

Exploring the Relationship between Corporate Social Responsibility (CSR) and Directors' Decision Making in Organizations

¹Aditi Shankar Ganesh, ²Gaurav Raj

¹Advocate, B.A. L.L.B, LL.M in (Criminal and Security Law),

²Advocate, B.A. L.L.B, LL.M in (Criminal and Security Law)

¹Bar Council of Delhi, India ²Bar Council of Bihar, India

aditi.s.ganesh@gmail.com, gauravraj4223@gmail.com

Abstract – In this particular research we shall be dealing specifically with the question of ‘How are the decisions made by directors’ impacted Corporate Social Responsibility of the Organization’.

The main objective of this research is to provide concise and straightforward information about the relationship between ‘Corporate Social Responsibility here on referred to as CSR and directors’ decision making in organizations’ to individuals who may not have prior knowledge in this topic. The main intention of this paper is to provide the reader with crisp and fundamental information about the topic without stating much technicalities of the related matter. Thereby explaining the topic in a quite simple, informative yet easily comprehensible manner so that the reader is able to get food for thought.

Methodology: The research methodology utilised in writing this research is *Secondary Data Analysis* where in we shall write our research based on the data collected by from compiling pre-existing data sourced from a variety of different channels.

Key Words: CSR, Directors, Decision Making, Organisation, Internal Factors and External Factors.

INTRODUCTION:

Noreena Hertz once said “All company bosses want a policy on corporate social responsibility. The positive effect is hard to quantify, but the negative consequences of a disaster are enormous”. In this research, we shall be looking at how different factors may affect the decision-making of the director with respect to CSR.

CHAPTER I – DEFINITIONS

Corporate Social Responsibility, commonly referred to as known as CSR, is defined under *section 135¹ of the CA, 2013(CA,2013)* which states that every company having during the immediately preceding financial year:

1. A net worth of rupees five hundred crore or more, or
2. A turnover of rupees one thousand crore or more, or
3. A net profit of rupees five crore or more

Shall constitute a CSR committee of the board consisting of three or more directors, out of which at least one director should be an independent director. CSR is a mandatory responsibility for all types of companies, whether it be a private or public company, and even if its holding or subsidiary company. It is a moral and ethical practice of an organisation towards the society.

CSR activities are carried out by formulating a CSR committee after compliance to section 135 of the CA, 2013. In the event that the average expenditure in the form of CSR is less than 50 lacs then the company need not necessarily constitute or have a CSR committee.

The composition of the CSR committee varies from company to company. However, in general a CSR committee should consist of minimum three directors and one independent director hereon referred to as ID. If there is a private company having only two directors, then both of them shall be included in the committee. In the case of foreign company, there should be two people among which one ought to be a resident of India and the other one can be any person appointed by the company.

The main function of the committee is to frame CSR policy which carries the rules and regulation of these activities which is further presented to the Board of Directors here on after referred to as BOD. A list of all the initiatives which shall be considered as CSR are mentioned under schedule VII of CA, 2013 The CSR committee recommends that the amount that is to be spent on these activities. This committee also aims at providing a more transparent monitoring mechanism by keeping a constant check on the CSR policy.

“Director” means any person who is appointed to the board of a company; it is defined under section 2(34)² of the CA, 2013. A director is responsible for the company's corporate policy. Section 149(1)³ of the CA, 2013 talks about the BOD and states that it ‘comprises of a minimum of three directors in the case of a public company, two directors in the case of a private company and one director in the case of one person company. The maximum strength of directors should be fifteen, but this limit can be increased by passing a special resolution.’ Exceptions are provided to section 8 companies where they can have minimum two directors and maximum not limit director.

There are many types of directors namely, Executive Director (also known as Managing Director / MD), ID, Resident director (RD), Women Director(WD), Additional Director, Alternative Director, Small Shareholder Director(SSD), Whole Time Director(WTD), and Non-Executive Director among the few.

CHAPTER II – RELATIONSHIP BETWEEN CSR AND DIRECTOR’S DECISION MAKING

As we know a decision is made collectively by the BOD unless a specific director is delegated with the power to make a decision on behalf of the company. Looking at the aspect of how the stakeholders of a company can be affected by the decisions made for CSR activities the directors of the company may be for certain pressurised by the fact that they need to constantly ensure that the stakeholders are kept satisfied.

CSR undoubtedly has a very great outcome with regards to increasing brand image of the company and customer loyalty but on the other hand it can have negative consequences like decreased profit due to increase in expenditure on CSR activities and in event where in CSR activities fail can be very detrimental so the directors have to always take into consideration all factors that shall, and may be affected by CSR initiatives taken by the BOD.

CSR initiatives provide a company with long term benefits which is a well-known fact by the directors of the company hence the BOD are always burdened by the fact that any decisions they take with respect to CSR may have either a very positive or negative affect upon themselves.

The main reason why CSR has such a grave impact on the decision making ability of a director is because the company performs a number of activities to sustain in this competitive world, CSR is one of the activities which help them to be interactive with the world in every manner whether it be politically, socially or economically, which somewhere helps them to maintain their image in the market against their competitors. The company is supposed to be a stakeholder in the society and as a responsible member of the society it has to take decisions beyond a reasonable interest of the owners of shareholders of the company for better future of the company.

There can also be a clash between the board of directors and the CSR committee which also affects the directors’ decisions made for the company. The CSR committee always focuses on the ethical goals, values and vision of the company while on the other hand the board of directors are always in favour of the shareholders and the decision which fetches the company's maximum profit. Sometimes activities or investment suggested by the CSR committee do not provide the company with huge or instant returns, where

directors prioritize investing in places where there is huge and instant returns. At times the committee wants additional funds to perform various activities but the board of directors can have objections to this stating that they want to only spend the prescribed 2% amount as mentioned in section 135 of the companies act because they might use their funds in other operations which might provide them with better returns as compared to the CSR activities.

CHAPTER III – FACTORS AFFECTING DECISION MAKING OF DIRECTORS WITH RESPECT TO CSR

Internal Factors: There are many internal factors which can affect the decision making of a director. It can be the personal morals and values of a person. So when connecting this to the aspect of CSR one director might believe in spending more on CSR another director might oppose it due to personal belief of performing social service or contributing to the growth of the local people around them. Experience of a director can also be an internal factor affecting its will to make decisions. An expert of financial background would focus on generating more income by investing in other activities rather than investing in CSR activities. Corporate culture can be one more internal factor here, if the culture of the organization is into risk bearing then they might take decisions related to CSR like spending twice or thrice amount on these activities.

1. **Company Culture:** The internal environment of a corporation especially with respect to how it encourages its employees to take risks and express their creativity impacts the decision making of a director. If a director has to consequently fear any reprimand he may have to face for decisions he may have taken such may decrease the risks he/she takes thereby limiting their capabilities. (Though with the introduction of legal personality of a corporation/ company it has given more room for directors to take more risks without fearing too much about the consequences they might face by hiding behind the corporate veil).
2. **Resources Available:** As a director of a corporation the decision he / she makes with regards to the company is influenced by the resources (monetary, labour, technological etc.) available at his/ her disposal. Limited resource availability may affect what the director prioritizes thereby affecting the impactfulness of CSR initiative.
3. **Company Strategy:** The company's strategy do affect the directors decision making for example if the company approaches or has the aim to enter into new markets or sector than the directors will focus on this goal of the company rather than more focusing on CSR because getting in new sector need a big investment so the company might not be interested in spending of CSR for that particular time being .
4. **Board Dynamics:** The power structure of the board also determines the decisions made on half of the company. If the board has a dominating CEO concerned with the profit making factors he or she may not focus or give importance to CSR activities but end result would lead to degradation of the company's reputation so in future a dominant director will also see the aspects of CSR activities and perform it as per the CA, 2013 act.

External Factors:

1. **Economic Conditions:** In a economic growth phase a director might take a decision to invest more in CSR activities because when in future if the company is in recession stage than it has to spend less on these activities as accordingly to rules and regulations if a company spends more money in advance on CSR activities than they can further claim that amount for the next year in which it need to spend on CSR activities.
2. **Industry Trends:** There are various multiple trends going on in the corporate world one of them is social justice according to which directors need to prioritize the social justice issues like LGBTQ rights which itself results in performing the CSR activities.
3. **Regulatory Environment:** The corporate social responsibility includes the activities concerned to protecting and preserving the environment. As they know it indirectly provides them with a better environment to work so the directors are always concerned with this particular CSR activity.

4. **Stakeholders Expectations:** Stakeholder concerns is also a trend in the corporate world where they prioritize their stakeholder's interest as important as any other aspect of the decision making of the directors. So, it has a conflict with the decisions made for the CSR activities and stakeholders.

Corporate veil can be a shield to the directors of the company while taking decision relating to the matters of CSR activities but it can be lifted up in the case where the decisions are not in the interest of the company and society as whole.

CHAPTER IV - CASE STUDY – 2022 MORBI BRIDGE COLLAPSE CASE.

In Morbi, Gujarat on 30th October 2022 a pedestrian suspended bridge collapsed resulting in the unfortunate demise of about 135 people and injuries to over 180 others. In this case the MD of Ajanta Manufacturing Private Limited of OREVA group Mr. Jaysukh Patel was held as one of the accused of this tragedy. On 25th January an arrest warrant was issued against Mr. Patel by the sessions court when the probe team found that the documents related to repair, operation management all bore his signature and were directly under Patel's purview. The main allegation that was made against Mr. Patel was that he was aware of the risk that came along with this CSR initiative yet he failed to take appropriate measures to address them he has allegedly opened the bridge without obtaining a fitness certification and had also not replaced the main suspension cable that was corroded and had done the repair with ordinary fabricators rather than expert engineers.

This particular case highlighted the importance of directors' fiduciary duties to address CSR risks and potential legal and financial consequences upon failing to do so. More specifically the Director of a company is said to have the fiduciary duty to act keeping the best interest of the company, and stakeholders at mind while working in accordance to the AOA of the company all of this is inclusive of addressing CSR risks as they can cause damage to the company's reputation, result in loss of investors leading to legal and financial consequences. Also, a director's failure to monitor and address those risks he may be held liable for breach of fiduciary duties this can range from suspension, removal, and payment of fine to pressing of criminal charges and imprisonment (the extent of punishment is dependent upon the level of intent and negligence on the part of the director).

Viewing such consequences, a director may become hesitant in taking the necessary risks required to develop itself fearing hefty punishments in the off chance a mishap occurs under their purview.

CONCLUSION:

In conclusion we'd like to pinpoint that there exists a large array of internal and external factors that may affect the relation between CSR and directors' decision making. The decisions that a director makes with respect to the company and its working and how and what CSR initiatives he can suggest, and implement has been mentioned in this research. This research simply intends to bring to light that leaving certain examples of altruistic personalities and professions when it comes to safeguarding one's own interest the decisions made by directors towards CSR initiatives whose primary intention is to give back to the society they are a part of can be may be tinted with personal biases, greed, fear or even opinions beliefs and overconfidence. It is essential that there is a clear-cut distinction between the actions of the Organisation and that of the director and this is where the corporate veil aids in allowing the directors to take risks that are needed for development of the company and providing opportunities to take more CSR initiatives that give back to the community.

^[1] Section 135. 'Corporate Social Responsibility.— (1) 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 shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director. (2) The Board's report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee. (3) The Corporate Social Responsibility Committee shall, — (a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the

activities to be undertaken by the company as specified in Schedule VII; (b) recommend the amount of expenditure to be incurred on the activities referred to in clause (a); And (c) monitor the Corporate Social Responsibility Policy of the company from time to time. (4) The Board of every company referred to in sub-section (1) shall,— (a) after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and (b) ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company. (5) The Board of every company referred to in sub-section (1), shall ensure that the company spends, 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 Corporate Social Responsibility Policy: Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities: Provided further that if the company fails to spend such amount, the Board shall, in its report made under clause (o) of sub-section (3) of section 134, specify the reasons for not spending the amount. Explanation. —For the purposes of this section —average net profit shall be calculated in accordance with the provisions of section 198.’

^[2] Section 2(34)“ director” means a director appointed to the Board of a company.

^[3] Section 149. Company to have Board of Directors.— (1) Every company shall have a Board of Directors consisting of individuals as directors and shall have— (a) a minimum number of three directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company; (b) a maximum of fifteen directors; Provided that a company may appoint more than fifteen directors after passing a special resolution; Provided further that such class or classes of companies as may be prescribed, shall have at least one woman director.