in India and having either a net worth of INR 500 crore or more or a turnover of INR 1000 crore or more, or a net profit of INR 5 or more, in any financial year, to spend percent of their average net profits of the immediately preceding three financial years towards CSR activities, it should have been adopted by most companies wholeheartedly and seen as an opportunity to build a strategic stakeholder management program or an Environment, Social, and Governance (ESG) program. However, it did not happen.

There are challenges, as enumerated in the earlier section of this article. However, there is no doubt in this author's mind that CSR is an essential vehicle for ensuring the sustainable growth of firms. If the firms look at CSR as an extension of their long-term corporate strategy itself, they will gain much more than they spend.

Earlier, the mantra was 'perform or perish'. Now the mantra is 'perform, contribute-continue-repeat, else perish'. It is just a matter of time when all non-compliant firms will feel the heat from the investors, competitors who have adopted and integrated CSR with their corporate strategy, and all stakeholders. So, 'perform, contribute-continue-repeat, else perish'.

Views are personal. She can be reached at npbang@gmail.com