



ILLUSTRATION BY BINAY SINHA

In order to ensure accountability and better enforcement to strengthen the corporate social responsibility (CSR) and compliance management, the government had introduced a Bill last month to amend the Companies Act to restructure provisions about unspent funds for CSR and impose penalty on firms and officials not adhering to these provisions. Aneel Karnani tells Aditi Phadnis how the law is fundamentally flawed, and why India needs not just economic but inclusive development. Edited excerpts:

'In CSR, outcomes matter more'

The number of firms complying with CSR has increased year after year and latest data suggests 90 per cent firms registered in India are now CSR compliant. But your argument is that the CSR law may have actually brought down, rather than sent up, company spends on this activity, especially those companies that were spending more than 2 per cent of their profits earlier...

Based on a study of the 100 largest Indian firms, Professors Dharmika Dharmapala and Vikramaditya Khanna found that while firms that were initially spending less than 2 per cent increased their CSR activity, but those that were initially spending more than 2 per cent reduced their CSR expenditures. It is possible that the 2 per cent level intended as a threshold becomes an unintended focal point (or an anchor), both a floor and a ceiling.

However, there is a bigger issue here. According to PRIME Database, Indian firms collectively spent more on CSR projects than

required by law. The Indian press in general sees this as positive and, on this basis, argues that the CSR law has been a success. This is a fallacy. What matters is not the amount of money spent, but rather the outcomes achieved. There is no attempt by the government nor the press to even attempt to measure the outcomes. The real issue is whether some other mechanism could have been achieved more societal good with the same money.

It is impossible to have true responsibility (the 'R' in CSR) without accountability. In a private company, if the managers behave irresponsibly, the shareholders hold the managers accountable and can fire the managers. In a democracy the citizens hold the government officials accountable and can "fire" them at the next election. But, under the CSR law, if the managers do not spend the CSR funds in a responsible manner, nobody holds them accountable. It is significant that the focus of the CSR law is on money spent, not results achieved. It is somewhat like shareholders

rewarding managers for how high their costs are rather than profits achieved.

Now, the government, for 10 per cent of the non-compliant firms has effected an amendment in the law that mandates a prison term for officials in those companies that do not comply. Isn't this like using a hammer to crush a fly? Despite the finance minister's assurance that the law would not be implemented, the fact is, it continues to exist on the statute books.

The original law did not even discuss, let alone define, an enforcement mechanism or penalties for non-compliance. The law was an enforcement nightmare, exacerbating an already bad situation where many laws are poorly enforced in India, and further undermined respect for law. Now the enforcement is being strengthened, or at least potentially strengthened — and simultaneously weakened by the finance minister giving a bizarre assurance that the law would not be implemented. This is symptomatic of a larger problem in India: Too many laws that are not enforced nor obeyed.

The definition of what constitutes CSR has been broadened. So you have state-owned companies now spending money to build statues of historical leaders and justifying this as CSR activity. The next step would be to deploy CSR funds to build statues of gods and goddesses... Should CSR be defined more liberally? Or would its purpose be served better if it was defined more rigorously?

CSR is a controversial idea with many executives, academics and officials on both sides of the issue. According to two researchers at the United Nations, Peter Utting and Jose Carlos Marques, "CSR thinking is largely ahistorical, empirically weak, theoretically thin and politically naive." Nobel Prize economist Milton Friedman argued that discussions of CSR are notable for their "analytical looseness and lack of rigor" — apparently not much has changed since that observation in 1970, especially in India.

Thus it is not surprising that the Indian law does not clearly define CSR for the purposes of expenditures. The law lists only a few genres of CSR activities: "Eradicating extreme hunger and poverty," "promotion of education," and "social business projects." This is much too vague to work as a legal definition — it is another way the CSR law is designed for weak enforcement. The vague definition of CSR also opens up much room for wasteful expenditures and even corruption.

Despite a strong tradition of voluntary philanthropy, India has a law to enforce philanthropy by companies. What, in your view, are the faults in the design?

The CSR law is fundamentally flawed. The concept is controversial, and experts do not

even agree on how to define it, but both critics and enthusiasts agree that CSR is voluntary by its nature. Because CSR is voluntary, it precludes a legislative agenda by definition.

Mandatory CSR is inherently contradictory. CSR is an aspirational exercise, and it is not feasible to legislate aspirations. Laws only set minimum standards. For example, law can mandate expenditure on education, but it cannot mandate companies build "excellent schools." If CSR expenditure is no longer voluntary and becomes mandatory, it is no longer CSR — it is just a tax. This is a hidden way to increase corporate taxes. Given the need for economic growth and economic liberalisation, it is unlikely the Indian polity desires an increase in corporate taxes. The corporate tax rate in India is already very high by international standards. Increasing taxes certainly will not help to make Indian firms more globally competitive nor attract more foreign investment into India and is not conducive to economic development.

What India needs is not just economic development, but inclusive development. Even to the extent that the

CSR law has resulted in a real increase in socially beneficial expenditures, the spending has not gone to democratically determined priorities, but rather to whatever the companies prefer to emphasise. The CSR law works like a centralised tax with decentralised expenditures undertaken by private (unelected) parties according to their own priorities. This is clearly contrary to the fundamental logic of democratic governance. It is in effect taxation without representation.

It is the government's responsibility to determine high-priority needs of society and target public expenditures in these areas to achieve the nation's goal of inclusive economic development. With the CSR law, the government has abdicated one of its primary functions and responsibilities.

Inequality in India, which was already high, has increased even more. The CSR law does not go far enough in reducing inequality and helping the disadvantaged. Inequality in India has several dimensions; an important one is geographic inequality. Some parts of India enjoy significantly higher levels of industrial development and per capita income than other parts. It is the responsibility of the central government to help achieve a geographically more egalitarian society. Perversely the CSR law helps entrench the current geographic inequality in development. A few states that are more industrialised account for a disproportionate share of all CSR spending. This, of course, reflects the inclinations, interests, and priorities of the business sector.

Without appropriate enforcement, and without an emphasis on accountability of results achieved (not funds spent), it is very unlikely that the CSR law will result in real effectiveness. But it does give the illusion of progress. This is "greenwashing" on a national scale.



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