

# INTRODUCTORY APPROACH TO CORPORATE SOCIAL RESPONSIBILITY FOR MSME'S

*A Critical analysis*

Dr. Anju Jain

Associate Professor

Department of Commerce

Shyama Prasad Mukherji College, University of Delhi, New Delhi, India

**Abstract:** MSME entities constitute around 90% of the global businesses today, generating around three fourth of employment levels and half of the economies exports. Having direct access to local communities and societies, MSMEs possess most up to date information about societal preferences and civic requirements. With the mandate of CSR framework in India, the corporate sector is required to channelize technical and professional expertise towards societal development. This research has been made with the objective of establishing a CSR implementation model that an MSME organization may adopt in order to ensure deployment of a sound operational, functional and taxation friendly CSR policy. Applied research utilizing quantitative inputs and empirical evidences has been used to analyze the industry wide reaction to the CSR policy, the reform of business models and the urgent need of implementation of triangular oriented CSR policy which has the capability of satisfying business objectives, stakeholder's commitments and societal interests.

**Keywords:** Corporate Social Responsibility in India, CSR, CSR compliant business policies,

## 1. Introduction

It has been critically observed that the incessant exploitation of natural and human resources to achieve economic gains has left an abysmal impact over the environmental and ecological equilibrium. Masqueraded under the faces of urbanization and modernization, the massive construction / demolition activities have ensued in harmful climate change, contaminated rivers, toxic air quality, soil degradation and entire ecological imbalance. The modern corporate sector has become one of the most advanced economic sector. Companies with valuations in billions and trillions of dollars are having worth more than the entire GDP of few economies. Unfortunately, the fast growth of industrialization has led towards reckless utilization of societal resources without taking any suo – moto cognizance of ecological balance. Moreover concentration of economic wealth and disproportionate distribution of assets is becoming the prime cause of a societal divide. With the second decade of 21<sup>st</sup> century going to pass by, very few entities have actually taken up rectification steps voluntarily. Many western countries had mandated reporting requirements of Corporate Social Responsibility (“CSR”), however, India became the first country to requisite mandatory spending on CSR.

With the mandate of Section 135 of the Companies Act, 2013, the corporate sector in India has witnessed an absolute overhaul on their business operations in India. CSR as the name suggests entails acceptance by the corporate sector about their moral responsibilities towards the society. The CSR legal framework in India has been designed based upon the Gandhian Trusteeship Model with the twin objectives of utilizing professional approach in societal development and mandating the enterprises to payback the society in return of intensified exploitation of resources. The modern Triple Bottom Line (“TBL”) approach states that environmentally accountable attitude, societal values and the financial implications form the triplet which constitute the basic drivers of business model of an enterprise. Therefore without taking cognizance of all the factors collectively, sole focus on financial improvements cannot be achieved.

The voluntary responsibility of the corporates towards the society is governed by legal provisions in the form of CSR. In order to adhere to the newly introduced obligatory framework, organizations need to realign their business model so as to integrate the legal requirements with the stakeholder's objectives. It has been observed that the new compliances often perceived as a hurdle in ease of doing business.

Predominantly the Micro, Small and Medium Enterprises (“MSME”) are most affected in determining the appropriate multi-dimensional business policies and practices.

A detailed criteria has been framed for determining which entities are required to conform with the CSR norms. Such criteria largely cover stable business organizations which have considerable amount of net worth invested and profit generation capacity. Since numerous Indian MSME’s are yet to satisfy the jurisdictional criteria they have got a time leverage to adjust their business policies. With the inculcation of MSME business welcoming programs of the Government of India which is being reflected in India’s ranking for Ease of Doing Business, multiple MSME’s are growing at a fast pace and it is imperative for these entities to understand the quantitative impact of CSR implementation, what are the basic requirements of CSR application and what kind of policies can be instigated which can satisfy the legal requirements in tandem with business objectives at the least costs.

## 2. Research Objectives

The main objective of the present research is to:

- Construct a detailed CSR adoption strategy by MSME’s entailing comprehensive approach providing beginning to end solution.
- Evaluate different CSR policies and practices that may be adopted by Indian MSME’s which have the capacity for providing maximum societal advantage.
- Align the taxation and regulatory framework to integrate the CSR objectives as provided under the Companies Act, 2013 in consonance with organization’s vision so as to yield tax efficiency.

## 3. Research Methodology

The research methodology shall be a comprehensive approach coalescing active research and participatory observation. Detailed analysis of applicable provisions of Companies Act, 2013, Companies (Corporate Social Responsibility Policy) Rules, 2014, Income Tax Act, 1961 and the definition provisions of The Micro, Small and Medium Enterprises Development Act, 2006 are carefully made. CSR implementation program has been prepared on the basis of surveys, questionnaires and existing literature available. The questionnaire had been structured comprising 15 questions pertaining to operational efficiencies under the CSR regime, frequency of involvement of top management in CSR activities, tax department’s response to CSR activities. Secondary data has been further obtained from a variety of resources such as companies annual reports, CSR reports, journals, book releases.

## 4. Literature Review

The existing studies have been predominantly focusing on the legal obligation of the mandatory CSR spending and the legal provisions relating to it. Only selective studies have been made on aligning the business daily practices with the CSR objectives and integrating them towards achieving a tax friendly stakeholder wealth maximization objective. Study by Munmun Dey & Shouvik Sirkar (2012) has proved that the organizations generate substantial return on their investments made on CSR activities. Exploratory research has been conducted examining the CSR integrated business model of Indian conglomerates like TATA, Maruti Udyog. Research by Arevalo, Jorge A. and Aravind, Deepa (2011) had been constrained to only the prominent Indian entities which are partaking in the UN Global Compact. Therefore there arises a need to further evaluate the CSR practices for the entire industry as a whole comprising of MSME sector. Joint research by Tiwari, Ruchi and Pathak, Taral (2014) has explained the concept and related advantages of collaborative approach of CSR highlighting the importance of Cluster CSR and Collective CSR.

## 5. CSR implementation juncture for MSMEs

Micro, Small and Medium Enterprises (“MSME”) refer to the classification of business entities into diverse categories based upon their turnover<sup>1</sup>. MSME segment constitutes those business entities which are not heavy capital intensive and are therefore segmented from the large cap conglomerates. 90% of global businesses are being conducted in the form of MSME segment. With the introduction of the start-up culture

<sup>1</sup> The erstwhile MSME classification based upon investment criteria has been shifted to turnover based classification vide The Micro, Small and Medium Enterprises Development (Amendment) Bill, 2018

and growing demands for technological innovations, major thrust has been imbued upon the growth of MSME segment.

The Micro, Small and Medium Enterprises Development Act, 2006 has laid down the following turnover limits grouping business entities into Micro, Small and Medium category:

**Table 1: MSME Turnover based classification criteria**

MSME Category	Annual turnover (INR)
Medium	75 crores to 250 crores
Small	Between 5 crores to 75 crores
Micro	Less than 5 crores

MSME entities primarily operate on offline model with the local community contributing the most in their success. Therefore these entities access the most updated information about the community expectations, societal desires and needs.

According to Section 135 of the Companies Act, 2013, companies satisfying any of the following criteria are covered within the CSR mandatory provisions:

**Table 2: CSR applicability requirements**

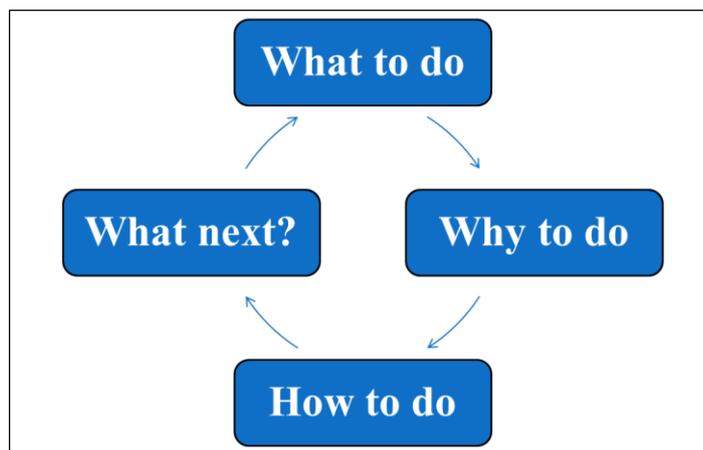
Particulars	Amount (INR)
Net worth	500 crore or more
Turnover	1,000 crore or more
Net profit	5 crore or more

The condition for net profit specifies the amount of 5 crore as the floor limit. By requiring this base amount it is very much probable that majority of the Small and Medium enterprises may get covered within the CSR ambit. Thus the MSME sector has to undergo rigorous CSR compliances and therefore it is imperative for the MSME segment to onboard the CSR platform expeditiously.

The concept of CSR is being actively looked upon by international organizations like the European Union, United Nations, International Civil Society Organizations etc. With increased importance being provided to societal protectionist policies, corporates need to adjust and realign to conform to the global requirements. CSR compliant organizations are able to obtain soft power advantage and thereby get access to newer global markets.

## **6. Drafting CSR strategy by the corporates**

CSR implementation requisites a careful and a detailed execution plan. The CSR strategy can be bifurcated into four difference phases as depicted below:



The above state four phases can be given the terminology of WWHW Cycle. The What, Why, How and What Next cycle depicts a continuing and an enduring process.

The phases can be discussed as below:

- **Phase I: What?**

This involves evaluating the CSR parameters. Active involvement of top management is imperative for definite understanding of the CSR requirements. The entity desiring to implement CSR needs to amass exhaustive data and collate the information on the basis of legal obligations, stakeholder's requirements, vision and mission of the entity, budgetary constraints and pre - existing CSR capacities.

The What phase involves identification of strengths and weaknesses of the organization and thereafter examining the gap between where the organization is presently and where it desires to be.

- **Phase II: Why?**

This phase primarily involves satisfying the top management's question about why the Phase I assessment is needed to be made at a detailed level. Since the senior management and the owners are not hands on about the desired outcome from a new business practice it is required that a meticulously analyzed data is represented to them which assist in taking better commercial decisions.

It has been observed that multiple firms have been engaging in CSR projects without terming these projects as CSR activities<sup>2</sup>. For instance organizations often take up initiatives such as free supplies of goods to nearby needy communities, grants and donations to charitable organizations, educational institutions, education awareness camps etc. qualify within the CSR terminology as laid down by the statute. Therefore the legal requirements can be satisfied without much additional investment.

- **Phase III: How?**

This phase entails drafting the CSR framework providing all the implementation information at one single place. This would require determining the CSR committee structure viz. who shall form part of the CSR committee. Maximum benefits can be extracted when a comprehensive CSR committee is established representing interests of varied sectors, i.e. apart from inclusion of the Board of Directors, representations may be invited from finance, marketing and HR personnel, external representations bringing into notice the concern of the society may be accepted as well. Further employees at all levels can be motivated to provide their suggestions for inclusion in the CSR policy of the organization.

Well defined CSR charter would play a crucial role for long term success of the CSR activities of the enterprise. Firm commitment to CSR initiative that the organization is striving to make must be implicitly imbued in the CSR charter.

Holistic understanding about the legal requirements is sine qua non for comprehensive implementation of CSR. A voluntary initiative can be channelized for fulfilling the statute's purpose if implemented purposefully. It is pertinent to note that it is not mandatory for the applicable companies to incur CSR expenditure absolutely on their own. It is plausible to contribute the requisite amount to a Section 8 company or a NGO trust or society subject to the prescribed conditions. The CSR provisions direct that

<sup>2</sup> Hohnen Paul, Potts Jason (2007), "Corporate Social Responsibility: An Implementation Guide for Business", International Institute for Sustainable Development. ISBN: 978-1-895536-97-3. [http://www.iisd.org/pdf/2007/csr\\_guide.pdf](http://www.iisd.org/pdf/2007/csr_guide.pdf)

the applicable corporates satisfying any of the state criteria are required to institute a CSR Committee comprising at least 3 directors<sup>3</sup>. It is to be further ensured that at least one director amongst the CSR committee is an independent director. Any company falling within any of the above limits is required to contribute at least 2% of its average net profits of the past three financial years towards societal activities. It has been further laid down that if an entity desires to obtain foreign funds for the purposes of conducting CSR activities in India, it is required to adhere to the provisions of Foreign Contribution Regulation Act, 2010 (“FCRA”) under which the entity is required to obtain FCRA registration or prior permission from the Central Government prior to accepting foreign contribution or foreign hospitality. Reviewing the existing business policies shall be a crucial aspect for establishing the CSR framework. The CSR provisions state that mere extension of business principles shall not comprise CSR. For instance hosting of a free medical camp by a hospital will not be called as CSR because such camp’s amounts to indirect promotion of hospital interests. As per the provisions of Companies Act, 2013, CSR has to be made within India with preference being given to local areas within the vicinity of the enterprise. Moreover any surplus balance remaining from the CSR budget cannot form part of the business profits. The CSR policy so finalized is also required to be hosted at the company’s website.

- **Phase IV: What next?**

With customized CSR handbook in place the next step involves instigating community and social work and measuring the actual results with the desired results. Periodical involvement of top management shall be required to ensure systematic variations in the entities CSR policy i.e. suitable amendments shall be required as per the changing needs of the society. For instance if an organization had been targeting on spreading education and had been accordingly contributing to the society in terms of opening schools, providing free education etc. will later on start to realize the need for shift from education to health of the community. Therefore the CSR policy of the organization will experience a shift.

Internal punctilious reports must be generated to gather detailed information about the enterprises CSR initiatives. Further evaluation of the key performance indicators can be used for examining the progress of the CSR initiative. Key functioning of standard operating procedures should be confirmed for prolonged functioning of the CSR committee. Regular review of legal compliances, returns filings and outcome assessment should be made by the CSR committee. Any misinterpretation with respect to CSR provisions can be revised in the What Next phase.

## 7. CSR Policies and Practices for MSME sector

CSR as referred to above is a concoction of policies and practices being undertaken by an entity. Careful selection of desired CSR practices is imperative for fulfilling the objective of community development. MSME’s because of selective availability of resources are further required to make informed decisions about the long term results of the CSR activity being executed. The Companies Act, 2013 has referred to a list of CSR practices which can be adopted by the enterprises under Schedule VII. This list of CSR policies includes CSR practices such as maintenance of ecological balance, efforts in diminishing income inequality, assistance for technological innovations, donation to Prime Ministers National Relief Fund etc. Based upon existing CSR practices being followed by conglomerates across the globe, the MSME’s can adapt the following CSR practices:

### **Joint CSR collaborations and alliances**

MSME sector has been observed to be contributing with short term objectives. Long term objectives prerequisite heavy investment needs. Thus significant contributions can be made by MSME in collaboration with big organizations making headway in CSR. Such collaborations achieve diminished cost of operations, possibility of taking up long term operations and gathering experience of several entities. The collaborative CSR is plausible only when the collaborative entities are in consonance with each other on the terms and objectives of CSR. An inter-company CSR committee may be formed supervising the CSR prospects and CSR activities. CSR activities in joint venture with big business entities help in reducing regional

<sup>3</sup> As amended by Companies (Amendment) Act, 2017; the companies which are not mandated under Section 149(4) to appoint an independent director shall be required to institute CSR committee of at least 2 directors

imbalances through the growth of infrastructural activities specifically in the north-eastern states, Bihar, Jharkhand etc.

### **CSR conduct in collaboration with Group Entities**

It is highly possible that the group entities of a company may also be willing to contribute towards CSR either voluntarily or on mandatory basis. Therefore CSR activities can be undertaken jointly in collaboration with group entities as well. It is not mandatory for a company to partner only with other firms in the same area. Companies can form an alliance with their holding, subsidiary and associate companies as well. Such grouping can result in benefit of synergies being obtained by the company. It may be agreed upon further the detailed working criteria about the CSR implementation, for instance the creation of new society / trust / charitable company or joint operations of CSR etc. It is pertinent to note that where the collaborating entities are covered within the CSR jurisdiction, such collaborations shall be permitted only if the entities report their CSR contributions separately i.e. the individual CSR contributions must be reported in standalone financial statements of every participating entity instead of single reporting in the consolidated financial statements.

### **CSR through personnel capacity development**

Corporations have been permitted to classify the amount of expenditure incurred on honing its personnel skills in performing CSR activities as CSR expenditure subject to a cap limit of 5% of entire CSR budget of the company for a financial year. Payments made to company's employees or the employees of the CSR agencies hired by the company can also be included within this limit. Companies have also been allowed to take into account administrative expenditure and overheads relating to personnel development within the parameters of CSR expenditure.

### **Inference from internationally accepted agreements**

With world organizations realizing the importance of CSR, regular frameworks are being established to smoothen the community development process across the continents. Internationally agreements have been signed upon agreeing to work solely upon societal development and excluding business interests from community work. International societal agreements include United Nations Global Compact, United Nations Convention against Corruption, Universal Declaration of Human Rights, Rio Declaration on Environment and Development 1992, Organization for Economic Co-operation and Development Guidelines for Multinational Enterprises etc. The MSME can take benefits of such arrangements through their CSR policy.

## **8. Taxation aspect related to CSR expenditure**

General deduction from profits and gains of business and profession is provided under Section 37(1) of the Income Tax Act, 1961. General admissibility is provided to all the revenue expenditure which are incurred in the course of business. Since CSR spending explicitly excludes those activities which are in the nature of the business, any CSR activity shall be outside the purview of the business and hence shall not be provided with an income tax deduction. CSR expenditure shall be considered as an appropriation of profits rather than a charge on profits has been clarified by the provisions of the Finance Act, 2014 and further by Ministry of Corporate Affairs<sup>4</sup> ("MCA"). Therefore non admissibility of general CSR expenditure has been accepted at the macro level but it is also important to note that at the micro level few tax litigations have also been pronounced in favor of the assessee accepting CSR expenditure incurred within the proximity of assessee's place of business as deductible<sup>5</sup>.

However realignment of CSR initiative with the societal initiative provisions as provided under the tax law can achieve tax efficacy with assurance of not involving into litigations. Even if these activities are not associated with the regular course of business, tax deductibility has been provided keeping in view the societal development perspective. The general tax tenet has been the allowance of contributions and donations made for charitable purposes under Section 80G of the Income Tax law. Therefore the corporate

<sup>4</sup> MCA Circular No. 01/2016 dated January 12, 2016

<sup>5</sup> CIT v. Madura Coats Ltd. [24 DTR 24](Mad); Infosys Technologies v. JCIT [109 TTJ 631](Bang)

entity can contribute to third party NGOs registered under Section 80G or the corporate entity may itself incorporate a NGO and get it registered under the Income Tax law. While CSR expenditure under the Corporate Law can be claimed to have been incurred while contributing to the entities, tax deductibility can also be taken under the referred section. It can be further ensured that the entity towards whom the donation has been made is rightly making contributions towards the society or not. Funds registered under Section 80G include Prime Ministers Drought Relief Fund, Prime Ministers Relief Fund, Jawaharlal Nehru memorial Fund etc. Similar donations can be made to organizations covered under Section 35AC of the Income Tax Act.

Fastidious analysis of tax provisions reveals that careful integration of the CSR policy with tax statute requirement may provide weighted deduction of 125%, 150%, 175% or 200% as the case may be. For instance the Income Tax law provides certain additional deductions for expenditures made on activities such as skill development initiatives, rural development, charitable and welfare activities. Say an expenditure of Rs. 1 lakh is made on skill development activity, the company assessee becomes eligible to obtain deduction of Rs. 1.50 lakhs while computing its taxable income, thus yielding a straight benefit of Rs. 50,000, subject to other prescribed conditions. Other avenues that may be explored include expenditure on scientific research. Contributions made to universities, colleges or other notified institutions for conducting scientific research yields deduction of 1.5 times the amount of contribution. Similar contributions made to research associations or colleges for conducting social research or statistical research shall be eligible for 100% tax deductibility (as amended by Finance Act, 2018). Expenditures on notified agricultural extension project also provide tax incentives of 1.5 times the amount incurred. For obtaining tax advantages related to CSR expenditures it is needed to be ensured that deductibility shall be allowed only of expenses which are revenue in nature. Capital expenses are governed by depreciation provisions which is granted only in relation to those capital assets which are used for active business purposes.

## 9. Conclusion

Corporate Social responsibilities have long been perceived as an additional encumbrance in facilitating business in India. In fact any mandate not directly attributing towards revenue generation is often considered as an impediment, however if observed critically, CSR obligation possesses the potential to completely transform the business model of an enterprise. The amount of benefits and value addition that a business provides to the society are immense. The use of qualified professional skills with managerial corporate innovations in CSR implementation is further expected to deliver a multiplier phenomenon in societal development. Consequently the business entities obtain advantages of better public image, increased customer satisfaction, improved visibility etc. Therefore the organizations are able to derive attractive returns from their CSR activities. This implies that CSR framework can achieve the objective of increased welfare of public along with encouraging the corporations in engaging in CSR activities regularly.

To ensure smooth onboarding of CSR regime, the business entities shall be required to make apposite alterations in the work methodology transforming the business model. Apart from justifying the Companies Act regulations, the entities are also required to satisfy multiple other regulations for instance the Income Tax Act, 1961. As per the applicable provisions of the direct tax law, the CSR expenditure is not allowed as a deduction while computing the profits and gains from business or profession. Therefore the CSR expenditure might add as an additional expense on the organization's account. However with proper scheduling and drafting and careful execution of CSR practices, MSME's may be able to satisfy the requirements of Income Tax law as well. Therefore meticulous analysis of multiple policies and practices that an organization can adopt in order to have a sound operational, functional and taxation friendly environment along with their analogy with statute mandated CSR policy forms a critical objective of this research.

MSME corporations need to instigate CSR approach cautiously since the new CSR policies may have an impact over the financial functioning of the entity. A well drafted CSR strategizing document has been prepared through this research providing the corporations a phase by phase approach for shifting towards CSR regime. Further MSME corporations have been advised with particular CSR policies and practices which can be adopted for satisfying legal and societal requirements.

## 10. References

- Arevalo, Jorge & Aravind, Deepa. (2011). Corporate social responsibility practices in India: Approach, drivers, and barriers. *Corporate Governance*. 11. 399-414.
- Arora, B. & Puranik, R. 2004. A review of corporate social responsibility in India. *Development*, 47(3): 93–100.
- Ayub Mehar & Farah Rahat, 2007. "Impact of Corporate Social Responsibility on Firm's Financial Performance," *South Asian Journal of Management Sciences (SAJMS)*, Iqra University, Vol. 1(1), pages 16-24.
- Bafna, Arpit (2017). A Study on the Impact of CSR on Financial Performance of Companies in India. *International Journal of Engineering Technology Science and Research*. Volume 4, Issue 12 December 2017.
- Beekman, A. & Robinson, R. 2004. Supplier partnerships and the small high growth firm: Selecting for success. *Journal of Small Business Management*, 42: 59–77.
- Emiliani, M. 2000. Supporting small businesses in their transition to lean production. *Supply Chain Management: An international journal*, 5: 66–70.
- Hohnen Paul, Potts Jason (2007), *Corporate Social Responsibility: An Implementation Guide for Business*, International Institute for Sustainable Development. ISBN: 978-1-895536-97-3.
- Munmun Dey & Shouvik Sirkar (Jan 2012), *Integrating Corporate Social Responsibility Initiatives with Business Strategy: A Study of Indian Companies*, *IUP Journal of Corporate Governance*, ISSN-0972-6853
- Parquet, I. Robert & Eilbirt, Henry, 1975. "The practice of business social responsibility: the underlying factors," *Business Horizons*, Elsevier, Vol. 18(4), pages 5-10.
- Prasad Anirudh & Sudeep Kumar (2013). "Poverty Alleviation through Corporate Social Responsibility Policy: An Ethnographic Study of TATA Steel Initiatives in a Jamshedpur Village". *Jharkhand Journal of Development and Management Studies XISS Ranchi*, Vol. 11, No. 2, June 2013, pp. 5297 – 5323.
- Rajmohan, S., Dhurairaj, D. (2012), "Empowering SMEs through Priority Sector Advances", *International Journal of Business and General Management*, Vol.1, Issue 2, pp. 13-20.
- Sharma Sanjay (2013). A 360 degree analysis of Corporate Social Responsibility (CSR) Mandate of the New Companies Act, 2013. *Global Journal of Management and Business Studies*. Volume 3, Number 7 (2013), pp. 757-762.
- Spence, L. 1999. Does size matter? The state of the art in small business ethics. *Business Ethics: A European review*, 8(9): 163–172.
- Suresh, P., Mohideen, A. (2012), "Small Medium Enterprises in India - Issues and Prospects", *International Journal of Management Research and Review*, Feb. 2012, Vol. 2, Issue 2, pp. 247-245.
- Teoh, Siew Hong & Welch, Ivo & Wazzan, C Paul, 1999. "The Effect of Socially Activist Investment Policies on the Financial Markets: Evidence from the South African Boycott," *The Journal of Business*, University of Chicago Press, vol. 72(1), pages 35-89.
- Tiwari, Ruchi & Pathak, Taral (December 2014), *Sustainable CSR for Micro, Small and Medium Enterprises*, *Journal of Management and Public Policy*, Vol.6, Pp 34-44
- Tripathi, Abhishek & Bains, Anupama (2013). A Study Of Indian CSR Practices In Small And Medium Enterprises, *International Journal of Advanced Research in Management and Social Sciences*. Vol 2, No. 10, pages 92 – 103.