Quarterly Briefing

NSE Centre for Excellence in Corporate Governance

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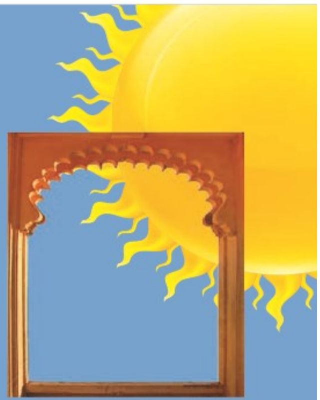
Statutory CSR under Companies Act – Stylized Facts and Way Forward



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Executive Summary

- The legal provision mandating CSR expenditure for all listed companies satisfying certain specified criteria came on 30th August 2013 under the Companies Act, 2013.
- An analysis of the first two years of data on CSR expenditure shows that;

  - A small number of large, profitable companies account for the bulk of the CSR expenditure.

  - Education, health and environmental sustainability together account for about half of the total CSR expenditure.

  - Contribution to government relief funds is picking up sharply, perhaps because the smaller companies find it a very convenient route.

  - The distribution of CSR expenditure across states is also highly skewed, with Maharashtra accounting for about one-fourth. There are indications that CSR expenditure is relatively high in states with high concentration of factories.

- An analysis of these early trends could provide useful insights to review the implementation framework of CSR and fine-tune it in the coming years so that CSR activities can better attain the objectives for which they were designed.

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I. Introduction

Section 135 of the Companies Act, 2013 that came into effect from August 30th, 2013 had made expenditure towards meeting corporate social responsibility (CSR) mandatory for all listed companies satisfying certain specified criteria. Statutory CSR has been lauded in policy circles as a "historical opportunity" that could be a "game changer" for India where corporates would work hand in hand with the government and civil society to bring about "national regeneration" through sustainable development. Unorthodox as it may seem, some have argued that for an emerging market like India, statutory CSR may be an instrument to pursue a "middle path" between a liberal and a regulatory state so as to balance growth with social stability. In fact, statutory CSR for corporates could be beneficial for both the government as well as the companies, the latter because of the increasing emphasis put by investors on the environmental, social and governance (ESG) framework for valuing companies. [2]

It is about four years since the provisions of Section 135 came into effect and it seems appropriate to examine the emerging trends with respect to CSR expenditure in India. In particular, how much resources are being generated under the statutory CSR regime, what is its distribution across companies, which are the sectors that are attracting most of the CSR expenditure and which are the states in which most of the CSR expenditure is taking place? An analysis of these early trends could be helpful for both the companies as well as the government to review the implementation framework of CSR and fine-tune it in the coming years so that CSR activities can better attain the objectives for which they were designed. This Quarterly Briefing is a modest attempt towards these simple goals.

II. Provisions of Section 135 of the Companies Act, 2013

Section 135 of the Companies Act, 2013 specifies that every company having net worth of Rs 500 crore or more, or turnover of Rs1000 crore or more, or net profit of Rs 5 crore or more during any of the three preceding financial years (as per circular no. 21/2014 dated June 18, 2014), should 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 CSR Policy (MCA, 2013). The Act prescribes that the company shall give preference to the local area and areas around it where it operates for spending the amount earmarked for CSR activities. The Act requires the covered companies to set up a CSR committee of at least 3 directors (one independent director) which will formulate a CSR policy, recommend the amount of expenditure to be incurred on various activities and monitor the CSR policy of the company from time to time.

Subsequent to the passage of the Act, the Ministry of Corporate Affairs notified the CSR Rules on February 27, 2014 (MCA, 2014a) listing out the specific activities on which the companies are free to spend the amount earmarked under their CSR Policy. [3] Notable among these are education and vocational training, health, eradication of poverty and hunger, promotion of gender equality and women empowerment and environmental sustainability and ecological balance. The provisions of Section 135 and the Rules framed under them came into force from April 1, 2014.

III. Stylized Facts

The stylized facts of the initial pattern and trend of CSR expenditure discussed in this quarterly bulletin is based on the data sourced from the PRIME Database, which provides CSR expenditure amounts of NSE listed companies. So far, such data are available only for the financial years 2014-15 and 2015-16, the first two years since the provisions of Section 135 came into effect. [4]

[2] This idea is also reflected in SEBI's LODR regulations that the top 500 listed companies disclose their expenditure on CSR activities in the Business Responsibility Reports (BR Reports) accompanying the Annual Reports, a requirement that represented a move towards integrating social responsibility with corporate governance. https://www.sebi.gov.in/sebi_data/attachdocs/1344915990072.pdf

[3] The list of activities specified in the Notification of April 27, 2014 is a slight reorganization of the order and the list specified under Schedule VII of the Companies Act, 2013.

[4] www.nseinfobase.com

a. Stylized Facts – Companies

In the year 2014-15, of the 1270 NSE listed companies, 894 companies came under the purview of Section 135 (Table 1). Of these 894 companies, 758 companies, or 85% undertook CSR expenditure for a total of Rs. 6521 crore, [5] as against the total minimum mandated CSR expenditure of Rs 8115 crore under the provisions of Section 135 (i.e. 2% of average net profit). 2014-15 being the first year of implementation of the statutory CSR regime, it was not surprising that a large number of companies (421) spent less than the minimum mandated amount; the shortfall being Rs. 2355 crore or about 30 %. Noticeably, there were about 115 companies which spent Rs. 761 crore more than what was required of them under the CSR provisions. In the second year (2015-16), there was both an increase in the number of companies that came under the purview of CSR, and improvement in compliance rate. As a result, the total CSR spend rose sharply by about 29 %.

Table 1: Statutory CSR by Companies

Variables	2014-15	2015-16
Total number of companies	1270	1391
Companies applicable for CSR	894	944
Companies that incurred CSR	758	864
CSR amount - mandated (Rs. Crore)	8115	9140
CSR amount - spent (Rs. Crore)	6521	8396
CSR amount - unspent (Rs. Crore)	2355	1928
CSR amount - overspent (Rs. Crore)	761	1184

Note: All amounts pertain to companies that incurred CSR
Source: Prime Database

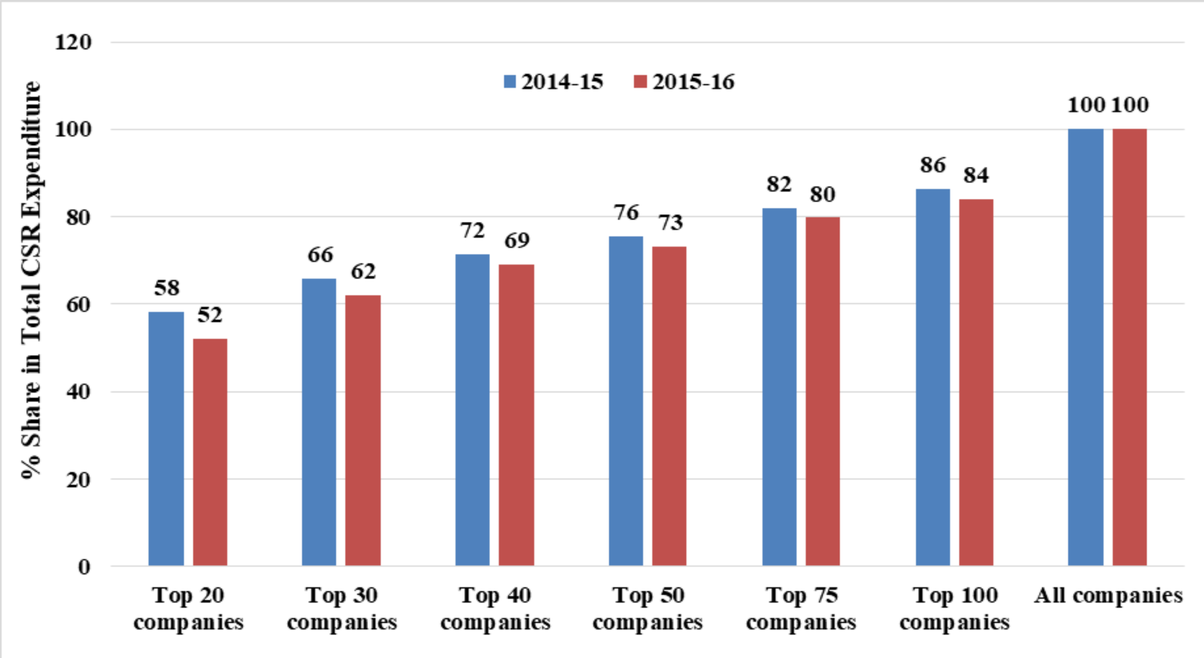
Furthermore, we observe that in 2015-16 again, about 205 companies spent Rs. 1184 crore more than the mandated amount. One possible reason of these overspends could be that while in the voluntary regime prevalent earlier, the mere undertaking of CSR activity constituted a signal of social consciousness given that companies were not required by law to undertake the activity, the value of this signal is reduced in the statutory regime and over compliance becomes one way of retaining that signal value.

How does the CSR spend differ across companies? Total CSR resources generated under Section 135, though applicable to all listed companies satisfying certain specified criterion, is concentrated among a limited number of companies. In 2014-15, the mean CSR spend was Rs. 8.6 crore, while the median spend was much lower at only Rs. 80 lakhs suggesting that a small number of companies were incurring disproportionately large amounts of CSR expenditure. This is confirmed by the percentile distribution which shows the top one per cent of the companies (about 8) spent in excess of Rs. 171 crore on average, as against the overall average spending of Rs 8.6 crore. This skewed nature of distribution of CSR spends across companies in 2014-15 remained broadly the same in the financial year 2015-16 and is further illustrated in Figure 1.

The Ministry of Corporate Affairs (MCA) collates and compiles the CSR data for all qualifying companies and therefore maintains a much wider database of CSR spends. According to that database, a total of 5097 companies undertook CSR expenditure in 2015-16 which is about six times the number of companies (864) covered by the Prime Database. The total CSR expenditure of these 5097 companies came to Rs. 9822 crore. Thus the qualifying NSE listed companies accounted for nearly 87% of the total spend recorded by MCA reiterating our finding that a very large number of companies are collectively contributing only a small fraction of the total CSR amount. This has implication regarding the cost and benefit of CSR when judged in terms of the potential implementation, monitoring and compliance costs both from the viewpoint of the government as well as the companies.

[5] It is possible that some of the companies that did not make any CSR expenditure, because they did not make any net profits.

Figure 1: Dominance of CSR Expenditure by Top Companies



Source: Prime Database

Furthermore, does the CSR framework have any impact on the viability of the CSR projects of companies, because of the linkage of CSR spends with net profits? As the economy or some of its sectors get into a down cycle, the profitability of companies in general or those in the affected sectors, is likely to get depressed. The implication is that the mandated expenditure of those companies passing through bad times may be less than what is required to make the CSR projects viable. Of course, the companies can spend more than what is required of them; but can they, given that they are in trouble? Two years' data, which is what we have, is not enough to reach any conclusion; but, it is a trend worth monitoring. The cyclical fluctuation in net profits may not affect larger, more profitable companies; but will certainly impact the sustainability of CSR projects of smaller companies. This might have unintended consequences on the beneficiaries as well as the success of some projects which require continuing engagements.

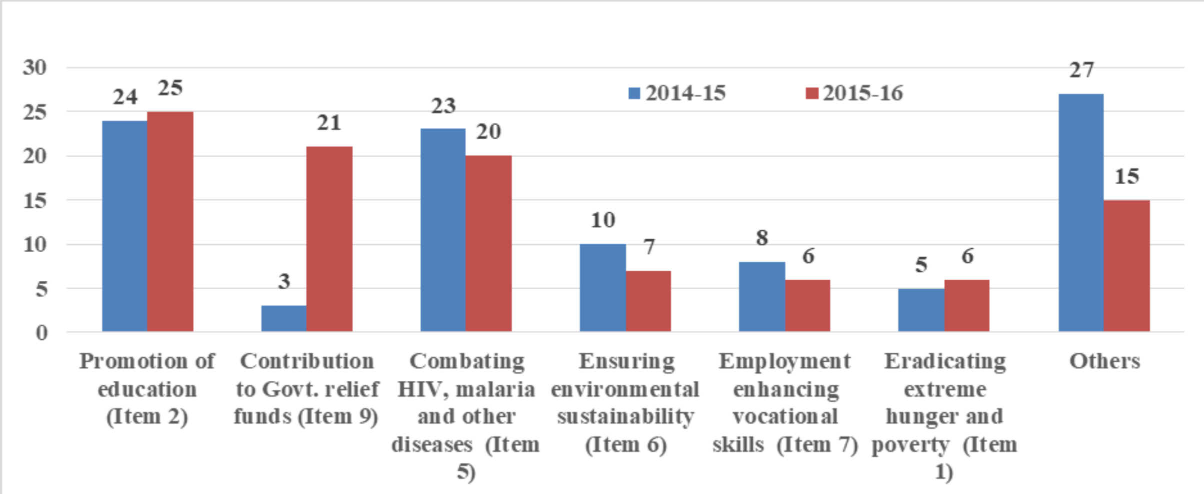
b. Stylized Facts – Distribution by Activity

Schedule VII of the Companies Act, 2013 provides an itemized list of ten broad activities in which companies can undertake their CSR expenditure. Figure 2 shows the distribution of CSR expenditure into these activities. Clearly, in both the years, education, health, environmental sustainability and vocational training were the top sectors attracting substantial CSR expenditure.

One noticeable feature from Figure 2 is the significant increase in the percentage of CSR expenditure that went into Item (ix) [6] namely contribution to the Prime Minister's National Relief Fund or any other fund set up by the central government or the state governments for welfare purposes. The total expenditure towards this item increased from Rs. 167.71 crore (share of about 3%) in 2014-15 to Rs. 871.56 crore (share of about 10%) in 2015-16. This item provides a convenient route for smaller companies to meet their CSR obligation without having to create in-house capabilities for identifying and monitoring CSR projects which may be too costly for them.

[6] Item (ix): Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women.

Figure 2: Percentage Distribution of CSR Expenditure



Notes: The category 'Others' include 'Social business project', 'Promoting gender equality and empowering women', 'Reducing child mortality and improving maternal health', 'Such other matters as may be prescribed'.

All categories excluding 'Others' are sorted in descending order of % CSR Expenditure in total.

Source: Prime Database

c. Stylized Facts – Distribution by State

Figure 3 gives the pattern of state-wise total, and per capita CSR expenditure of companies for the year 2015-16 with the states sorted in descending order of their per-capita net state domestic product so that richer states appear first. [7] Amongst the richer states excluding the union territory of Delhi, Maharashtra by far received the highest total amount of CSR expenditure at Rs. 1138 crore which was about one fourth of the total CSR expenditure made by companies. Although Karnataka and Andhra Pradesh were in the middle of the per capita income distribution, were distant second and third accounting for about Rs. 400 crore CSR expenditure with a share of about 8%. They are followed by Gujarat and Uttar Pradesh with a share of 7% each, though Gujarat is one of the richer states and Uttar Pradesh is the second lowest state in terms of per capita income. The distribution in 2014-15 is similar. The concentration of CSR spends in certain states is not surprising, given that (a) companies have inherent incentives to earn social capital from the immediate community especially if their operation leads to undesirable polluting activities and (b) the CSR provisions encourage companies to give preference to local areas due to reasons of practicability. Thus states with a greater concentration of factories are expected to see more CSR spends.

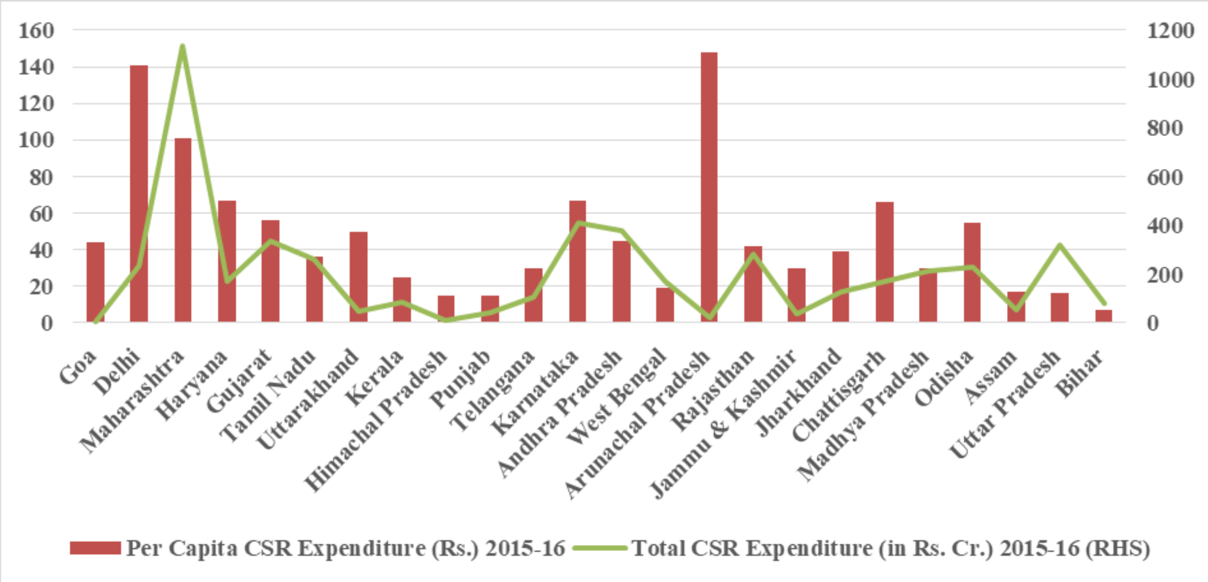
The pattern of state-wise *per-capita* CSR expenditure shows that there is no clear relationship between per capita CSR expenditure and per capita income across states. Arunachal Pradesh which is in the middle of the per-capita income distribution, receives highest per capita CSR expenditure among all states. Haryana, Karnataka and Chhattisgarh receive high per-capita CSR expenditure which are almost similar, although these states are from high, middle and low income groups respectively.

IV. Way Forward

What do these stylized facts suggest? Let us take them one by one. The first one is that the bulk of the total CSR expenditure of the corporate sector are accounted for by a small number of large companies. In view of the same, it may be wise to have a simplified procedure for implementing and monitoring the CSR expenditure of these small, less profitable companies keeping in view the compliance and monitoring costs.

[7] The state-wise distribution of CSR expenditure is based on the MCA database that provides CSR data at the state level. Many companies carry out CSR projects that are spread over multiple states. The MCA database classifies expenditure on such projects as "All India". Out of the Rs. 9883 crore CSR expenditure that was incurred by companies in 2015-16, Rs. 4871 crore was on "All India" projects. The above distribution is based on single state projects which account for Rs. 4951 crore in 2015-16.
Tribes, other backward classes, minorities and women.

Figure 3: Total and Per Capita CSR Expenditure with States Sorted by Descending Order of Per Capita NSDP: 2015-16



Source: Ministry of Corporate Affairs and Reserve Bank of India

The second trend relates to the distribution of CSR spends across activities. It is seen that a relatively higher emphasis is placed on projects related to education and health which are encouraging patterns. However, it is important to emphasize that CSR expenditure is only an *input* to the "social production" process which does not guarantee the desired *outputs*. So, there is a need to undertake periodic impact assessment studies to evaluate the performance of their CSR projects, without which CSR may become just a "tick-box" regulation.

Finally, the distribution of CSR expenditure across states shows that in future, companies need to consider the economic status of states in which their CSR expenditures are to be incurred. Assuming a fifteen per cent annual growth rate in CSR expenditure that can come through increase in net profits, extended coverage, and higher compliance, CSR expenditure can touch upwards of Rs. 40,000 crore in the next ten years. This will be a sizeable amount and it may be appropriate for the MCA to carry out harmonization so that regional equality becomes a consideration in the distribution of CRS spends of companies. One solution could be that companies in industries which do not have a definite location, such as financial services and information technology, make more of their CSR expenditure in the lower income states.

References

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