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CSR in context of Companies Act 2013 and SMEs

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Abstract: India is a country of myriad contradictions. On the one hand, it has grown to be one of the largest economies in the world, and an increasingly important player in the emerging global order, on the other hand, it is still home to the largest number of people living in absolute poverty (even if the proportion of poor people has decreased) and the largest number of undernourished growth which many believe, is the root cause of social unrest. Companies too have been the target of those perturbed by this uneven development and as a result, their contributions to society are under severe scrutiny. With increasing awareness of this gap between the haves and the have-nots, this scrutiny will only increase over time and societal expectations will be on the rise. Many companies have been quick to sense this development, and have responded proactively while others have done so only when pushed. Responsibility Reports mandated by the SEBI for the top 100 companies and the CSR clause within the Companies Act, 2013 are two such instances of the steps taken. The paper attempts to build a common understanding of the concept of CSR and the provisions of the Companies Act, 2013.

Introduction

Meaning of CSR?

The roots of CSR lie in philanthropic activities (such as donations, charity, relief work, etc.) of corporations. CSR is the responsibility of enterprises for their impacts on society. To completely meet their social responsibility, enterprises should have in place a process to integrate social, environmental, ethical human rights and consumer concerns into their business operations and core strategy in close collaboration with their stakeholders. It is also the continuing commitment by business to contribute to economic development while improving the quality of life of the workforce and their families as well as of the community and society at large.

Corporate social responsibility is a management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders. It is generally understood as being the way through which a company achieves a balance of economic, environmental and social imperatives (Triple-Bottom-Line Approach), while at the same time addressing the expectations of shareholders and stakeholders. In this sense it is important to draw a distinction between CSR, which can be a strategic business management concept, and charity, sponsorships or philanthropy. Even though the latter can also make a valuable contribution to poverty reduction, will directly enhance the reputation of a company and strengthen its brand, the concept of CSR clearly goes beyond that. Therefore It can be said that:

- The CSR approach is holistic and integrated with the core business strategy for addressing social and environmental impacts of businesses.
- CSR needs to address the well-being of all stakeholders and not just the company’s shareholders.
- Philanthropic activities are only a part of CSR, which otherwise constitutes a much larger set of activities entailing strategic business benefits.

CSR in India

CSR in India has traditionally been seen as a philanthropic activity. The practice of CSR in India still remains within the philanthropic space, but has moved from institutional building (educational, research and cultural) to community development through various projects. Also, with global influences and with communities becoming more active and demanding, there appears to be a discernible trend, that while CSR remains largely restricted to community development, it is getting more strategic in nature (that is, getting linked with business) than philanthropic, and a large number of companies are reporting the activities they are undertaking in this space in their official websites, annual reports, sustainability reports and even publishing CSR reports.

The Companies Act, 2013 has introduced the idea of CSR to the forefront and through its disclose-or-explain mandate, is 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. It will be interesting to observe the ways in which this will translate into action at the ground level, and how the understanding of CSR is set to undergo a change.

CSR and sustainability

Sustainable development is defined as development that meets the needs of the present without compromising the ability of future generations to meet their own needs. Corporate sustainability essentially refers to the role that companies can play in meeting the agenda of sustainable development and entails a balanced approach to economic progress, social progress and environmental stewardship.

Benefits of CSR

Communities provide the licence to operate: Many companies have started realising that the 'licence to operate' is no longer given by governments alone, but communities that are impacted by a company's business operations. Thus, a robust CSR programme that meets the aspirations of these communities not only provides them with the licence to operate, but also to maintain the licence, thereby precluding the 'trust deficit'.

Attracting and retaining employees: Several human resource studies have linked a company's ability to attract, retain and motivate employees with their CSR commitments.

Communities as suppliers: There are certain innovative CSR initiatives emerging, wherein companies have invested in enhancing community livelihood by incorporating them into their supply chain. This has benefitted communities and increased their income levels, while providing these companies with an additional and secure supply chain.

Enhancing corporate reputation: The traditional benefit of generating goodwill, creating a positive image and branding benefits continue to exist for companies that operate effective CSR programmes. This allows companies to position themselves as responsible corporate citizens.

The Companies Act, 2013

In India, the concept of CSR is governed by clause 135 of the Companies Act, 2013, which was passed by both Houses of the Parliament, and had received the assent of the President of India on 29 August 2013. The CSR provisions within the Act is applicable to companies with an annual turnover of 1,000 crore INR and more, or a net worth of 500 crore INR and more, or a net profit of five crore INR or more. The new rules, (applicable from the fiscal year 2014-15 onwards) also require companies to set-up a CSR committee consisting of their board members, including at least one independent director.

The Act encourages companies to spend at least 2% of their average net profit in the previous three years on CSR activities. The ministry's draft rules, that have been put up for public commitment, define net profit as the profit before tax as per the books of accounts, excluding profits arising from branches outside India.
The indicative activities which can be undertaken by a company under CSR have been specified under Schedule VII of the Act

- Promotion of education,
- Eradication of extreme hunger and poverty,
- Gender equality and women empowerment,
- Reducing child mortality and improving maternal health,
- Combating HIV-AIDS, malaria and other diseases,
- Contribution to Prime Minister's relief fund and other such state and central funds,
- Social business projects,
- Environmental sustainability,
- Employment enhancing vocational skills,

- And such other matters a may be prescribed.

Some of the highlights of the draft rules (as of September 2013) are as follows:

- Surplus arising out of CSR activities will have to be reinvested into CSR initiatives, and this will be over and above the 2% figure.
- The company can implement its CSR activities through the following methods:

✓ Directly on its own
✓ Through its own non-profit foundation set-up so as to facilitate this initiative
✓ Through independently registered non-profit organizations that have a record of at least three years in similar such related activities
✓ Collaborating or pooling their resources with other companies

- Only CSR activities undertaken in India will be taken into consideration
- Activities meant exclusively for employees and their families will not qualify
- A format for the board report on CSR has been provided which includes amongst others, activity-wise reasons for spends under 2% of the average net profits of the previous three years and a responsibility statement that the CSR policy, implementation and monitoring process is in compliance with the CSR objectives, in letter and in spirit. This has to be signed by either the CEO, or the MD or a director of the company.

Governance

Clause 135 of the Act lays down the guidelines to be followed by companies while developing their CSR programme. The CSR committee will be responsible for preparing a detailed plan on CSR activities, including the expenditure, the type of activities, roles and responsibilities of various stakeholders and a monitoring mechanism for such activities. The CSR committee can also ensure that all the kinds of income accrued to the company by way of CSR activities should be credited back to the community or CSR corpus. For effective implementation, the CSR committee must also oversee the systematic development of a set of processes and guidelines for CSR to deliver its proposed value to the company, including:

- one-time processes such as developing the CSR strategy and operationalizing the institutional mechanism
- Repetitive processes such as the annual CSR policy, due diligence of the implementation partner, project development, project approval, contracting, budgeting and payments, monitoring, impact measurement and reporting and communication.

Reporting

The new Act requires that the board of the company shall, after taking into account the recommendations made by the CSR committee, approve the CSR policy for the company and disclose its contents in their report and also publish the details on the company's official website, if any, in such manner as may be prescribed. If the company fails to spend the prescribed amount, the board, in its report, shall specify the reasons.

CSR and SMEs

What are SMEs?
Small and medium enterprises (SMEs) significantly contribute towards India's economic growth. These serve independently and also as ancillary to larger units and help generate employment and industrialize the rural and backward regions of India. They employ nearly 40% of India's workforce and contribute around 45% to India's manufacturing output.

What do they do?
The business activities of SMEs are performed in proximity to the locals. This enables them to be aware of community needs, manage expectations and develop CSR programmes appropriately.

Eligible companies in a specific geographic area combine and pool their resources for funding CSR activities. The CSR activities of these enterprises are driven by the personal interests of promoters who hold a significant financial stake in the business. They tend to be in clusters and engaged in similar business activities. While the quantum of revenue available for CSR with individual SMEs is expected to be small, all eligible companies in a specific geographical cluster, who single handed as well as collectively impact the same community, can pool their resources to create a sizeable CSR fund.

Why collaboration of SME's is required for CSR initiatives?
CSR is for all companies. SMEs in India have participated in CSR activities but these efforts have not been optimally delivered. One possible reason can be the fact that CSR activities depend on the profits of an SME and any fluctuations in profits can adversely affect their capability to continue their contribution for CSR. Another reason can be the limited human resources available to SMEs which may also result in the lack of a professional approach. SMEs tend to focus on short-term activities that involve lesser operational costs. 31% to 79% of the SMEs in these clusters prefer charity donations rather than long-term programmes for local communities. With the introduction of the new Companies Act, 2013, the SME's approach to CSR has to be modified while keeping operational costs low. One viable alternative is to pool resources with other SMEs in the cluster and create joint CSR programmes managed by a single entity. This collaboration can be formed within the units in a cluster as they interact with the same communities and have already established associations that cater to the business needs of the units.

Collaboration has the following advantages:

Reduces operational cost: Individual CSR efforts by a company consist of establishing a CSR department, assessing the needs of local communities, undertaking programmes directly or through an NGO and conducting regular impact assessment studies. A common organization catering to a number of companies will carry out these activities collectively and thus reduce the operational cost of management.

Undertake long-term projects: A major hindrance in developing long term projects is the uncertainty in the CSR budget. A fluctuating performance implies that the CSR budget allocations can be unreliable. Pooling resources addresses this issue to a certain extent as the other partners can increase their share in case there is variance in allocation from a certain segment of the cluster. Long-term programmes lead to better community relations and this ensures avoiding situations of community unrest that hamper business activities.

Learning from experiences: A common entity with multiple participants from the cluster will help assess community needs, undertake relevant programmes based on past experiences and address a greater number of community issues.

Collaboration among the SMEs in a cluster also provides an opportunity to manage social and environmental issues and respond better to the pressure from buyers, who are trying to establish ethical supply chains and gain appreciation from the international community. The CSR policy of individual SMEs should be designed to allow for flexibility in case of a collaborative effort to undertake CSR. This implies that a policy should allow Flexibility in selecting thematic areas from Schedule VII of Companies Act 2013, beneficiary groups and geographies as per the priorities of the entire association and Support to initiate CSR programmes to the extent possible, in case the association is abandoned. In cases where the total CSR funds are insufficient to cover the cost of collaboration, SMEs can also contribute to the Prime Minister's National Relief Fund or any other fund set up by the central government or the state governments as per activity ix of the Schedule VII of the Companies Act, 2013.

Conclusion

Every single major policy initiative in this country has been driven with a perspective that an overwhelming concern for the disadvantaged and marginalised, a multidimensional view of poverty and human deprivation, the focus on our fundamental rights and the need to expand opportunities while ensuring its equal distribution are fundamental for achieving strong human development. But disparity, inequality and the growing divide in our societies define our existence today. The inclusion of the CSR mandate under the Companies Act, 2013 is an attempt to supplement the government's efforts of equitably delivering the benefits of growth and to engage the Corporate World with the country's development agenda.

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