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PROACTIVE APPROACH TO CORPORATE SOCIAL RESPONSIBILITIES (CSR) SPENDING POST-LEGISLATION MANDATING CSR

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ABSTRACT

The recent legislation making CSR discharge mandatory for qualifying firms has been a game changer as it requires all qualifying firms to form a CSR committee for planning and executing the CSR function. Different modes of implementation have been provided for discharging CSR namely- through other implementing agencies or directly. Firms generally choose between different implementing strategies depending on the cost benefit analysis, nature of activity, requirement of expertise, resources, etc. Since the CSR committee weighs the cost and benefits associated with each strategy, the effect of different strategies should be positive on CSR. This paper attempts to understand the effect of different strategies adopted by the firms on CSR. The result of the logistic model reveals a positive impact of the two strategies- directly and other implementing agencies on the probability of the firm to spend more than 2% on CSR or proactively perform CSR.

Key words: CSR, CSR Spending, Schedule VII, Implementing Strategies- Directly And Other Implementing Agencies, Corporate Governance

INTRODUCTION

The recent amendment in the Companies Act has bought an end to the debate of urging corporates to engage in their social responsibility. It requires firms having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more, or a

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net profit of rupees five crore or more, during any financial year to spend at least 2% of the average net profits of the three immediately preceding financial years in corporate social responsibility as provided in schedule VII. Further to discharge the CSR function firms have different strategies available namely- directly (in-house) or engaging the services of other implementing agencies like NGOs (out-house). Firms select strategies for discharge of CSR activities depending on various factors like requirement of expertise, knowledge, resources, etc. the choice of the strategies for discharge of CSR is also based on the cost and benefits associated from them. Generally companies directly discharge their CSR obligation, in cases where either the CSR activities are related to their business operations or where they possess knowledge or expertise. Thus firms internalise or directly discharge their CSR if CSR activities are related to the mission or objectives of the business and benefits of such activities would follow. Internalising CSR entails greater control and supervision over CSR project and also engages the employees of the firm in socially responsible activities. But services of other implementing agencies are procured when companies lack expertise in the area of CSR discharge. Also engaging services of other implementing agencies requires shared supervision and control over the CSR project.

The CSR mandating legislation has been a game changer as it entrust the CSR committee to select, plan and execute CSR activities from the schedule VII. Interestingly the mandatory CSR legislation does not provide for penalties for non-compliance rather it is based on 'comply or explain' rule. Thus qualifying firms spending less than 2% of their profits need to explain the reason for not meeting the mandatory 2%. But some proactive firms have been spending more than 2% of their profits in CSR activities, probably, because they were associated with philanthropy before the legislation or engage in production of environmentally friendly product or participate in measures to mitigate environmental damage. This study is undertaken to understand the effect of different strategies (directly and other implementing agencies) on the CSR expenditure.

LITERATURE REVIEW

Corporates follow different strategies while adopting CSR. Some firms believe in adopting CSR to enhance their competitive advantage and others adopt operation related CSR to enhance their firm value (Lee et al., 2013; Jonikas, 2014). Even in context of implementation of CSR activities, different firms follow different implementation strategies depending on the kind of activity, cost and benefit associated with that activity, expertise in relation to the activity, etc. The alternative strategies explored for implementation of CSR include involving trust, other implementing agencies like NGOs or collaborating with other corporate giants. These implementation strategies are often categorised as in-house (introduction of new products that are environmentally friendly), out-house (amount spent on community building) and collaboration (environmental supply chain management) as suggested by Husted et al., 2003. As pointed by Husted (2003) the decision of alternative discharge strategies is dependent on altruistic or strategic objectives of the firm. An altruistic firm would be driven by social concern and would be dependent on philosophy of top management but a strategic firm would be driven by cost and benefit associated with CSR. It is suggested by Lee et al. (2013) and Sayekti (2015) that firms generally engage in operation related CSR rather than non-operation related CSR as operation related CSR positively impacts the firm value.

The result of hierarchical linear model used by Husted et al. (2017) reveals that the effect of collaboration scores over out-house and in-house and panel regression model reveal a positive and significant impact of country risk and stakeholder orientation on the three governance strategy approaches- in-house, outhouse and collaboration (Husted at al., 2017). Even the support provided by environment supplier development (ESD) as intermediaries to reduce the environmental damage by green, knowledge or resource transfer could have an impact on firm performance and competitiveness. The results of partial least square structural equation model reveal a positive and significant relation between ESD and CSR, positive relation of ESD, firm performance and competitive advantage for Turkish manufacturing firms (Agan et al., 2016). Interestingly in context of CSR spending Marques & Srinivasan (2018) found that high involvement and high

Indian shareholdings are associated with high spending in CSR, business group is associated with spending mandate, advertising expense is associated with mandated CSR spend and R&D expense is associated with higher CSR spend. Lioui & Sharma (2012) also suggest that R&D has a direct impact on ECSR as firms invest in environmentally safe production process or produce environmentally friendly product/ service. Additionally Lim & Greenwood (2017) also suggest that advertising is instrumental of sensitising the public of the social responsibility discharge made by the firm, thus creating customer awareness which results in adoption of socially responsible products. The information in relation to social responsibility would not be facilitated in the absence of advertising, thus advertising impacts CSR activities.

HYPOTHESIS

Firms are generally faced with the challenge of selecting from among the various alternative strategies available for discharge of CSR activities which include engaging services of other implementing agencies, trust, collaboration with other firms or engaging directly in CSR activities. Since CSR committee is entrusted with the task of selecting CSR activities and strategies for discharge. They are guided by different factors like cost and benefits associated with CSR function, requirement of expertise, knowledge or resources (both financial and non-financial) or even recruitment and training of employees.

Since selection of strategies is a well-planned process, firms choose to directly engage in CSR projects if CSR activities are related to their core business or they possess expertise, knowledge and resources for their discharge. If, for example firms engage in CSR activities related to their business, like participation in climate change or production of environmentally friendly products, there is a possibility that firms would spend more than 2% of their profits. But other implementing agencies are engaged in CSR activities for the firms in case firms either do not possess expertise to deal with them or CSR activities chosen are unrelated to their business operation but bring the benefit of enhanced goodwill. Thus, there is possibility of spending more than 2% of the profits in case the services of other implementing agencies are utilised. Thus the hypothesis for the study is as follows.

H1: There is a positive effect of different strategies (directly or other implementing agency) adopted by corporates for discharge of CSR.

METHODOLOGY

With the objective of determining the effect of strategies adopted by the firms in discharging their social responsibility on the CSR spending of the firms following logistic random effect panel regression has been estimated where the dependent variable is binary in nature and it takes a value of 1 in the year in which the firm spends more than 2% of the profit on CSR (or proactively perform CSR activities) and 0 otherwise. The model is as follows:

$$Y_{it} = \ln[p/(1-p)] = \beta_1 + \beta_2 X_{1\,it} + \beta_3 X_{2\,it} + \beta_4 X_{3\,it} + \beta_5 X_{4\,it} + \beta_6 X_{5\,it} + \beta_7 X_{6\,it} + \beta_8 X_{7\,it} + \varepsilon_{it} \quad (1.1)$$

Where, β_1 is the intercept, subscript i and *t* indicate firm and time respectively

$Y\,it$ = 1 if the firm spends more than 2% of the profit on CSR (or proactively perform CSR activities) and 0 otherwise.

$X_{1\,it}$ = R & D Intensity

$X_{2\,it}$ = Age of the firm

$X_{3\,it}$ = Advertising intensity

$X_{4\,it}$ = Operational efficiency

$X_{5\,it}$ = Governance index

$X_{6\,it}$ = CSR activities carried out by the firms themselves

$X_{7\,it}$ = CSR activities outsourced to other agencies (other implementing agencies)

ε_{it} = error term

i. Sample Selection

The Companies Act 2013 requires, every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more, or a net profit of rupees five crore or more, during any financial year to spend at least 2% of the average net profits of the three immediately preceding financial years. This study includes the companies listed on National Stock exchange (NSE Nifty 500) and Bombay Stock Exchange (BSE S&P 200) qualifying the requirement of net worth or turnover or profit and spending at least 2% of the average net profits of the company made during the three immediately preceding financial years. Data of 545 listed firms was taken from the Prowess database, out of which 249 firms had spent at least 2% or more of their average net profits made during the three immediately preceding financial year on CSR activities listed in schedule VII in a year after the mandatory legislation. These 249 firms (168- Manufacturing and 81- Non-Manufacturing) have been selected for this study as they fulfil the criteria laid down in the CSR legislation. Since the objective is to study the effect of strategies after the mandatory legislation, the time period considered for our analysis is from 2014-17.

ii. Data sources

Data for the study has been taken from three data sources which include (i) Prowess- a database for Indian Companies maintained by Centre for Monitoring the Indian Economy (CMIE) which is used to extract data on firm characteristics, corporate governance and CSR, (ii) National CSR Data Portal, maintained by Ministry of Corporate Affairs, Government of India (csr.gov.in), is utilised to provide information on CSR and strategies for discharging CSR and (iii) CSR reports of the companies.

iii. Description of the Variables used

1. **Corporate Social Responsibility**- For the study, CSR is measured as a binary variable taking value 1 for the year in which firm spends more than 2% of the average net profits of the company made during the three immediately preceding financial year on CSR (or proactively perform CSR activities) and 0 otherwise.

2. **Age** – Firm age is defined as the number of years since incorporation of the firm (i.e. year in consideration – year of establishment). Age has an impact on CSR as older and established firms might find it easier to initiate CSR whereas younger firms might face difficulty in planning, evaluating and reviewing CSR activities.

3. **Advertising intensity** – It is defined as (Advertisement Expenditure/ Net Sales)*100. Firms utilise advertising to create customer awareness of the social responsibility undertaken by them and sensitise the public that firms are valuing social concern.

4. **Operational efficiency**- CSR compliant firms are operationally efficient firms (Wang et al., 2014) and non- CSR performing firms engage in environmental dimension of CSR to meet the expectations of external stakeholders (Saorin et al., 2018). The present study defines operational efficiency as the ratio of net sales to average total assets.

5. **Governance** – Prior studies (Liu & Zhang, 2017; McGuinness et al., 2017; Hoje et al., 2016) are evidence that good corporate governance practices positively impact CSR. The legislation mandating CSR also requires the formation of CSR committee for planning, executing and evaluating the CSR activities according to schedule VII. For this study a governance index has been constructed using principal component analysis (PCA). The multivariate technique of PCA is used to create a new variable or component as a linear combination of a given set of similar variables which is unobserved or latent. The variables used for PCA include executive director's remuneration, number of shareholders outside India, audit fees, auditor's fees for company law matters, director's perquisites, director's salary and non-executive director's fees.

   Based on the variance of the underlying factors explained by the components represented by the eigenvalues (as suggested by Kaiser criteria, components with eigenvalue greater than 1 were retained), 3 components were extracted.

The three components collectively explained 71.17% of variation in the underlying factor with 37.08%, 18.75% and 15.35% variations explained by component 1, 2, and 3 respectively. The three components were then subjected to rotation using the varimax criterion and finally combined to construct a single governance index with factor loading used as weights. The results of PCA are given in Appendix.

6. **Research and Development (R&D) intensity** –The investment by the firms in research and development indicates potential for growth and advancement. A firm engaging in operation related CSR will invest in R&D to ensure product innovation, product differentiation, premium price for product or modification in production technique. Lioui & Sharma (2012) suggest that R&D impacts ECSR and firm performance. For example, adoption of energy efficient, low carbon technology, and climate change participation affect environmental dimension of CSR. It is defined as (R&D expenditure/ net sales) *100.

7. **Directly**- It is defined as 1 if the firm discharges CSR activities directly on its own and 0 otherwise. Firms who engage directly in CSR activities internalise the cost and benefit associated with CSR. Internalising is easy when the CSR project is related to the core business of the firm like production of green product, use of environmentally safe technology for production. The benefits of directly engaging in CSR project affect the firm performance in terms of cost savings or energy efficiency. This strategy can go a long way in building the innovative and creative capabilities of the firm which can ensure long term benefits.

8. **Other implementing agencies**- If the firm discharges the CSR activities through other implementing agencies like NGO's etc. then it is defined as 1 otherwise 0. Firms generally engage non-profit organisations or other implementing agencies in CSR projects when they are typically unrelated to the business operations or when they lack the expertise to deal with the CSR project. Engaging other implementing agencies saves cost of internalising CSR, ensures expertise in area of CSR project, lesser administrative control

and effective transfer of resources to third party for completion of CSR project. Firms engaging other implementing agencies ensure better goodwill and reputation for themselves.

RESULT AND DISCUSSION

The Table 1 presents coefficients, marginal effects and odd ratios of the logistic random effect panel regression estimated to determine effects of strategies on CSR.

Table 1: Results- Effects of Strategies on CSR

CSR expenditure > 2% of the profit (*csr_grt_two*)	Coef.	Marginal effect	Odds Ratio	Std. Err.
Research intensity *(rnd_intensity)*	0.1883*	0.0135	1.2072	0.1035
Age of the firm (*age*)	0.0094	0.0007	1.0094	0.0079
Advertisement intensity (*adv_sales*)	0.9296	0.0665	2.5334	2.6665
Operational Efficiency (*operational_effciency*)	1.0737***	0.0768	2.9262	0.3681
Governance index (*index_final1*)	0.4311*	0.0309	1.5389	0.2571
CSR activities carried out by the firms themselves (*directly*)	3.4842***	0.2493	32.5958	0.5297
CSR activities outsourced to other agencies (*otherimplementingagency*)	3.7105***	0.2655	40.8755	0.5858
_cons	-4.2755		0.0139	0.8866
Number of obs	638			
LR chi2	6.32			
Prob> chi2	0.006			

'***', '**', '*' denotes 1%, 5% and 10% level of significance respectively

R&D intensity has a positive and significant influence on the probability of the firm's decision to spent more than 2% of the profits on CSR (proactively perform CSR). The results also indicate that with every unit increase in expenditure on research and development the probability of the firm to spent more than 2% of the profits in CSR (or proactively perform CSR) increases by 1.35%. The results also show that with every unit increase in research and development the odds of the firm to spent more than 2% of profit on CSR (or proactively perform CSR) is 1.2 times. The positive impact is in conformity with Lioui & Sharma (2012) finding that R&D indirectly positively impacts ECSR rather than directly. There is a possibility that the firms investing in research and development to ensure product innovation or differentiation or eco-friendly techniques of production might spend more than the mandate amount in CSR activities as such investment would ensure enhanced sale of the product.

Age has a positive and insignificant influence on the probability of the firm's decision to spend more than 2% of the profit on CSR (or proactively perform CSR). This implies that more than 2% CSR spend is not influenced because of old age or young age of the firms. Thus age does not act as a determinant of a firm being proactive in its CSR performance.

Advertising intensity has positive and insignificant influence on the probability of the firm's decision to spent more than 2% of the profit on CSR (or proactively perform CSR). Advertising is viewed as the communication tool through which firms enlighten customers about their product and even CSR efforts. Since most firms are not in the practice of advertising about their CSR efforts or activities to enable the target customers to make a meaningful distinction between CSR product and non-CSR product so advertising intensity does not influence the firm to spend more than 2% on CSR.

Operational efficiency has a positive and significant influence on the probability of the firm's decision to spent more than 2% on CSR (or proactively perform CSR). With every one unit increase in operational efficiency the probability of the firm to spent more than 2% on CSR (or proactively perform CSR) increases by 7.68%. The results of odd ratio indicate that with every one unit increase in operational efficiency the odds of the firm to spent more than 2% of the profit on CSR (or proactively perform CSR) is 2.92 times. The positive relation of operational efficiency with CSR can be attributed to the fact that firms actively engage in CSR especially external CSR as witnessed in the previous study of Saorin et al. (2018).

Governance has a positive and significant influence on the probability of firm's decision to spend more than 2% of profits on CSR (or proactively performs CSR). Also with one unit increase in governance the probability of the firm to spent more than 2% of the profit on CSR (or proactively perform CSR) is 3.09%. The result of odd ratio reveal that with every one unit increase in governance the odds of the firm to spent more than 2% of the profit on CSR (or proactively perform CSR) is 1.53 times. The positive relation is attributed to the fact that good governance practice supports proper planning, execution and evaluation of CSR projects in the firms. Poorly governed firms lack the support for proper planning and implementation of the CSR projects.

It is evident from the results that both the strategies namely- CSR carried out by the firms themselves (directly) and CSR discharged through other implementing agencies has a positive influence on the probability of the firm to spend more than 2% of profits on CSR. This is because the firms engage in proper planning through their CSR committee to categorise the projects which should be undertaken directly and through other implementing agencies to ensure that CSR project is handled by expert team of professionals and there is optimum utilisation of resources.

The discharge of CSR activities directly has a positive and significant influence on the probability of the firm's decision to spend more than 2% of the profits on CSR (or proactively perform CSR). Also with one unit increase in discharge of CSR directly the probability of the firm to spent more than 2% on CSR (or proactively perform CSR) is 24.93%. The odds of the firm which are carrying out CSR activities themselves (directly) to spent more than 2% of the profit on CSR (or proactively perform CSR activities) is 32.49 times more than the firms opting for other strategies. This implies that firms generally engage in core business related CSR activities themselves which can be related to making the product environmentally friendly or making the production process environmentally friendly which might further influence the firms decision to spend more than 2% in their CSR activities. (Husted et al., 2017).

The discharge of CSR activities through other implementing agencies has a positive and significant influence on the probability of the firm to spend more than 2% of the profit on CSR (or proactively perform CSR). With every one unit increase in discharge of CSR through other implementing agencies the probability of the firm to spent more than 2% on CSR (or proactively perform CSR) is 26.55%. The odds of the firm which are carrying out CSR (or proactively performing CSR activities) is 40.87 times more than the firms opting for other strategies. The positive relation is in conformity with finding of Husted (2003) and Husted et al. (2017). This implies that firms generally engage other implementing agencies to discharge their CSR in non-core areas where the implementing agencies have expertise and experience to plan and execute the CSR activities that are beneficial to the society. Firms generally do not internalise non-core CSR activities for want of expertise, knowledge and experience.

CONCLUSION

The study was undertaken to understand the effect of different strategies (directly and other implementing agencies) adopted by firms for discharge of CSR after the legislation mandating CSR. For this study, data of 249 companies listed on National Stock exchange (NSE Nifty 500) and Bombay Stock Exchange (BSE S&P 200) complying with the requirement of discharging at least 2% profits were chosen. The results indicate that the two strategies- directly and other implementing agencies positively effect the probability of the firms to spend more than 2% of their profit in CSR activities.

The positive effect is attributed to the fact that CSR committee is effectively discharging its obligation of selecting the CSR activities and the strategies for discharge of CSR activities. The strategies for discharge of CSR are decided keeping in mind various factors such as expertise, knowledge, resources, etc. and the firm engages in those CSR activities directly which are related to core business operation of the firms. Other implementing agencies are generally employed to discharge CSR activities in case the CSR activities are not related to the business operation of the firm and additional expertise or resources are required to undertake the project. This reasoning is in accordance with the understanding advanced by Husted (2003) and Husted et al. (2017)

that the non –operation related CSR should be discharged through other implementing agencies and operation related CSR directly to create positive impact on CSR.

Additionally, investment in research and development and corporate governance practices are also associated with the probability of the firm spending more than 2% of their profits in CSR activities.

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Appendix

Table 2 Eigenvalues and proportion of the variance explained by the extracted components after PCA

Component	Eigenvalue	Difference	Proportion	Cumulative
Comp1	**2.59572**	**1.28342**	**0.3708**	**0.3708**
Comp2	**1.3123**	**0.23812**	**0.1875**	**0.5583**
Comp3	**1.07418**	**0.269607**	**0.1535**	**0.7117**
Comp4	0.804574	0.16525	0.1149	0.8267
Comp5	0.639324	0.262852	0.0913	0.918
Comp6	0.376472	0.179043	0.0538	0.9718
Comp7	0.197428	.	0.0282	1

Table 3 Factor loadings of the Governance variables

Variables	Comp1	Comp2	Comp3
Executive director’s remuneration (*executivedirectorsremuneration*)		0.6752	
Number of shareholders outside India (*noofshareholdersoutsideindia*)	0.6103		
Fees for audit (*auditfees*)	0.5129		
Auditor’s fees for company law matters (*auditorsfeesforcompanylawmatters*)	0.5866		
Director’s perquisites (*directorsperquisites*)		0.6709	
Director’s salary (*directorssalary*)			0.5194
Non-executive director’s fees (*nonexecutivedirectorsfees*)			0.8209

Note: Only factor loadings greater than 0.45 are presented