The Impact of Mandated Corporate Social Responsibility: Evidence from India's Companies Act 2013

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Overview

- Corporate Social Responsibility (CSR) has generated a vast literature. We use quasi-experimental variation created by Indian law to examine some consequences of CSR activity.
  - Section 135 of India's Companies Act 2013 requires (on a comply-or-explain basis) that firms crossing certain thresholds spend 2% of net profits on CSR.
- Primary Findings:
  - Firm Value: Regression discontinuity combined with event study finds negative 2.6% - 3.3% effect centered on low advertising firms. Coefficient size likely reflects spending, compliance/disclosure, executive time & low private benefits.
  - CSR Spending: Difference-in-difference finds increase in CSR spending (intensive and extensive margins), but firms with >2% before law decline to ~2%.
  - Caveat: Our study examines mandatory CSR rule not firm value effects of *voluntary* rule, or *social value* effects. But our results raise interesting insights on these questions.
- Future/Continuing Work:
  - Gov't could have opted for a straight CSR tax – instead current rule. When is such a rule advantageous: competence/better informed and corruption risks?
  - What activities get most CSR spending?: Short/Medium run payoff?
  - Which providers are receiving the funds? Are firms using their information?

Indian CSR Law – Section 135

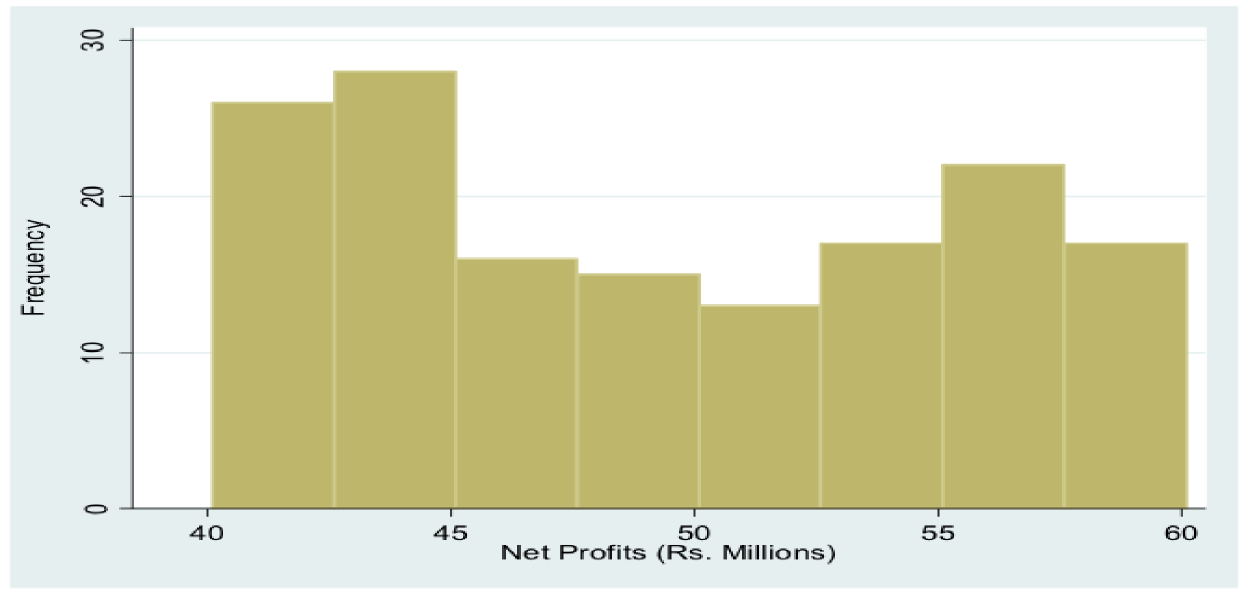
- India is the first country to <u>require</u> (on comply-or-explain basis) some firms to engage in CSR activity.
- Section 135 has multiple parts:
  - Threshold for application – net worth (INR 5 Bn), sales/turnover (INR 10 Bn), net profits (INR 50 Mn ~USD 750K). Net profit is most binding (about median publicly traded firm).
  - Obligations if cross threshold(s):
    - Form CSR committee (at least one independent director) and it must formulate and monitor CSR policy.
    - Disclose composition of CSR committee, firm's CSR policy & ensure follow it.
    - Spend at least 2% of average net profits of last 3 years on CSR or explain why not ("comply-or-explain").
    - Ministry of Company Affairs (MCA) develops rules in 2014 to delineate what is CSR. Very broad, but do not count as CSR any spending undertaken in normal course of business or to benefit employees or political parties or outside India.

Development of CSR provision and event dates

- Initial draft of Companies Act did not have any provision on CSR (JJ Irani Committee (2005)) – that came later.
- Event Dates:
  - **Dec. 2009 -** First hint of CSR – Voluntary guidelines on CSR issued by MCA. Response to concerns about effects of liberalization (not uniform) and its support. Little response by India Inc. in terms of CSR spending increases.
  - **Aug. 6, 2010** – report that Gov't to propose new mandatory CSR rule with thresholds & req'ts (no other provision has thresholds). India Inc. dislikes.
  - Sept. 8, 2010 – Standing Committee on Finance puts forward CSR draft.
  - **Dec. 24, 2010** – Report that draft to be changed to comply-or-explain.
  - Feb. 10, 2011 – more reports of moving to comply-or-explain.
  - March 14, 2011 – more discussion of moving to comply-or-explain.
  - July 11, 2011 – Companies Bill has comply-or-explain language.
  - Dec. 18, 2012 – *Lok Sabha* (lower house of parliament) passes Bill.
  - Aug. 8, 2013 – *Rajya Sabha* (upper house) passes Bill.
  - Aug. 29, 2013 – Presidential Assent.
  - April 1, 2014 – MCA rules on CSR.

Event Study: Identification & Regression Discontinuity Design

- Section 135 has 3 thresholds (net worth, sales and net profits), but in the vast majority of instances it is the net profit threshold (INR 50 Mn) that is binding. This net profit threshold is ~median in Prowess.
- However, concerns with manipulability and volatility:
  - Manipulability – firms near threshold, keep profits below threshold: "bunching" – little strong evidence. Figure 1 (2015):



Identification & Regression Discontinuity Design, II

- Volatility – may lead investors to think firms close to threshold may cross it (bias against finding a result). Test using "donut-hole" RD (Almond & Doyle, 2011) as a robustness check (results are robust).

- Implement RD here using nonparametric local polynomial regressions with a bandwidth that optimizes mean squared error.

Figure 2

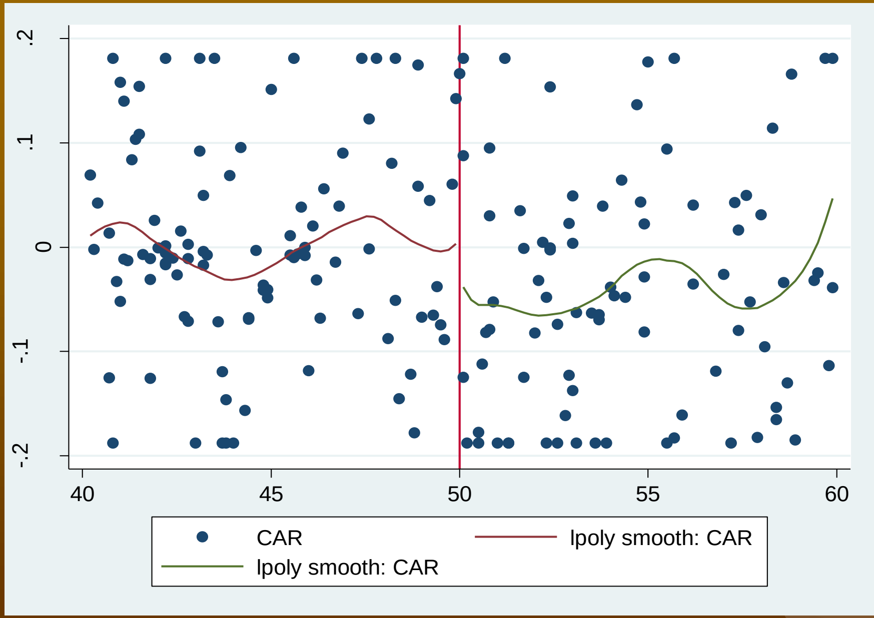
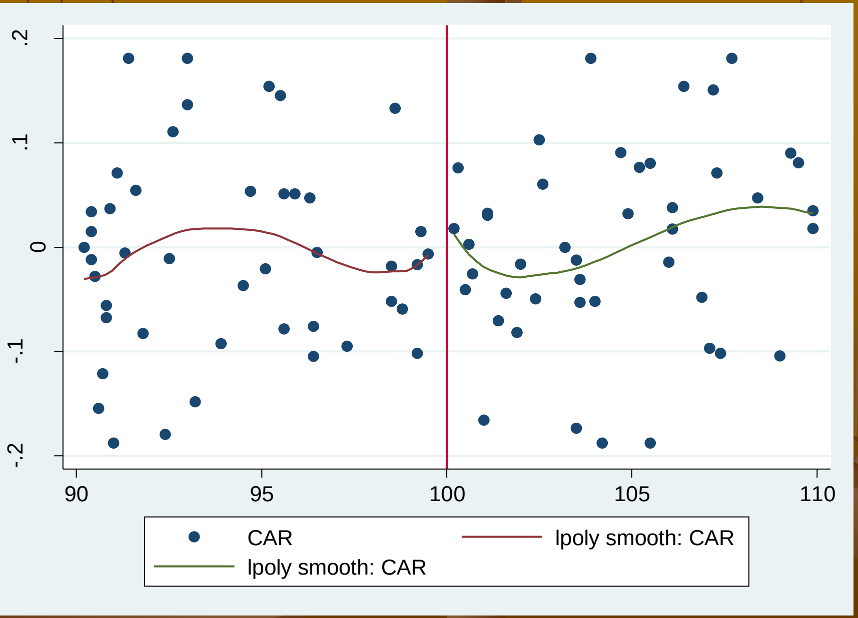


Figure 3



Firm Value Results

- Nonparametric local polynomial regressions:

Event Window (+/- 3 days around date).	Event	RD Estimate
Aug. 6, 2010	Report of mandatory CSR rule with thresholds.	**-0.03318*** (0.01803) (2252)
Dec. 24, 2010	Report of relaxing rule to comply-or-explain	0.01161 (0.01955) (2278)
July 11, 2011	Current Section 135 rule put forward in Bill	-0.00156 (0.01145) (2195)
Dec. 18, 2012	Lok Sabha enacts Companies Bill	-0.01646 (0.01137) (2257)

* significant at 7% level.

NB: Placebo test is insignificant at threshold profits of INR 100 Mn & 150 Mn.

Empirical Strategy & CSR Spending Effects

- "Social and Community" and "Environment-related" expenses as proxies for CSR from 2012-15, but caveat selection issues and missing observations.
- Difference-in-difference (DiD) analysis using panel data from 2012-15 and an RD design.

$$CSR_{it} = \beta(S135_{it}*YR2015_t) + \mathbf{X}_{it}\boldsymbol{\gamma} + \mu_i + g_i t + \delta_t + v_{it}$$

- Where CSR_{it} is CSR spending for firm i in year t.
- $S135_{it}$ is indicator =1 if firm is subject to section 135.
- $YR2015_i$ is a year indicator =1 for when section 135 came into effect.
- μ_i is firm fixed effects, δ_t is year fixed effects and g_i is firm specific time trend for growth in CSR.
- X_{it} is a vector of controls.
- <u>β is the extent to which a treatment firm's CSR spending deviates from its underlying trend following S. 135, relative to the corresponding deviation for unaffected firms. We implement this using estimation in first differences:</u>

$$\Delta CSR_{it} = \beta\Delta(S135_{it}*YR2015_t) + \boldsymbol{\Delta}\mathbf{X}_{it}\boldsymbol{\gamma} + g_i + \zeta_t + \eta_{it}$$

CSR Spending Results I

- Visual depictions – CSR spending by treatment firms increases in 2014 onwards, but treatment firms' spending is volatile (Figure 4). Increase in fraction of treatment firms with positive CSR spending ("extensive margin") after 2014 (Figure 5).

Figure 4

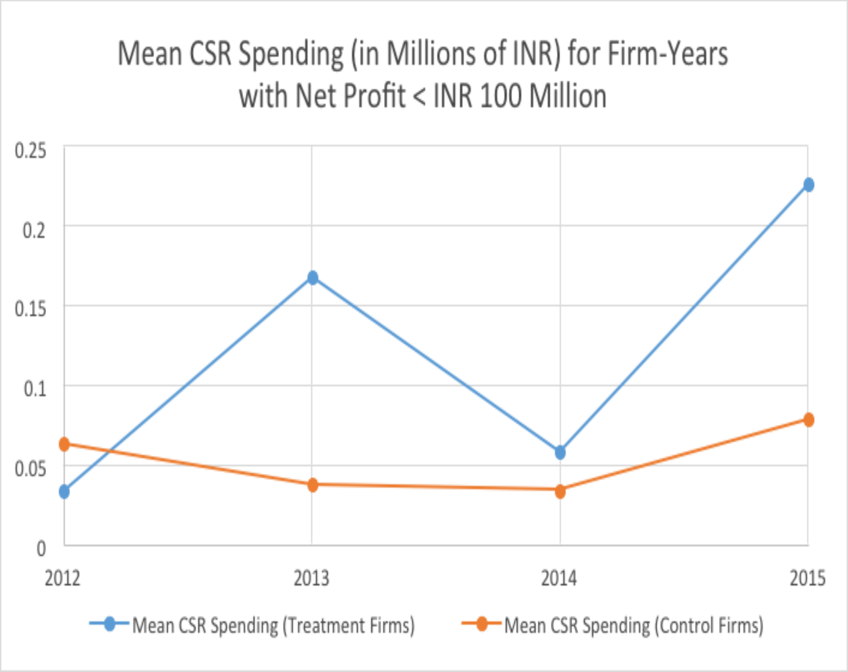
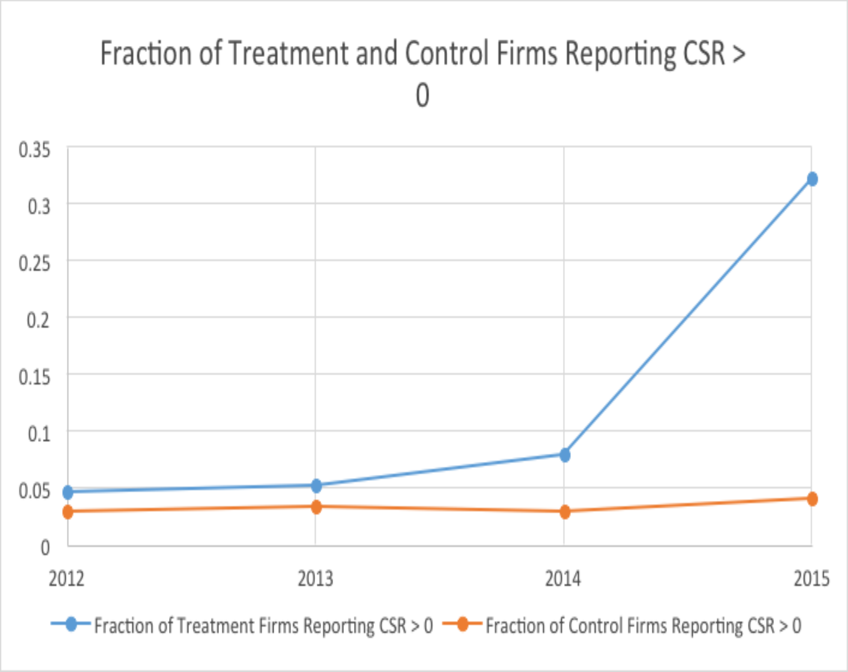


Figure 5



CSR Spending Results III

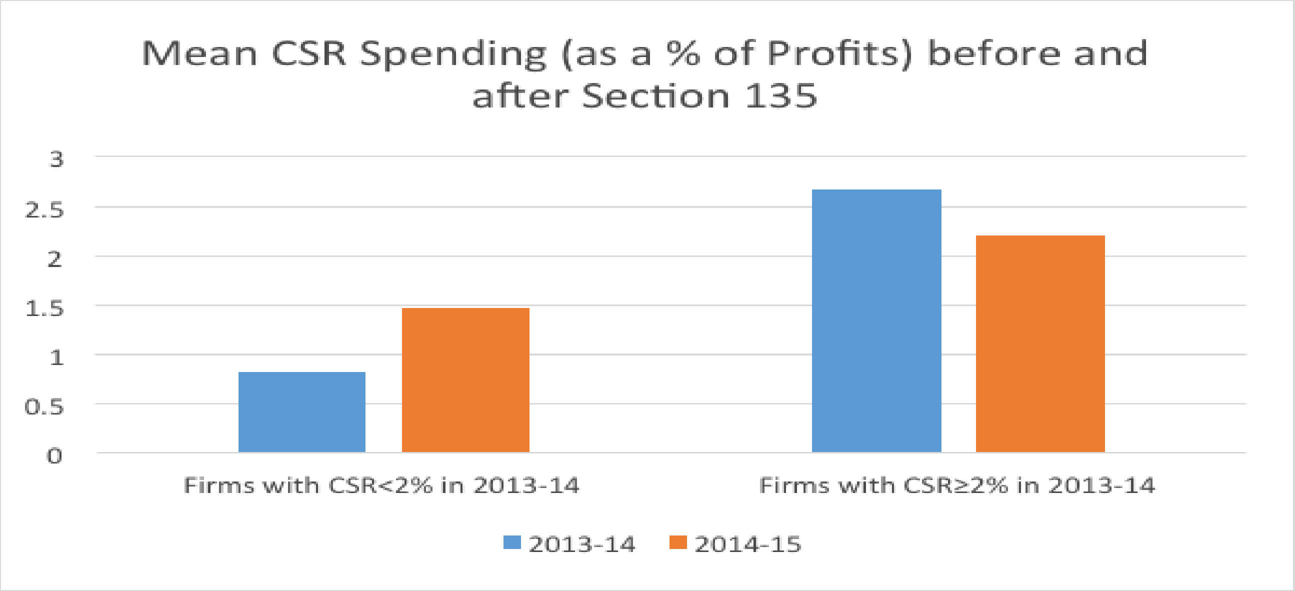
- "Extensive" margin results – the fraction of firms engaging in CSR spending.

	(1) Full Sample	(2) Firm-years with π INR 0-100 Mn	(3) Full sample	(4) Firm-years with π INR 0-100 Mn
DV	*Indicator for CSR spend >0*		*Indicator for Advertising spend >0*	
Indicator =1 is s. 135 applies	**0.32815***** (0.012)	**0.04693**** (0.019)	**-0.02118**** (0.010)	-0.02647 (0.019)
Observations	13770	5659	13770	5659
# of firms	3988	2196	3988	2196

- Large effect on probability of spending +ve amount on CSR (col. 1 & 2).
- Some indication (col. 3) that advertising decreases as s. 135 applies suggesting substitutability between CSR and advertising expenses, though some caution given weaker col. 4 result.
- RD estimates are consistent with this.

CSR Spending of Large Firms (Top 100 Firms)

- Top 100 firms required to disclose business responsibility spending from fiscal 2013 onwards (pre- and post-Section 135 data).
- Appears firms spending less than 2% of net profits on CSR before the law increased their spending, but firms spending more than 2% before the law dropped their spending to ~ 2% after it. This latter category strongly opposed the law reform.



- Could the decline be the result of "mean reversion" – appears not.

Discussion

- Firm Value – decline in firm value for treatment firms.
  - Suggests low private benefits to firms of CSR (given coefficients).
  - Varies across firms – concentrated in low advertising firms. Primary benefit to firms in India of CSR seems to be goodwill or public relations.
  - Caution in how generalizable – CSR firm value effects likely depend on context and timing – Ioannou and Serafeim 2015.

Discussion II

- CSR Spending – overall increase, but decrease by firms doing >2% pre-law (not likely “mean reversion”).
  - Consistent with primary benefit of CSR being goodwill/public relations.
  - Focal point and “anchoring” (Harris and Livingstone, 2002).
  - Mandating CSR crowd out intrinsic aims (Gneezy and Rustichini, 2000).

Discussion III

- CSR Rule vs. Corporate CSR Tax?
  - Contrast S. 135 with a CSR tax: who spends the funds - Gov't employees vs. Firm employees. Firm employees incentives are different (e.g., may want goodwill) and may (i) lead to "better" project selection, (ii) use of private information in directing funds (which may influence others) and (iii) less siphoning of funds. However, firm's incentives may not always align with society's. Future research project… .
  - Begun to examine what firms spend CSR funds on:
    - Short/Medium Run focus.
    - Education – post grad one year programs
    - Healthcare – antibiotics.
  - To whom are firms directing CSR spending?