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ETHICAL AND LEGAL BASIS OF CORPORATE SOCIAL RESPONSIBILITY

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Abstract

Economic globalization has resulted in a demand for corporations to play a central role in efforts to eliminate poverty, achieve equitable and accountable systems of governance and ensure environmental security. There is an urgent need to make the business a part of society and maximize the positive benefits that business endeavours can bring to human and environmental well-being and minimize the harmful effects of responsible business. The idea conceptualized in this direction is termed corporate social responsibility. There are many companies in the world whose annual sales are more than the Gross National Products of many countries. These companies control a large part of the earth's resources, the price of which is paid in the form of sacrifices by different sections of society.

On the other hand, governments are redefining their roles and are limiting themselves to governance and facilitation. This development is sometimes dubbed as symbolizing a shift from a state-centred polity to a market-centred polity. Within the world of business, the main "responsibility" for corporations has historically been to make money and increase shareholder value. In other words, corporate financial responsibility has been the sole and main driving force. However, in the last decade, a movement defining broader corporate responsibilities– for the environment, local communities, working conditions, and ethical practices–has gathered momentum and taken hold. This new driving force is known as corporate social responsibility (CSR). One significant aspect of Corporate Social Responsibility is the promotion of "trusteeship" Under this notion the businesses were motivated to manage their business entity as a trust held in the interest of the community. It has also been made mandatory in the form of legal responsibility.

In light of the above, every corporate is required not only to concentrate on earning money but on the furtherance of their work, it is also required to be ethical and legal. Through this paper, the author is trying to establish that certain responsibilities of the corporate sector are ethical and legal.

Introduction

The framework for corporate social responsibility has focused on corporations' voluntary actions[1] which are over and above legal requirements[2] and which contribute to

[1] K. Davis,"The Case forand against Business Assumption of Social Responsibilities" (1973) 16 Academy of Management Review 312.

sustainable economic development[3] so that businesses can address both their competitive interests and the interests of wider society ethically and legally.

Meaning of Ethics

Ethics have been derived from the ancient Greek word *ethos*; ethics has come to mean moral character. Ethical behaviour is what is good or right. Ethical senses always make use of good, bad, right and wrong. Ethics has to do with questions relating to the fairness, justness, rightness, or wrongness of an action. Many of our ethical decisions are made for us by our laws. However, simply obeying the law does not fulfil all ethical obligations. Some actions in business may be legal but not ethical.

Business Ethics

The term "business ethics" is used in a lot of different ways. Business ethics is a form of applied ethics[4] that examines ethical principles and moral or ethical problems that arise in a business environment.[5] Business ethics is a system of moral principles applied in the commercial world. Business ethics provide guidelines for acceptable behaviour by organizations in both their strategy formulation and day-to-day operations. An ethical approach is becoming necessary both for corporate success and a positive corporate image.

It applies to all aspects of business conduct[6] and is relevant to the conduct of individuals and business organizations as a whole.[7] Business ethics consists of a set of moral principles and values that govern the behaviour of the organization concerning what is right and what is wrong.[8] It spells out the basic philosophy and priorities of an organization in concrete terms.[9] It also contains the prohibitory actions at the workplace. It provides a framework on which the organization could be legally governed.

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[2] European Commission, Communication from the Commision Concerning Corporate Social Responsibility: A business contribution to Sustainable Development (Brussels: July 2, 2002), COM(2002)347final,at http://trade.ec.europa.eu/doclib/docs/2006/february/tradoc 127374.pdf [Accessed July 4,2012].

[3] R. Holme and P. Watts,"Corporate social responsibility: Making good business sense". World Business Council on Sustainable Development (2000), at http://www.wbcsd.org/web/pubHcations/csr2000.pdf [Accessed July 4, 2012].

[4] Broni, G. (2010). Ethics in Business.

[5] Solomon, Robert (1991), Business Ethics, In: Peter Singer (Ed.), A Companion to Ethics, Malden, MA: Blackwell, 354-365.

[6] Baumhart, Raymond (1968). An Honest Profit: What Businessmen Say About Ethics and Business, New York: Holt, Rinehart and Winston.

[7] Bernard, W. (1972). Morality, Harper & Row.

[8] Badiou, A. (2001). Ethics: An Essay on the Understanding of Evil. London, Verso.

[9] French, P. A. (1979). The Corporation as a Moral Person, American Philosophical Quarterly 16, 207-215.

Ethical Duty of Corporations toward Society

Corporate Social Responsibility refers to the ethical behaviour of a company towards society. Carroll has proposed that corporations have four responsibilities or four faces to accomplish to be good corporate citizens: economic, legal, ethical and philanthropic (also referred to as altruistic or humanitarian).[10] The concept of corporate charitable gifts runs counter to the aim of maximizing shareholder wealth and thus calls into question traditional corporate law norms" [11] Corporate Social Responsibility is the result of perceived change in societal expectations regarding the role of companies within society.[12]

The concepts of Corporate Social Responsibility, corporate citizenship, corporate social performance, corporate sustainability and increasingly, responsible business, are prominent aspects of many companies in India. Corporate Social Responsibility leverages the unique expertise and resources of the company to create economic value by creating social value."[13]

3.6 Need for a Corporate Code of Ethics

Past massive disasters like the Bhopal MIC gas tragedy, Delhi *Oleum gas leak case* and other examples of Indian companies in which we have seen that companies are not accountable to governments, this can lead to non-compliance with basic safety and operational standards, resulting in widespread human rights abuse. The victims of these disasters still await compensation from the companies. In the absence of international conventions that clearly outline the jurisdiction of the State and accountability of companies, a Corporate Code of Ethics is necessary to avoid tragedies like these in future.

Ethical Policies of Companies in India

Ethics flows in the veins of Indians. Indians and Indian culture are respected everywhere for their sense of responsibility, ethics and accountability towards each other. They inculcate the morals and values from the very beginning of the life of a child to help him to become a good human being to maintain an ethical society. People within the society join an organization and helps in developing the culture of the organization. Employees within an organization sow the seeds of ethical or unethical values, whatever they bring with them to the organization and nurture the crop of different cultures and ethics in the

[10] Louis Prandtl, A Briefing Paper on Corporate Social Responsibility: Mandatory or Voluntary ? (Apr 19, 2008).
[11] Tarja Ketola, A Holistic Corporate Responsibility Model:: Integrating Values, Discourses and Actions, Journal of Business Ethics, Vol. 80, No. 3 (Jul., 2008) (pp. 419-435)
[12] Lisa Whitehouse, Corporate Social Responsibility: Views from the Frontline, Journal of Business Ethics , Vol. 63, No. 3 (Feb., 2006), pp. 279-296
[13] Ibid

organization. People performing in organizations decide their level of responsibility towards different sectors of society. In today's fast-moving competitive globalised world man is becoming more and more materialistic and selfish to attain the objectives of his life. It is a matter of solemn consideration that human beings today are ignoring their social responsibilities at large and are becoming self-centred. They are exploiting and even damaging their natural resources as well as this life-giving planet Earth.[14]

Legal basis of Corporate Social Responsibility

By its nature, the business world focuses on only one thing, making money. The ultrahigh competition also forces them to fiercely concentrate on this objective solely. Technologies have advanced so much that business operations leave significant footprints on society as well as the environment. Just look at the status of ethics and the environment around the world; everywhere the development of businesses is causing severe degradation of morality in societies and damage to ecology and natural resources. Global warming and climate change problems are glaring examples of the potential harm of unbridled corporate activities. Therefore, some mechanism is needed to make businesses accountable. Although voluntary action is the best solution that often doesn't work. Hence, some form of legal enforcement is being planned or tried in different countries.[15]

Relationship between Corporate Social Responsibility and the Law

There is a close relationship between Corporate Social Responsibility and the law. The main instrument governments use to address a firm's social, environmental and economic impacts is the law. Many countries have a wide range of laws, whether at the national, state or local levels of government, relating to consumers, workers, health and safety, human rights and environmental protection, bribery and corruption, corporate governance and taxation. A firm's Corporate Social Responsibility approach should begin by ensuring full compliance with those laws already in place. No matter how good a Corporate Social Responsibility policy may be failure to observe the law will undermine other good efforts. Looking ahead, the Corporate Social Responsibility activities of firms can be seen as a proactive method of addressing potentially problematic conduct before it attracts legal attention.

[14] Corporate Social Responsibility and Ethics: An Indian Perspective, Vishakha Sharma, Akshita Gaur and Vibhor Goyal, VSRD International Journal of Business and Management Research vol.2.No.11

[15] Mandatory Corporate Social Responsibility: Is the Government Shifting its Failure to Corporate India?

Government Initiatives

Several major CSR initiatives have been launched in India since the mid-1990s. Among these is the first voluntary code of corporate governance, *"Desirable Corporate Governance: A Code*", established in April 1998. A *National Foundation for Corporate Governance* (NFCG) has been established by the Ministry of Corporate Affairs. This is a partnership with the Confederation of Indian Industry (CII), the Institute of Company Secretaries of India (ICSI) and the Institute of Chartered Accountants of India (ICAI). The basic purpose of the *National Foundation for Corporate Governance is* to promote better corporate governance practices and raise the standard of corporate governance in India towards achieving stability and growth. India's Ministry of Corporate Affairs has launched voluntary guidelines for responsible business which aim to add value to the operations and contribute to the long-term sustainability of the business. These guidelines also aim to enable the business to focus as well as contribute to the interests of the stakeholders and society. The new CSR guidelines state that the CSR initiatives of Indian companies should become an integral part of overall business policy and be aligned with business goals.

The Guidelines set out six core elements for companies to address: respect for all stakeholders; ethical functioning; respect for workers' rights and welfare; respect for human rights; respect for the environment and activities for social and inclusive development.

- **Care for all Stakeholders**
- **Ethical Functioning**
- **Respect for Workers' Rights and Welfare**
- **Respect for Human Rights**
- **Respect for Environment**
- **Activities for Social and Inclusive Development**

The Guidelines, though had a very broad vision, failed to guide as to what "Corporate Social Responsibility" meant and also failed to assist companies in selecting their Corporate Social Responsibility activities.

Again National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, 2011 has been passed by the Ministry of Corporate Affairs, Government of India. The Guidelines presented herein are elegance over the Corporate Social Responsibility Voluntary Guidelines 2009. Significant inputs, received from diverse stakeholder groups across the country had been considered, and based on these inputs; appropriate changes had been made in the Original draft Guidelines produced by the

Guidelines Drafting Committee. This document, therefore, represents the consolidated perspective of vital stakeholders in India and accordingly lays down the basic requirements for businesses to function responsibly, thereby ensuring a wholesome and inclusive process of economic growth.

These guidelines can be applied by all businesses regardless of size, location and sector. They target the spirit of the enterprise. The guidelines have been articulated in the form of nine principles:

1. Businesses should conduct and govern themselves with Ethics, Transparency and Accountability.
2. Businesses should provide goods and services that are safe and contribute to sustainability throughout their life cycle.
3. Businesses should promote the well-being of all employees.
4. Businesses should respect the interests of, and be responsive to all stakeholders, especially those who are disadvantaged, vulnerable and marginalised.
5. Businesses should respect and promote human rights.
6. Businesses should respect, protect, and make efforts to restore the environment.
7. Businesses, when engaged in influencing public and regulatory policy, should do so in a responsible manner.
8. Businesses should support inclusive growth and equitable development.
9. Businesses should engage with and provide value to their customers and consumers in a responsible manner.

The adoption of these guidelines will improve the ability of businesses to enhance their competitive strengths, attract and retain talent, improve their reputations, and manage their relations with investors and society at large.

The guidelines come with a set of core elements which elaborate on the principles. The guidelines are not exclusive; rather they should be applied as a whole. A business shouldn't adopt only those guidelines which it finds convenient. This will make them socially, environmentally and economically responsible. For a business to be responsible, it should be transparent and accountable. The guidelines suggest that a Business Responsibility Reporting Framework should be put into place; it can in turn not only help to reach out to various stakeholders but also throw up some good guidance models.

The most demanding feature of sustainability guidelines is the mandatory expenditure by medium and large corporations of 2% of the profit on corporate social responsibility.

Another guideline, Guidelines on Corporate Social Responsibility for Central Public Sector Enterprises (CPSE), 2010 was issued by the Ministry of Public Enterprises and Ministry of Heavy Industries. The object and reason behind issuing these guidelines are:

- *Planning of Corporate Social Responsibility Action Plan:*
- *Implementation of Corporate Social Responsibility Action Plan*

National Corporate Social Responsibility Hub

The Department Of Public Enterprises, in conjunction with the Standing Conference of Public Enterprises (SCOPE) and the CPSEs, will create a National Corporate Social Responsibility Hub, which will undertake/facilitate activities like Nationwide compilation, documentation, and creation of a database; Advocacy; Research; Conferences, Seminars, Workshops -both national and international etc.

Monitoring

- Monitoring of the Corporate Social Responsibility projects is crucial and needs to be a periodic activity of the Enterprise.
- The Boards of CPSEs should discuss the implementation of Corporate Social Responsibility activities in their meetings.
- Corporate Social Responsibility projects should also be evaluated by an independent external agency.

Additionally, the Department of Public Enterprises had issued guidelines for CPSEs for mandatorily creating a Corporate Social Responsibility budget as a specified percentage of the net profit of the previous year.

The Union Government has finalised the CSR guidelines for public sector units under which they will have to earmark a portion of their profit for social activities. The revised guidelines on corporate social responsibility (CSR) and sustainability would come into effect on 1st April 2013. According to the guidelines, “the financial component/budgetary spend on CSR and sustainability would be based on the profitability of the company and shall be determined by the profit after tax (PAT) of the company in the previous year”. If the PAT of CPSE in the previous year is less than Rs 100 crore, the range of budgetary allocation for CSR and sustainability activities would be 3-5 per cent and if the PAT is between Rs 100 crore and Rs 500 crore, it would be 2-3 per cent. For the public sector unit whose PAT in the previous year is Rs 500 crore and above, the range of budgetary allocation for CSR and sustainability activities would be 1-2 per cent. Loss-making companies are not mandated to earmark specific funding for CSR activities. “However, they must pursue CSR and sustainability policies by integrating them with their business plans, strategies and processes, which do not involve any financial expenditure," the PSUs are required to have a policy approved by their respective boards of directors. According to the guidelines, the unutilised budget for CSR activities planned for a year will not lapse and will instead be carried forward to the next year, "however, the CPSEs will have to disclose the reasons for not fully utilising the Budget allocated". CPSEs must take up at least one major project for the development of a backward district as identified by the Planning Commission for its backward region grant fund scheme and one major project for environmental sustainability. "Five per cent of the annual budget for CSR and sustainability activities has to be earmarked for emergency needs, which includes relief work undertaken during natural calamities,"

The Parliament has passed the Companies Bill, 2012, which aims at making the corporate sector more transparent, efficient and responsible. Interestingly, this is also an attempt on the part of the Indian Government to foster philanthropy and introduce mandatory provisions for responsible corporate governance in India in the form of Corporate Social Responsibility.

The Companies Bill makes Corporate Social Responsibility a mandatory legal requirement for India Inc. determined by a financial threshold. A company in this provision refers to an entity incorporated under the Companies Bill or the other previous company law.

• ***Applicability:*** As prescribed under Section 135 of the Companies Bill, the company satisfying any of the following criteria has to comply with the Corporate Social Responsibility provisions as stipulated under the Companies Bill:

Constitution of a* Corporate Social Responsibility *Committee: The company which falls within the above criteria shall be required to constitute a Corporate Social Responsibility Committee ("CSR Committee") of the Board comprising a minimum of three directors, out of which at least one director shall be independent.

Formulation of Corporate Social Responsibility Policy: The Corporate Social Responsibility Committee shall formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken; recommend the amount of expenditure to be incurred on the activities referred and monitor the Corporate Social Responsibility Policy of the company from time to time. The Board after taking into account the recommendations made by the Corporate Social Responsibility committee, approve the Corporate Social Responsibility policy for the company.

Corporate Social Responsibility Activities: Corporate Social Responsibility activities which may be included by companies in their Corporate Social Responsibility Policies may relate to (i) eradicating extreme hunger and poverty; (ii) promotion of education; (iii) promoting gender equality and empowering women; (iv) reducing child mortality and improving maternal health; (v) combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases; (vi) ensuring environmental sustainability; (vii) employment enhancing vocational skills; (viii) social business projects; (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 socioeconomic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; and (x) such other matters as may be prescribed.

Allocation towards *Corporate Social Responsibility****:*** The Board is required to ensure that the company spends, in every financial year, at least 2% of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy.

Disclosure and reporting: The Board is required to provide in the General Meeting, a report disclosing the composition of the Corporate Social Responsibility Committee along with the details about the Corporate Social Responsibility policy developed. The contents of the policy shall also be placed on the company's website. Further, the statement of profit and loss statement shall accord the amount of expenditure incurred on Corporate Social Responsibility activities.

Reasons for non-spending: The Corporate Social Responsibility provision follows a "comply or explain" approach, which requires the company to formulate a Corporate Social Responsibility policy and furnish details of spending of such amount. If the company does not have an adequate profit or is not in a position to spend the prescribed amount on Corporate Social Responsibility, the Board is required to disclose and report the specific reasons for not spending the amount.

India's proposal is part of the new wave of development in the realm of Corporate Social Responsibility. The key points of the proposed regulations are as under:

Additional taxes v. 2% of net profit: The lawmakers instead of simply taxing companies in the name of "social good" have mandated expenditure for the same. The intention has been to invoke the spirit of voluntary corporate philanthropy. The major advantage of mandating Corporate Social Responsibility spending, as opposed to levying additional taxes, is the preservation of the company's autonomy in selecting how its funds should be used and what Corporate Social Responsibility activity the company invests in. The company would have the leverage to invest its resources into the desired cause directly.

A broad scope of Schedule VII of the Companies Bill: Traditionally, the majority of Indian companies have been investing in education, and health followed by environmental issues. Several social sectors such as creating jobs, providing employment enhancing vocational skills, resources for social business projects and promoting gender equality and empowering women have not received much attention. Schedule VII of the Companies Bill covers such aspects of social growth and will ultimately result in broadening the view of Indian companies, giving them diverse opportunities.

All Corporates at a level playing field: Several companies have been imbibing the case for social good in their operations long before Corporate Social Responsibility become a popular cause. Despite having such successful examples, Corporate Social Responsibility in India is at a very nascent stage and is one of the least understood initiatives in India. With the Government making it a mandatory requirement for Indian companies to do Corporate Social Responsibility spending, all companies will be put on a level playing field to engage in Corporate Social Responsibility.

Global access to companies: Corporate Social Responsibility *is seen* as an enabler for companies trying to access the global international markets since spending on social development guarantees a positive public image. Apart from this, it helps in retaining staff, higher productivity and reduction costs and increases profitability, improving customer satisfaction. A positive impact on the company's image due to Corporate Social Responsibility investment makes a company more acceptable and attractive as a global player.

Fiduciary duty and reinvestment: Corporate Social Responsibility ultimately leads to re-investing in communities, where a company functions/operates. It builds reputational legitimacy, trust and reciprocity from which companies benefit. It also makes the stakeholders feel that the company is extending its fiduciary duty to encompass their well-being. Companies engaging in Corporate Social Responsibility spending also create positive externalities recognised and appreciated by the local community.

The Corporate Social Responsibility clause is comprehensive in its approach; however, the absence of a penalty for non-compliance with the Corporate Social Responsibility provision is a potential setback because there is no deterrent force. Likewise, the absence of the powers, responsibilities and duties of the Corporate Social Responsibility Committee to carry out the Corporate Social Responsibility policy cannot foster the purpose of providing a framework to companies for the Corporate Social Responsibility road ahead. Further, the extent of liability of the Board is also not outlined in the Companies Bill. In terms of disclosure and reporting of the Corporate Social Responsibility Policy of the company, apart from the shareholders, the Companies Bill does not provide as to whether there is a requirement to disclose or report before any regulatory authority.

A strict reading of the Companies Bill entails that Corporate Social Responsibility is not required to be followed by business structures such as limited liability partnerships and partnerships, which are also profit-making business entities and this is unlike other countries mandating Corporate Social Responsibility provisions, for example in the Philippines, a large taxpayer falls within the Corporate Social Responsibility provision, in Mauritius, even banks, trusts and societies are covered and the UK includes subsidiaries of companies as well, based on a monetary threshold. The Companies Bill should cover such business structures to carry out Corporate Social Responsibility activities as they are responsible for the society they operate in.

Conclusion

The introduction of mandatory Corporate Social Responsibility instead of imposing additional tax liabilities on companies in the name of "social good" is evidence of the fact that voluntary Corporate Social Responsibility has been a success in India. It represents the government's faith in India Inc.'s spirit for corporate philanthropy and giving back to the community. The companies have been given a free hand to determine how and where their funds are used for this cause. It has to be connected ethically rather than legally.