SAMHITA SOCIAL VENTURES

THE COMPANIES BILL 2012 – IMPLICATIONS FOR CSR

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Executive Summary

The passage of the revamped Companies Bill in the Rajya Sabha on 8th August 2013, has ushered in a new regulatory stance towards corporate social responsibility (CSR) in India. The Bill, which should get enacted into law soon, lays down mandatory requirements in regards to CSR for larger companies (those with at least Rs5Cr net profit/Rs500Cr net worth/Rs1,000Cr turnover), which includes a requirement to spend annually at least 2% of average profits of the previous three years on CSR activities. An estimated 7-8,000 companies in India will be covered under the CSR legislation and the total annual spend, if companies were to meet this norm, could be equivalent to US$1-2bn.

Encouraging strategic CSR

While most discussions in the run-up to the passage of the Bill have focussed on the 2% ‘surcharge’ on corporates’ profits, the moral issues around the government mandating CSR and the potential for misuse of mandated CSR spending, a closer look at the provisions on CSR (Sec 135 of the Bill) reveal that considerable thought has gone into delivering a regulatory framework that nudges companies to start thinking strategically about CSR and aligning these efforts to addressing stakeholder/community needs.

Focus on governance and accountability

The Bill clearly demarcates CSR from charity and does not position it as a ‘moral responsibility’ for companies. The accent appears to be on employing standard business principles to develop and roll-out CSR strategies and programs, so as to optimise resources and maximise impact. By requiring CSR policy formulation and monitoring to be governed by a Corporate Responsibility Committee (CSRC) comprised of at least three directors (one of whom should be a non-independent director), the Bill is ensuring that CSR becomes a Board level agenda and is therefore viewed strategically and subject to a high level of scrutiny within the company. The activities to be undertaken need to be clearly spelt out in the CSR Policy, approved by the Board, monitored carefully and will need to be disclosed in the Directors Report; a CSR ‘return’, akin to an Income Tax return will have to be filed each year. There are fines and/or imprisonment stipulated for non-compliance on disclosures.

Approach and evaluate based on business principles

Although the exact rules/guidelines for compliance with the regulation and reporting formats will come out in a subsequent notification, the drafts that were circulated for comments provide adequate perspective on the regulation’s orientation towards efficiency and impact; activities allowed for CSR spending will need to be in the form of ‘projects’, engagement of experts for implementation is encouraged and monitoring and impact assessment of project is recommended. The rules also exclude spending on employee benefits from 'allowed CSR' and underscore that beneficiaries of programs should be clearly identifiable. Donations to specified government funds should be viewed as a last option.

Huge capacity building requirement

While there are no stated penalties for companies that fall short of the spending targets, we believe the intent of the Bill is to nudge companies to achieve those benchmarks over a period of time. But this will require a huge degree of capacity building within corporate India, notwithstanding the well-developed CSR culture that some leading companies have developed and put into action over decades. For most, the new regulation will necessitate capacity building in regards to CSR – in terms of understanding the regulation, developing policies, building a governance structure, evaluating and deciding on programs, choosing partners, monitoring and assessing impact of programs. Probably in recognition of this, the Ministry has included expenditure on training on CSR under 'allowed' expenditure, but we would expect that ambiguities around implementation will be fully resolved only with time.

This capacity building challenge will likely be significant for implementation partners as well – since most NGOs will not be equipped to absorb the significantly higher support (and thus the scale-up in operations) that could arise from the step-up in CSR spend by corporates (we estimate current spending to be significantly below the 2% norm).

While the ecosystem will undoubtedly build-up to meet this demand, corporates will need to understand the landscape across different development sectors, evolve those strategies that are impactful and yet most appropriate to their needs and find the right implementation partners programs to help them deliver.

1 Background

The Companies Bill 2012, intended to replace the existing Companies Act of 1956, has been finally passed by Upper House of Parliament (Rajya Sabha) on 8th August 2013. It was earlier passed by the Lower House of Parliament (Lok Sabha) on 18 December 2012. The Bill, which could now get enacted into law in the next few weeks, lays down mandatory requirements in regards to CSR for larger companies (those with at least Rs5Cr net profit/Rs500Cr net worth/Rs1,000Cr turnover), which includes a requirement to spend at least 2% of annual net profit on CSR activities.

2 The Companies Bill 2012 and CSR

The provisions relating to CSR are covered in Section 135 of the Bill, though Sections 181, 197 and 198 are also referenced to provide definition and clarifications for some items. In addition, Schedule VII of the Bill lists out the activities that may be undertaken under the ambit of CSR.

2.1 Which companies will need to comply with the Bill on CSR?

The Bill deems CSR a mandatory requirement for companies that meet any one of the following thresholds on financial performance/position in any financial year;

- Net profit of at least Rs5Cr
- Net worth of at least Rs500Cr
- Turnover of a minimum of Rs1,000Cr

2.2 What are the key Bill's key provisions on CSR?

Companies for whom the CSR provisions are applicable will be required to put in place policies, a governance system, spell out activities to be undertaken and comply with a minimum requirement of spending on CSR activities linked to their annual profits.

2.2.1 Corporate Social Responsibility Committee

Every 'eligible' company will have to set up a Corporate Social Responsibility Committee (SCRC) with representation by a minimum of three Directors of the Board, with at least one of them being an Independent Director.

The CSRC will be responsible for formulation of the company's CSR Policy and the activities to be undertaken, recommending the expenditure to be incurred on each of these activities and monitoring the CSR Policy from time to time.

2.2.2 Schedule VII- Activities covered under CSR

There is considerable flexibility for corporates on the areas that they can address as part of their social responsibility activities, the geographical regions that could be chosen for the intervention and the manner of engagement.

Activities listed under Schedule VII are:

1. Eradicating extreme hunger and poverty;
2. Promotion of education;
3. Promoting gender equality and empowering women;
4. Reducing child mortality and improving maternal health;
5. Combating HIV, AIDS, malaria and other diseases;
6. Ensuring environmental sustainability;

7. Employment enhancing vocational skills;
8. Social business projects;
9. Contribution to the Prime Minister's National Relief Fund, Central or State Government Fund for socio-economic development and relief, welfare of SC/ST/OBC, minorities and women
10. Such other matters as may be prescribed

While Schedule VII in the original Bill listed nine such activities, we understand that this may be modified to cover as many as 22 activities and will provide the additional flexibility to the company's Board to decide on some other activity as well, as long as it is spelt out in the company's CSR Policy. All the core social needs – including education, healthcare, sanitation, environmental sustainability, employability – are covered under Schedule VII, so the Bill is clearly aiming to align corporates CSR activities with the country's social development imperatives.

2.2.3 Responsibilities of the Board of Directors

The Bill specifies that the Board will be accountable for approving the CSR Policy after reviewing the policy, the activities proposed and the resources to be committed. They will also be responsible for disclosure of its contents in their report as well as on the company's website and for ensuring implementation of the proposed CSR activities.

The Board will also have to ensure that spending on CSR by the company is at least 2% of net profits in the preceding three years. If overall spend falls short of this threshold, the Board will need to provide reasons for non-compliance in the Directors Report to the shareholders.

2.3 What are the immediate action points for a company?

A company that falls in the criteria mentioned in section 2.1 should, in our view, kick-off the first steps to endure smooth compliance with the regulatory requirements, as listed below.

- Apprise members of the Board on the impending CSR obligations under the new Bill
- Plan for setting-up the Corporate Social Responsibility Committee and decide on the constitution of the committee based on responsibilities, operational involvement and individual motivations. In cases where an Independent Director may need to be identified, the process could be started. Companies that are part of larger corporate groups may also need to look at composition of individual company CSRCs in the context of the larger group effort on CSR.

- The company should initiate steps to formulate a CSR Policy and put in place a broader CSR strategy to drive its initiatives in this area.
- The company should start to consider the activities (projects) that it will undertake over the next financial year, keeping in view the objectives of the CSR strategy and compliance with the regulatory requirement.
- The company/CSRC should frame monitoring and reporting systems that will facilitate smooth compliance with the regulatory requirements.
- The company will need to consider the optimal governance structure (including the option of a corporate Foundation). This will be particularly relevant for business groups that may have multiples companies in their fold that will be covered under Sec 135.
- The company will have to assess its capacity to develop and implement its CSR agenda and address these by recruiting personnel dedicated to CSR, undergoing training to identify and address gaps, hiring consultants and identifying implementation partners, as required.