

Corporate Social Responsibility: From ‘Comply or Explain’ to ‘Comply or Imprisonment’

Understanding the Amended Social-Role of Entrepreneurship

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Abstract

Corporate Social Responsibility is not a fresh term after the MCA's initiative. Previously only a few companies use to do something for the betterment of society. But there is a need to rethink and redefine the social value added of entrepreneurial activities to society. In this paper an attempt has been made to evolve social role of entrepreneurship. Over the years Corporate Social Responsibility (CSR), a concept comparatively new to India, is rapidly picking up pace. But compliance to the provision was becoming lenient as exemption provisions were laid down. Recent amendment to the statute will going to bring a revolutionary change. Stringent policy made with inexcusable penal provision would the compliance inevitable.

Key words: Corporate Social Responsibility

Acronyms: CSR - Corporate Social Responsibility, MCA – Ministry of Corporate Affairs

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“A company should have in its DNA, a sense to work for the welfare of the community. CSR is an extension of individual sense of social responsibility. Active participation in CSR projects is important for a company” – Tata R.

Proem:

The study of entrepreneurship has advanced significantly, showing greater research breadth, depth and rigor. Yet, researches need to cover some generic questions answered satisfactorily. For example, why the social responsibility of an entrepreneurship got considered? Do only the giants (corporates fulfilling the criterion) need to adhere? Do they really do the allocations? For some, these questions would have been fully addressed; but this need to have a rewording.

Some successful entrepreneurs (e.g., Bill Gates and Warren Buffet) have sounded the alarm that entrepreneurship's potentially dysfunctional effects on society are not being carefully considered. Entrepreneurs may add to (and even create) problems that impair progress in their societies, often without assuming responsibility for addressing these issues. The consensus from these different perspectives is that we need to rethink and redefine the social value added of entrepreneurial activities to society (Zhara & Wright, 2015)

1. Introduction:

Corporate social responsibility (CSR) also called corporate responsibility, corporate citizenship, a concept whereby organizations consider the interests of society by taking responsibility for the impact of their activities on customers, suppliers, employees, shareholders, communities and other stakeholders, as well as the environment.

The Companies Act 2013 has introduced the idea of CSR w.e.f. the Financial Year 2014-15 to the forefront and through its disclose or explain mandate, promoting greater transparency and disclosure. Schedule VII of the Act,

which lists out the CSR activities, suggests communities to be the focal point. On the other hand, by discussing a company's relationship to its stakeholders and integrating CSR into its core operations, the draft rules suggest that CSR needs to go beyond communities and beyond the concept of philanthropy.

1.1. Definitions:

Following are certain definitions that need to be consider to understand the approach the world carries and to mark the deprived area:

As stated by the **World Business Council for Sustainable Development**, "Corporate Social Responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large".

The Institute of Directors, United Kingdom, states that "CSR is about businesses and other organisations going beyond the legal obligations to manage the impact they have on the environment and society. Particularly, this could include how organisations interact with their employees, suppliers, customers and communities in which they operate, as well as the extent they attempt to protect the environment"

Kotler and Lee define CSR as "Corporate social responsibility is a commitment to improve community well-being through discretionary, business practices and contribution of corporate resources. Corporate social initiatives are major activities undertaken by a corporation to support social causes and to fulfil commitments to corporate social responsibility"

1.2. Evolution: Indian Perspective

The history of CSR in India has its four phases which run parallel to India's historical development and has resulted in different approaches towards CSR (Saluja & Kapoor, 2017).

The First Phase: In the first phase charity and philanthropy were the main drivers of CSR. In the pre-industrialization period, which lasted till 1850. The industrial families of the 19th century such as Tata, Godrej, Bajaj, Modi, Birla were strongly inclined towards economic as well as social considerations.

The Second Phase: This was when Mahatma Gandhi introduced the notion of "trusteeship", as per which the industry leaders had to manage their wealth to benefit the common man. "I desire to end capitalism almost, if not quite, as much as the most advanced socialist. But our methods differ. My theory of trusteeship is no make-shift, certainly no camouflage. I am confident that it will survive all other theories."

The Third Phase of CSR (1960–80) had its relation to the element of "mixed economy", emergence of Public Sector Undertakings (PSUs) and laws relating labour and environmental standards. During this period the private sector was forced to take a backseat. The public sector was the prime mover of development. Because of the stringent legal rules and regulations surrounding the activities of the private sector, the period was described as an "era of command and control". The policy of industrial licensing, high taxes and restrictions on the private sector led to corporate malpractices. This led to enactment of legislation regarding corporate governance, labour and environmental issues.

The Fourth Phase: In this phase (1980 - 2015) Indian companies started abandoning their traditional engagement with CSR and integrated it into a sustainable business strategy. In the 1990s the first initiation towards globalization and economic liberalization were undertaken. Controls and licensing system were partly done away with which gave a boost to the economy the signs of which are very evident today. Increased growth momentum of the economy helped Indian companies grow rapidly and this made them more willing and able to contribute towards social cause.

1.3. Changing Trends: From Charity to Responsibility and now Obligatory

A first formal attempt by the government of India to the table was in the issuance of Corporate Social Responsibility Voluntary Guidelines in 2009 by the Ministry of Corporate Affairs (MCA, 2009). Before that, it was discussed in the Report of the Task Force on Corporate Excellence by the Ministry of Corporate Affairs (MCA, 2000). The Voluntary Guidelines of 2009, CSR policy was brought out that included attention for all stakeholders, ethical functioning, respect for workers' rights and welfare, respect for human rights, respect for the environment and activities to promote social and inclusive development.

In 2011 the Guidelines of 2009 were followed by the National Voluntary Guidelines on Social, Environmental & Economic Responsibilities of Business, also issued by the MCA (MCA, 2011). As per 2009 Guidelines, the 2011 Guidelines were voluntary in scope wherein corporates were advised to utilise all the nine principles, and to report their adherence to the guidelines based on an 'comply or explain' principle. While one of the implementation strategies suggested in the 2009 Guidelines was to earmark "specific amount related to profits after tax, cost of planned CSR activities, or any other proper parameter," no such recommendation was included in the 2011 Guidelines.

The most aspiring attempt at mandated CSR activities for companies came with the enactment of Section 135 of the Companies Act 2013 (MCA, 2013). Section 135 made CSR spending as well as reporting compulsory for the very first time in India and established the CSR activities of Indian corporates under the purview of corporate law.

Recently, the Companies (Amendment) Act 2019 has amended the provisions of the CSR. The new crackdown provision is the revisions to the existing framework of Corporate Social Responsibility (CSR). The CSR regime is now no longer "comply or explain" but "comply or imprisonment".

2. Literature Review:

Rai and Singla (2011) in their paper has highlighted CSR activities as long term investment for the business. The study was undertaken on multinationals companies from 8 industries listed in Nifty index. Secondary data has been used for studying and qualitative approach was taken. Expectations of stakeholders is getting stronger, so companies should do CSR for sustainable business and developing good image in the mind of public and customers.

Ray, et.al. (2012) has tried to make an objective evaluation of the Corporate Social Responsibility and related ethical business practices that are being adopted by large corporate houses in India.

Tyagi, et. al. (2013) in their findings they have determined critical CSR factors that may influence the business and strategic decision making in the Indian business. They found CSR practice somewhere burdening and shuffling.

Premlata and Agarwal (2013), in the paper, have contended about the CSR concerning Indian Perspectives. The researchers have tried to find out the vitality of CSR for the national economy of India. Also, the difficulties faced by the companies by adhering to and compliance to CSR provisions were also highlighted. In one of the limitations it was highlighted that there is no incentive provisioned under the Act if company pay more than 2% of net profit.

Jagdeesh and Suparna (2014) in their paper have highlighted on various issues like Whether CSR is genuinely done or used to establish brand identification? Does CSR help in businesses to differentiate from the others and till what extent it is done? Should CSR be made compulsory or remain voluntary? Do CSR activities is done to really care for society?

It is to be noted that the out of sample literatures mentioned about, substantially focuses on highlighting the aspects where it is found difficult for a company for a compliance and many other aspects. But rarely any literature emphasises on their obligation or making the provision mandatory.

3. Research/Study Problem

CSR is a most talked word nowadays by the business house. Every company follows one or the other means for complying to the statutory provision. But till date companies were maintaining their CSR not under a strict provision. So, the research problem is to understand/interpret the Amendment and its impact on the corporate houses. The research-problem is mentioned as "*Corporate Social Responsibility: From 'Comply or Explain' to 'Comply or Imprisonment' Understanding the Amended Social-Role of Entrepreneurship*".

4. Methodology:

The research paper is an attempt of exploratory research, based on the secondary data sourced from various journals, reports and articles.

Interpretation of any statutory provision is not a parametric subject. Therefore, no use of any statistical tools or techniques have been done because there is no need of establishing any relationship between different variables.

5. Objectives of the Study:

While reviewing the literatures a research-gap was found where making the company not to escape or to postponed the allocation or in other words making the provision mandatory to be comply with. This paper will highlight the rationale of making the provision laid under section 135 of Act, mandatory.

Therefore, the objectives of this paper are:

1. To review the existing literatures and fill the gap prevailing.
2. To do the legal interpretation of the Amendment subject to Section 135 under the Companies (Amendment) Act 2019
3. To study the impact of the Amendment subject to Section 135 under the Companies (Amendment) Act 2019

6. Inherent Limitation of the Study:

On 31 July 2019, the Companies (Amendment) Act 2019 (Amendment) received assent of the President of India. The legal-provision studied in this research paper is newly inserted as an amendment to the existing provision of the Companies Act 2013, therefore case study has not been considered.

7. Erstwhile CSR requirements under Section 135:

The Companies Act 2013 has introduced the idea of CSR w.e.f. F.Y. 2014-15 to the forefront and through its disclose or explain mandate, promoting greater transparency and disclosure. Schedule VII of the Act, which lists out the CSR activities, suggests communities to be the focal point.

7.1. Applicability Section 135(1):

Under the erstwhile framework, all companies having net worth of INR 5 billion or more, or turnover of INR 10 billion or more, or net profit of INR 50 million or more during any financial year, are required to constitute a CSR committee of the board consisting of three or more directors, out of which at least one director shall be an independent director.

7.2. Composition of CSR Committee:

- (i) The committee shall be formed of Board members
- (ii) There shall be 3 Directors in the committee
- (iii) Out of the 3 Directors one director shall be Independent Director.

7.3. CSR Committee

There are cases where provision of section 135 regarding CSR Committee cannot be complied with such as private company where only 2 directors are there or case where No independent director is there because independent director is required to be appointed by Listed Companies. Following is the composition for CSR Committee in prescribed cases:

- a. An unlisted or a private company which has no Independent Director then in such cases CSR Committee will be formed without Independent Director.
- b. A private company that has only two directors in such case CSR Committee can be formed with 2 Directors.
- c. A foreign company CSR Committee shall comprise of two Directors.

The word company covers:

- a. A company incorporated under Companies Act, 2013 or under any previous Acts,
- b. Holding Company of a company,
- c. Subsidiary Company of a company,
- d. Foreign Company having its Branch Office or Project Office in India if fulfils any of the 3 Criteria of section 135 of Companies Act, 2013 shall constitute CSR Committee and comply with the provisions of CSR

7.4. Role and Responsibilities of CSR Committee:

- a. To form CSR Policy that shall provide only those activities to be carried by a company which are suggested under Schedule VII of Companies Act, 2013
- b. To Recommend the CSR Policy to the board
- c. To recommend the amount of expenditure to be incurred on above activities along with calculation of the same.
- d. To prepare a transparent monitoring mechanism for ensuring implementation of the projects /programmes /activities proposed to be undertaken by the company.

7.5. Requirement:

Such companies were required to develop a dedicated CSR policy (giving preference to local areas where the company operates) and establish a CSR fund equivalent to 2 percent of the average net profits made by the company in three immediately preceding financial years.

However, the profit calculated shall not include:

Any profit arising from any overseas branch of the company whether operated as separate company or otherwise. And,

Any Dividend received from other Companies in India which are covered u/s 135 of Companies Act, 2013.

Provided, that Net Profit of a Foreign Company shall mean as Net Profit of the Company calculated in compliance of Section 381(1)(a) and Section 198 of Companies Act, 2013.

7.6. Exemption:

Under the Companies Act 2013 (Companies Act), if the company failed to meet its CSR obligations, the reasons for not spending the CSR amounts were required to be disclosed in the directors' report.

8. Contemporary Provision:

No longer "comply or explain" but "comply or imprisonment": On 31 July 2019, the Companies (Amendment) Act 2019 received assent of the President of India. The Amendment introduces a new crackdown provision which is regarding the revisions to the existing framework of Corporate Social Responsibility (CSR) (Jhunjhunwala et. al., 2019)

8.1. Transfer of unspent funds – additional requirement under the Amendment:

- a. Amounts to be utilised towards a CSR activity, but unspent must be parked in a special account as prescribed under the provision within 30 days of the end of the relevant financial year. The unspent amount must be utilised by the company for the particular CSR activity within a period of 3 financial years from the date of such transfer, failing which, it must be transferred to any fund provided for in schedule VII of the Companies Act namely inter alia the Clean Ganga Fund, Swachh Baharat Kosh, Prime Minister's National Relief Fund.
- b. Such account, to be opened with a scheduled bank by the company, will be called an Unspent Corporate Social Responsibility Account and the proceeds of the Unspent CSR Account must be spent by the company towards the CSR projects (under its CSR policy) within 3 financial years from the date of such transfer.
- c. If the company is unable to spend the sum in the Unspent CSR Account within the prescribed period of three financial years, then, such unspent amount should be transferred to a fund specified under Schedule VII of the Companies Act within 6 (six) months from the end of the relevant financial year.
- d. However, if there are any unspent CSR funds at the end of a financial year and there are no ongoing CSR projects, the funds should be directly transferred to the Schedule VII Fund, within 6 (six) months from the end of the relevant financial year.
- e. In effect, the Schedule VII Fund means, 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 castes / tribes, other backward classes, minorities and women.

Prior to the amendment, the only requirement that fell upon companies who had failed to spend the prescribed amounts was to have the reason noted in the Board's report.

8.2. Penal liability for non-compliance:

If a company fails to comply with above mentioned obligations, the Amendment provides for imposition of penalty of not be less than INR 50,000 but which may extend to INR 2.5 million.

Additionally, the Amendment also provides for imprisonment of every officer of the company who is in default for up to three years and a fine of not be less than INR 50,000 but which may extend up to INR 500,000 or with both. Additionally, separate penalty for continuing offences has also been prescribed (Vijaylakshmi, 2019).

Prior to the amendment, companies were being prosecuted under Section 134 of the Companies Act if the board's report did not reflect "details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year". The penalties proposed under Sec. 135 are similar to those that exist under Sec. 134. Till the new provisions under Sec. 135 are notified, procedures under Sec. 134 will continue.

8.3. Central government to have rule making power:

Under the Amendment, the central government has been empowered to make rules and issue directions to ensure compliance.

8.4. CSR in case new companies:

It has now been clarified in the Amendment that if the company has not completed 3 (three) years from incorporation, the amount to be spent on a CSR fund will be equivalent to 2 percent of the net profits made by the company in the previous financial year (as against average net profits made by the company in 3 (three) immediately preceding financial years).

9. Key Takeaways/Conclusion:

Under current laws, despite of not meeting the CSR obligation, companies have merely received notices from the Ministry of Corporate Affairs asking for reasons for not meeting the CSR spend. Post the Amendment, not meeting the CSR obligation will carry penal consequences. The government's case for the Amendment is that this has been done to bring in more effectiveness to the CSR regime.

It is too early to assess the exact impact of the CSR related Amendment; the companies must watch out and meticulously comply with the CSR requirements. A substantial picture of compliance requirements will be clear only after the publication of the amendments to the Companies (Corporate Social Responsibility Policy) Rules, 2014 and other ancillary rules and regulations.

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