



CSR EXPENDITURE AND CORPORATE PROFITABILITY IN INDIA

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Abstract

The concept of Corporate Social Responsibility (CSR) has got vital significance in India, particularly in respect of the public sector enterprises (PSEs), because of the apprehensions regarding the growing exclusiveness in the country's growth process. Notwithstanding the commendable progress in economic growth in India, the fruits of development have not adequately 'tricked down' to the masses—the general public. The expenditure on CSR by corporates assumes significance in the above context, particularly when we note that the new Companies Act has already made provisions for mandatory CSR spending by PSEs, as a specific percentage of their net profits. It may be noted that even without any statutory compulsion as above many private companies are making substantial CSR investments as part of their business strategy, in order to enhance their corporate image, brand equity and hence competitiveness in the market. In this context this paper (i) analyses the significance of CSR in India for the sustainable growth of the country, and (ii) makes a comparative study of the pattern of CSR expenditure between companies in the public and private sectors. Thus, the paper suggests strategies for effective CSR spending by Indian corporates.

Key Words: Sustainable growth, PSEs, CSR expenditure, corporate Profitability.

1. INTRODUCTION

The consistently growing economic growth of India needs to be suitably redistributed among the lower strata of the society in order to ensure that the economic progress is balanced, equitable and sustainable in the long run. In the ongoing reforms era, the divides of all sorts are on the rise, particularly between the rich and the poor. Though the concept of Corporate Social Responsibility (CSR) had its beginning in the US, gradually it gained popularity throughout the globe. The basic tenet of CSR lies on the recognition that business and industrial organizations have some responsibility to multiple stakeholders in the conduct of their business, apart from their economic objectives targeted primarily at their shareholders. Such broader responsibilities that extend well beyond the scope of simple commercial relationships. Because of the obvious benefits of CSR many organizations have voluntarily adopted CSR, the benefits of CSR being enhanced customer loyalty and brand equity, better profitability etc. The mandatory CSR as insisted by the new Companies Act of 2011 in India upon public sector enterprises (PSEs) and also the demands from different corners for extending such mandatory provisions to private companies also have resulted in a growing debate on the advisability or otherwise of mandatory CSR. The case of central public sector enterprises (CPSEs) which are mandated to make certain percentage of their net profits for CSR activities, need special mention here, considering the huge investments by the Government in CPSEs vis-à-vis the returns that they make for the betterment of the society. Equally important is the need to make a comparative study of the CSR spending and corporate profitability between companies in the public and private sectors.

Businesses are an integral part of any society, and have an active role to play in the upliftment of the society. There is interdependence between business and society. Both these are mutually interdependent for survival and sustenance. CSR seeks to provide a part of the business returns to the society for its development. Taking into account the well documented merits of CSR, companies are thinking beyond the sole objective of profit-maximization and are becoming growingly conscious about their responsibility towards the society at large. This changing mindset of corporates as above has been an outcome of the economic benefits of CSR in the form of improved goodwill and long-lasting customer relations (Crowther, 2008).

In respect of public sector enterprises (PSEs) in India CSR is not a new concept, the very idea behind the setting up of PSEs being that of providing a means for the economic and social wellbeing of the society at large. Since independence, PSEs in India, both under the Central and State governments viz. CPSEs and SPSEs are mandated towards the socio-economic welfare of the nation. Thus, providing employment to the masses, both skilled and unskilled, upliftment of the socioeconomic conditions of poor etc. were the aims of the PSEs. The mandatory compulsion for earmarking a specific percentage of net profits of PSEs in India for CSR activities, contained in the new Companies Act of 2011, has given another dimension to the CSR initiatives in India.

2. RELEVANCE AND SIGNIFICANCE OF THE STUDY

Worldwide large corporates are growing trying to establish trust with their stake holders and clients in view of the increasing number of corporate scams year after year. Trust plays a vital role in having a good rapport with business clients and customers. CSR plays vital role in winning the customer confidence that will help growing the business. There are umpteen number of business models that have been developed in order to achieve CSR objectives. CSR deals with the motivation and encouragement to take up socially responsible activities that will improve the economic and ethical standards. Companies should make sure that environment is no way affected by executing their business activities. Another dimension for CSR is to go beyond everyone's expectation in giving back to society. This will display the commitment made by the company to serve its employees and the common public. This is a popular practice in the western countries where there are stringent rules imposed by various governments. A recent survey reveals that many people prefer to buy products of companies that actively engage in corporate social responsibility events. CSR was just a voluntary issue to many corporates. But, as times have changed, it doesn't allow for them to simply be in business for the sake of making a profit anymore. While consumers may rely on corporations for goods and services, the level of competition allows customers to make decisions based on several factors, including how much good a corporation is also doing outside of the workplace. Many individuals today are basing their corporate loyalties on how companies are positively impacting their community.

The provisions relating to CSR spending by the PSEs in the Companies Bill, 2011 have got high academic significance as these provisions imposes statutory compulsion on PSEs for CSR acts. The Department of Public Enterprises (DPE) under the Government of India has already issued a revised set of "Guidelines on Corporate Social Responsibility and Sustainability for Central Public Sector Enterprises" that these guidelines have become effective from April 1, 2013. While the previous version of the CSR Guidelines as applicable to the central public sector enterprises (CPSEs) focused largely on external stakeholders and CSR spending, the new version of the CSR Guidelines by the DPE emphasizes on CSR as a way of life and as an integral part of the operations and business of the company.

While the current debate in India equates CSR with corporate philanthropy, DPE's revised CSR Guidelines for the CPSEs does more than that and requires companies to follow ethical systems and sustainable management practices. There is provision for mandatory CSR spending by PSEs in the new Companies Act. Likewise, DPE's revised CSR Guidelines provide for the manner in which CPSEs can carry out their CSR practices, and also mandate every CPSE to carry out a minimum number of external projects "for development of a backward district" that "has the potential of contributing significantly in the long run to socio-economic growth in all the backward regions of the country". In the above context, apart from studying the significance of CSR, including provisions on mandatory CSR, it is meaningful to make a comparative study of the trend in CSR spending and profitability between the public and private sector companies.

3. OBJECTIVES OF THE STUDY

1. To study the significance of the concept of Corporate Social Responsibility (CSR) in India with a focus on the Public Sector Enterprises (PSEs), in view of the recent regulatory provisions relating to CSR and CSR expenditure by the Indian corporates;
2. To make a comparative study of the trend in CSR expenditure and profitability between companies in public and private sector in India; and
3. To make suggestions for systematic and effective adoption of CSR by corporates in India.

4.METHODOLOGY AND DATA SOURCES

This study is primarily of descriptive-analytical nature, as it makes use of latest available data on CSR activities by Indian companies and analyses the responses of corporates to relevant statutory provisions on CSR and market conditions. The study is exploratory too as it makes a comparative analysis of the trend in CSR expenditure and profitability between companies in public and private sector in India. The data used are secondary in nature and these include various government publications, official websites of regulatory bodies etc.

5.SIGNIFICANCE AND RELEVANCE OF CSR IN INDIA IN THE ONGOING GLOBALIZED REGIME

The growing significance of CSR arises from the fact that it arises from adherence to ethical values, legal compliance, and respect for people, community, and environment. CSR expects a company to go beyond whatever is required by the law. In fact, CSR seeks to (i) treat its employees fairly and with due respect, (ii) operate with integrity and in an ethical manner in all its business dealings with customer, suppliers, lenders, and others, (iii) respect the human rights, (iv) sustain the environment for future generations, and (v) be a responsible neighbor in the community and a good 'corporate citizen'. Occupational welfare and corporate community welfare or corporate social responsibility (CSR) are of growing importance to governments and service providers as they promise to meet challenges of social problems within changing welfare environments. The modern governments have increasingly resorted to corporate involvement in local services and have also encouraged the expansion of occupational welfare.

During the last two decades or more a growingly large number of companies have adopted CSR practices. Such a positive response towards CSR might be partly because of their aspiration to make their operations more ethical. It is noted that increasingly more and more companies have begun to incorporate ethics and CSR in their strategic planning and objectives. It may be pointed out that there is no statutory compulsion or governmental directives or such other external influences in making more and more companies to join the CSR bandwagon. Rather this change in mindset is quite voluntary in nature.

Large number of corporates has voluntarily adopted formal environmental policies and CSR practices. Their objectives have been creating sustainable businesses and at the same time being environment friendly. For example, a company that using large amounts of forest resources (like, timber in respect of newsprint industry) might adopt a policy of re-forestation to replace the trees cut down by them. As per the current practices, companies include CSR report in their annual report and accounts or may publish their separate corporate responsibility report which may also be called a 'social and environmental report' or a 'sustainability report'. Whichever may be the kind of report, these reports indicate a company's commitment toward ethical behavior and highlight their progress towards achieving their strategic CSR objectives.

6.CSR IN INDIAN COMPANIES: RETROSPECT AND PROSPECT

CSR is a concept that has been in existence in India since long. The concept though existed in an unorganized format during pre-independence era but the Indian companies were aware of their responsibilities towards social development. As already noted, the idea behind the setting up of PSEs during the post-independence era was socio-economic development of the masses through employment generation, besides the supply of goods and services. History says that the Indian companies contributed towards providing education, health and other kinds of social services.

The man behind the early initiatives relating to social responsibility of business was none other than Mahatma Gandhi, the father of the nation. In fact, Mahatma Gandhi sought to make Indian business houses discharge their societal responsibilities. Thus, the concept of CSR has already been there throughout India's industrial development experience though the technical term viz. 'CSR' has been of a recent origin. Now, the concept of CSR has become more formal as well as organized. Of late, CSR has become mandatory too in respect of PSUs in India. In the early days of India's industrialization, philanthropic activities of companies were undertaken separately and they did not form a part of their CSR initiatives. But, unlike in the past CSR activities constitute the highest level of organizational pyramid. Moreover, the scope of the term CSR has widened manifold. (Bhanumurthy and Krishna, 2010, p.156)

In the Indian context, the corporate initiatives towards fulfilling the concept of social responsibility of business could be traced back to those of the TATA's and the Birla's. These giant private companies in India could contribute positively for the betterment of society since the time when the CSR concept was hardly known or practised in the country. Today India is assumed the status of one of the top Asian countries in the CSR front. The report of the study done by the social enterprise named CSR Asia [viz. Asian Sustainability Ranking (ASR), 2009] has ranked India in the Fourth position among the Asian countries in respect of laying increasing emphasis on the concept of CSR. Moreover, at the level of individuals too there are commendable achievements. In fact, there are as high as 4 Indians among '48 Heroes of Philanthropy' according to the List of Forbes Asia for the years 2009 and 2010. The above facts very well depict the awareness of CSR among Indian citizens. (The Hindu dt. 05.03.2010).

7. RECENT REGULATORY PROVISIONS FOR MANDATORY CSR IN INDIA: AN OVERVIEW

Government of India made it mandatory for all public sector oil companies to spend 2 percent of their net profits on CSR activities in the year 2009. Accordingly, for all such companies a minimum expenditure of 2 percent net profits had to be earmarked for CSR activities and no slab was prescribed by the Government for them. The same move is being planned by the Government for coal mining firms. However, the percentage to be shared has not yet been decided and the proposal is not yet accepted (Business Standard dt. 25.04.2011).

The Companies Act, 2013 (hereinafter referred to as 'the Act') Section 135 (1) states that, 'Every company having net worth of Rs. 500 crore or more, or turnover of Rs. 1000 crore or more or a net profit of Rs. 5 crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board. It is further mentioned under Section 135 (5) that, 'In pursuance of its Corporate Social Responsibility Policy', the Board of every company referred to in sub-section (1) above, shall ensure that the company spends, in every financial year, at least 2 percent of the average net profits of the company (calculated as per Section 198) made during the 3 immediately preceding financial years.

It may be noted that the Companies Act, 2013 specifies the broad modalities of selection, implementation and monitoring of the CSR activities by the Boards of Directors (BOD) of companies. Besides, if the company fails to spend such amount for CSR activities, the BOD in its report should specify the reasons for not spending the amount for the intended CSR purposes. CSR activities that could be included by companies in their CSR policies are listed in Schedule VII of the new Companies Act. In fact, the provisions of Section 135 of the Act and Schedule VII of the Act apply to all companies, including Central Public Sector Enterprises (CPSEs). Department of Public Enterprises (DPE) Guidelines on CSR and Sustainability issued on Oct 21, 2014 (specifically states that, 'It is mandatory for all profit making CPSEs to undertake CSR activities as per the provisions of the Act and the CSR Rules. Even the CPSEs which are not covered under the eligibility criteria based on threshold limits of net-worth, turnover, or net profit as specified by Section 135 (1) of the Act, but which made profit in the preceding year, would also be required to take up CSR activities as specified in the Act and the CSR Rules, and such CPSEs would be expected to spend at least 2 percent of the profit made in the preceding year on CSR activities.' However, as per DPE guidelines, the amount spent on sustainability initiatives in the pursuit of sustainable development while conducting normal business activities would not constitute a part of the CSR spend from 2 percent of profits as stipulated in the Act and the CSR Rules. Besides, in case of CPSEs mere reporting and explaining the reasons for not spending this amount in a particular year would not suffice and the unspent CSR amount in a particular year would not lapse, it would instead be carried forward to the next year for utilization towards the purpose it was allocated. In case of PSEs in India, the revised guidelines on CSR and sustainability are being implemented from 1 April 2013. In view of the vast government investments in PSEs, they are mandated for discharging their social responsibility. Hence, they have to conduct their business in an economically, environmentally and socially sustainable manner. CSR acts by PSEs may be reckoned as a means of discharging such responsibilities. Now CSR is statutory compulsion too in respect of PSEs, as already noted.

8. TRENDS IN RESPECT OF CSR EXPENDITURE AND CORPORATE PROFITABILITY IN INDIA

The Government of India formed PSEs to attain inclusive growth, considering the social as well as economic development of the country. The government established them with the purpose of building industrial capacity,

creating employment opportunities and improving the socio-economic conditions. Both, central public sector enterprises (CPSEs) and state level PSEs have been playing a vital role in supporting the socio-economic development of the country. They are actively involved in various areas of CSR such as education, healthcare, improving infrastructure, social empowerment, vocational training and environmental protection among others. With a high degree of support from the government, CSPEs acts as a catalyst of social enterprise by providing such diverse services for grass root development. A chart showing the average CSR expenditure by the public and private sector corporates in India is given in Figure I.

Figure I: Trend in CSR Expenditure by Indian Corporate sector (Public and Private)

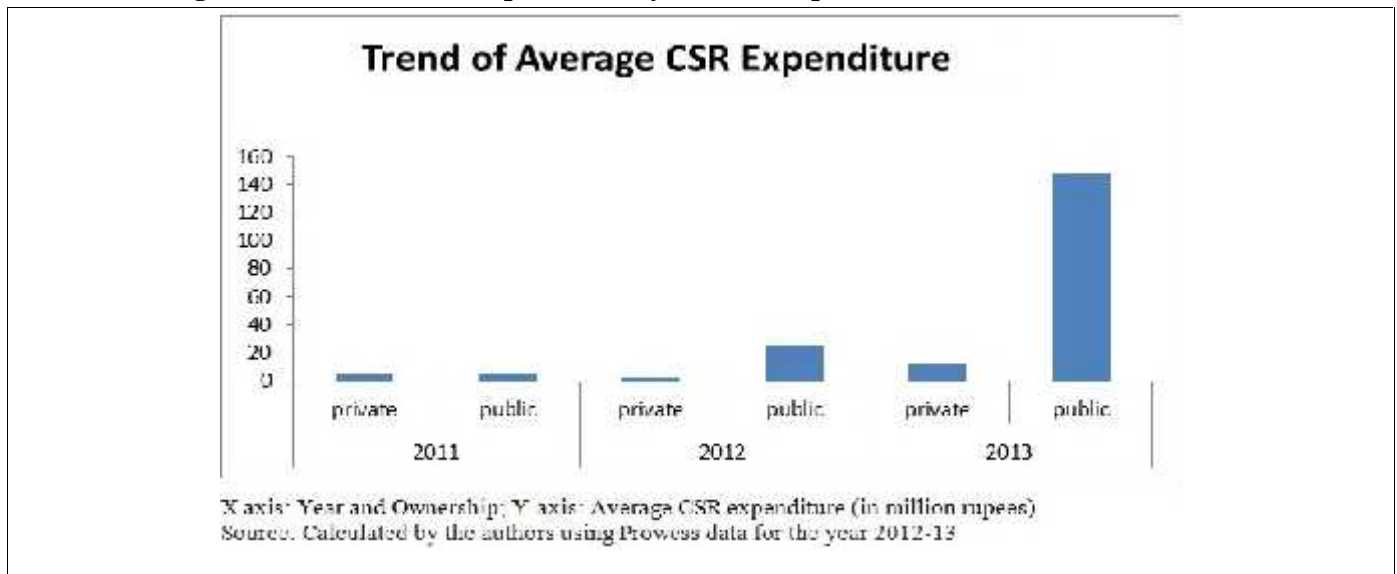
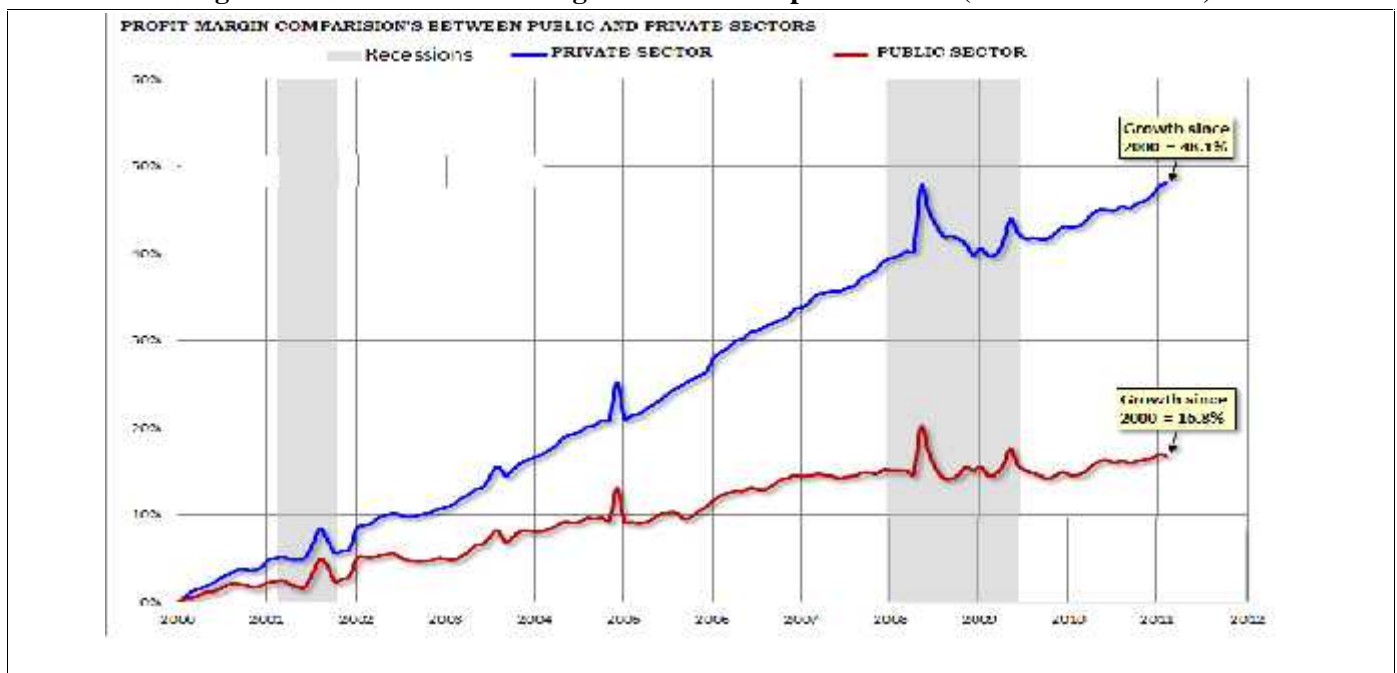


Figure I clearly shows the fact that the CSR spending of public sector is comparatively very high in recent years when compared to their private sector counterparts. The trend in profit margins of the public and private sectors is given in Figure II.

Figure II: Trend in Profit Margin of Indian Corporate sector (Public and Private)



On comparing the charts given in Figure I and Figure II above, the disparity between the private and public sector's spending on CSR is clear. Even though profitability of private sector companies has been growing fast, their CSR expenditure has been very low. (Figures I and II).

In August 2013, the Indian parliament passed the Indian Companies Act, 2013, which has replaced the Companies Act of 1956. The New Act has made far-reaching changes affecting company formation, administration and governance, and it has increased shareholder control over board decisions. The New Companies Act 2013 made it mandatory for all companies to spend on CSR. DPE issued guidelines to all PSU's, which are revised frequently, through which the amount of spending that is mandatory for profit making PSU's is defined.

Table I: Revised CSR and Sustainability Budgetary Allocation for CPSEs

| Net Profit in the previous year | Budgetary allocation as Percentage of Net Profit in the previous year |
|---------------------------------|---|
| Less than Rs. 100 Crores | 03 percent to 05 percent |
| Rs.100 Crores– Rs.500 Crores | 02 percent to 03 percent |
| Rs. 500 Crores and above | 01 percent to 02 percent |

Source: Govt. of India, Dept. of Public Enterprises, "Guidelines on CSR and Sustainability for CPSEs"

After the making of CSR mandatory, there has been a remarkable change in the CSR scenario. The chart given in Figure III shows as to how differently the companies registered in India and those registered abroad have spent on CSR activities. It is noted that while foreign companies have tremendously increased their CSR expenditure the same in respect of Indian companies has been less prominent though quite significant. (Figure III).

Figure III: Trend in CSR Expenditure by Foreign and Indian Companies



X-axis: Firms and Year, Y-axis: Average CSR expenditure (in million rupees)
Source: Calculated by the authors using Prowess data for the year 2012-13.

In view of the foregoing analyses, it is quite obvious that Indian companies need to scale up their CSR activities so that would be greater impetus for faster but equitable (and hence sustainable in the long run) economic development in the country. (Figure III). Besides, it may be pointed out that higher CSR expenditure would enhance the customer loyalty and brand equity of the companies concerned.

9. SYSTEMATIC AND EFFECTIVE IMPLEMENTATION OF CSR IN INDIA: SOME SUGGESTIONS

- To ensure a level playing field for all companies, CSR should be made applicable to both public sector and private sector companies alike. There should not be any discrimination to companies based on the ownership pattern.

- All CSR activities should ideally seek to address the long-term and broader societal issues like environmental pollution. CSR efforts should focus on really deserving social development activities including rural development, promotion IT, literacy including computer literacy, women empowerment, etc.
- The CSR activities for one's company or industry need to be defined, considering the specific nature of the business undertaken or the industry segment. For instance, CSR activities of a bank must be different from that of a manufacturer or a retailer.
- Costs involved in CSR activities should be systematically kept on vigil. Accordingly, accountability for discharging one's social responsibility could be fixed. This measure helps to avoid misuse of CSR funds and eliminate corruption in CSR implementation
- CSR initiatives of individual companies need to be widely publicized throughout the respective companies at all levels. Moreover, all the employees of the company be involved in defining and advancing CSR.
- Companies which engage in CSR activities should develop positive and pro-active relationships with other companies with CSR activities. Co-ordinated effort by different companies would be mutually beneficial to the companies concerned and also the society at large. Because, efforts would not be duplicated nor wasted, rather they could be made complementary to each other.
- Customer education should form the focus of all CSR activities. Educating the masses particularly those from the lower strata of the society as part of CSR efforts would strengthen the society through enlightening them.
- Last but not the least, all CSR efforts, whether discretionary or mandatory, must be oriented at social development in its true letter and spirit. A compliance-oriented CSR spending should be avoided in the case of mandatory CSR investment (eg. PSUs). Only whole hearted CSR efforts with the active support and co-operation of the respective stakeholders alone can ensure real social progress and development. This in turn would give the returns to the concerned companies in the form of long-term relationships, customer loyalty, corporate image and brand equity.

10. CONCLUDING REMARKS

In view of the foregoing discussions, it may be pointed out that the measures initiated by the Government of India regarding statutory stipulation of CSR by PSEs in India, prima facie, is an encouraging development. This measure would prompt the private sector companies also to join the CSR bandwagon voluntarily. The fact is that even without any statutory compulsion many private companies have initiated CSR activities voluntarily because of the obvious benefits in terms of better corporate image and brand equity, long-term customer relationships and customer loyalty, etc. However, extension of CSR activities to all private sector companies is quite advisable, as it will further strengthen the move towards social responsibility of business and will also ensure a level playing field for all players.

However, these CSR concepts are still in nascent stage in India. The PSUs and a few of the private companies have initiated various activities to give back to society. In the past, the various political and social reasons encouraged the companies to take up CSR activities. Though, the industries grew by a double digit ratio every year, there are several other problems that also grew simultaneously like illiteracy, poverty, lack of basic amenities etc. With the Indian economy trying hard to get back on track, Government cannot eradicate all these problems at once and people need help from such companies / corporates also.

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