

Objectives of Modern Corporation and Corporate Social Responsibility

Subrata Sarkar

Indira Gandhi Institute of Development Research
Mumbai, INDIA

7th Emerging Market Finance Conference
In collaboration with Vanderbilt Law School
Mumbai, INDIA
December 14-17, 2016

Normatively, what should a corporation be concerned about?

- ❖ Financial performance
- ❖ Environmental factors
- ❖ Social welfare
 - Triple bottom line approach

But taking a stakeholder view may be in-optimal or infeasible because

- ❖ Accountable to many \square accountable to none
- ❖ Mathematical difficulty of “maximizing” multiple objectives
- ❖ Why not maximize a weighted sum?
- ❖ Conflict may go away if environmental and social factors become inputs to maximizing financial performance
 - \square ESG framework, sustainable performance

Who gives the weights? □ The Board of Directors

- ❖ Modern corporation face team production problem
- ❖ BOD an organizational form that manages conflict and competing interests of
 - investors,
 - suppliers
 - employees, and
 - communitiesin the presence of incomplete contracts
- ❖ Crucial aspect of BOD □ has decision rights but not ownership rights

Importance of board of directors in India

- ❖ Proper design of the board is very important for India where ownership and management are highly correlated
- ❖ Large responsibility placed on independent directors and composition of the nomination committee
- ❖ Independent directors ought to be independent of the controlling shareholder as opposed to independent of management
- ❖ Pressure of market via disclosures is paramount
- ❖ The Companies Act, 2013 (section 178) and the Clause 49 of Listing Agreement (section IB) recognize the concept of stakeholder

Salient features of Section 135 on CSR in Companies Act, 2013

- ❖ Every company having a net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more, should
 - constitute a CSR Committee of at least 3 directors of which one should be an independent director, and under the guidance of the CSR Committee,
 - spend in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy

Salient features of Section 135 on CSR in Companies Act, 2013, cont...

- ❖ Companies are encouraged to give preference to the local areas for spending the amount earmarked for CSR activities
- ❖ Companies are allowed to collaborate among themselves on CSR projects
 - Could be relevant for small companies with limited CSR budget
 - Could be relevant for co-ordination for project planning
- ❖ Companies can undertake CSR projects through a registered trust, society or company
 - Could be useful for companies which have large resources to spend on CSR
- ❖ The Section provides for an exit clause in that a company that starts CSR but subsequently experiences consistent poor economic performance, need not continue to incur CSR expenditure

Salient features of Section 135 on CSR in Companies Act, 2013, cont...

- ❖ Subsequent to the passage of the Act, the Ministry of Corporate Affairs notified the Rules with respect to CSR on February 27, 2014.
- ❖ Section 135 of the Act along with the Rules, came into force from April 1, 2014.
- ❖ Schedule VII of the Act provides a list of activities that the corporate can potentially undertake, leaving the choice of activities to its discretion
- ❖ List of activities include
 - environment
 - society (education, health, empowerment)

CSR Regulations in India (section 135 of Companies Act, 2013)

- ❖ Balances well the economic concerns and a broader view of the corporation
- ❖ Under the current rules, CSR expenditure is an appropriation from profit and avoids the relevant issue of multiple objectives inherent in the stakeholder theory
- ❖ Companies have flexibility in project choice and implementation
 - which should lead to better project delivery
- ❖ Companies can coordinate CSR efforts
- ❖ Small companies can donate to Prime Minister's Fund and need not use develop in house structures dedicated to CSR

Implementation Challenges

- ❖ Finding adequate projects – especially for big companies
- ❖ Smoothing CSR expenditure – especially for medium and small companies
- ❖ Coordinating with local agencies for implementation and project harmonization
- ❖ Ensuring regional equality in CSR spending and social development
- ❖ Preserving voice of democracy when corporates invests substantial amount in society