MANDATORY CORPORATE SOCIAL RESPONSIBILITY IN INDIA: INTERLINKAGES WITH CORPORATE GOVERNANCE AND FINANCIAL MARKET REGULATION

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ABSTRACT

India's move to mandate corporate social responsibility (CSR) under the Companies Act, 2013, is a fascinating step toward building stronger connections between companies and the communities they serve. Section 135, along with the CSR Rules, encourages eligible companies to dedicate at least two per cent of their average net profits to activities that benefit society. This paper explores how mandatory CSR interacts with corporate governance and financial regulation in India. It looks at how compliance has helped redefine board responsibilities, boosted transparency and disclosure standards, and strengthened investor confidence through tools like SEBI's Business Responsibility and Sustainability Reporting (BRSR). A case study of Reliance Industries Limited (RIL) offers a real-world look at how CSR, governance, and financial markets come together. Overall, while mandatory CSR has improved transparency and accountability, there's a clear need for structural reforms to enhance governance integration and ensure corporate actions align with sustainable development goals.

Keywords: Board Responsibilities, Corporate Governance, Corporate Social Responsibility (CSR), Financial Regulation, Sustainability Reporting.

INTRODUCTION

Corporate social responsibility (CSR) is not a new idea in India. Long before the Companies Act, 2013, major industrial houses such as the Tata's, Birla's and Bajaj's supported philanthropy, education, and health initiatives as part of their ethical business traditions. However, the statutory embedding of CSR in Section 135 of the Companies Act, 2013, marks

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a standard shift; India became the first country in the world to legislate mandatory CSR expenditure.

The mandate obligates companies with a net worth of ₹500 crore or more, turnover of ₹1000 crore or more, or net profit of ₹5 crore or more in a financial year, to spend at least two per cent of their average net profits from the preceding three years on CSR activities specified in Schedule VII.[1] This obligation links corporate profits to public welfare in a legally enforceable way.

The research question looks into whether this legal requirement is just a compliance hurdle or if it actually helps improve corporate governance and makes markets work more smoothly. Two sets of interlinkages are crucial:

CSR and Corporate Governance: Board-level accountability, fiduciary duties, and stakeholder engagement.

CSR and Financial Market Regulation: Disclosure norms, ESG integration, and investor decision-making.

This paper investigates these interconnections.

CONCEPTUAL AND THEORETICAL FRAMEWORK

CSR has many interpretations, but can be understood as a concept imposing a liability on the company to contribute to society, along with the reinforced duty to conduct business ethically. It is also known as corporate conscience, corporate citizenship, social performance, or sustainable business/responsible business.

Although CSR was once voluntary, the Indian approach makes it a legal requirement.

Corporate governance, meanwhile, entails a system by which companies are directed and controlled, ensuring accountability, transparency, fairness, and responsibility towards shareholders and stakeholders.

[1] Companies Act, 2013, s. 135.

Financial market regulation seeks to ensure efficiency, integrity, and transparency in securities markets, with SEBI playing the central role. The intersection between CSR and markets arises because non-financial disclosures increasingly influence investor choices and firm valuation.

Three theoretical perspectives frame this study:

Stakeholder theory: Corporations must balance obligations to multiple stakeholders beyond shareholders.

Agency theory: Directors must manage conflicts between managers and owners; CSR duties alter fiduciary obligations.

Signalling theory: CSR disclosures provide non-financial signals to investors, affecting perceptions of firm quality and risk.

CSR IN INDIA: LEGAL AND REGULATORY FRAMEWORK

Statutory Basis: Section 135 of the Companies Act, 2013 requires qualifying companies to constitute a CSR Committee of the Board, formulate a CSR Policy, and ensure that at least 2% of average net profits are spent on CSR.[2] Non-compliance requires disclosure of reasons, and amendments in 2019 introduced monetary penalties and mandated transfer of unspent CSR funds to specified accounts.[3]

CSR Policy Rules: The Companies (CSR Policy) Rules, 2014 operationalised Section 135, defining permissible CSR activities (aligned to Schedule VII), implementation mechanisms, reporting formats, and exclusions (e.g., political contributions, activities benefiting employees exclusively). Amendments in 2021 and 2022 further refined these provisions, introducing compulsory impact assessment for large projects and stringent disclosure norms.[4]

Role of SEBI and Market Disclosures: CSR regulation intersects with financial markets primarily through disclosure. SEBI introduced the Business Responsibility Reporting (BRR) framework in 2012, later replaced with the Business Responsibility and Sustainability Reporting (BRSR) framework in 2021.[5] BRSR mandates the top 1,000 listed entities to disclose ESG-related information, enabling investors to evaluate social responsibility performance.

[2] Ibid.
[3] Companies (Amendment) Act, 2019, s. 21.
[4] Companies (CSR Policy) Amendment Rules, 2021; Companies (CSR Policy) Amendment Rules, 2022.
[5] SEBI Circular No. SEBI/HO/CFD/CMD-2/P/CIR/2021/562 (10 May 2021).

CSR spending thus becomes not just a statutory obligation but also a market indicator about the company's overall health, long-term viability, ethical standards, and values.

CSR AND CORPORATE GOVERNANCE

Board Responsibilities: CSR introduces new governance duties. The Board must approve the CSR policy, ensure spending, and disclose activities in the annual report. Independent directors on the CSR committee add oversight.[6] This framework ensures that social responsibility becomes part of boardroom deliberations, widening the scope of fiduciary responsibility to reflect both shareholder returns and stakeholder welfare.

Shareholder Engagement: Institutional investors are increasingly looking at companies' performance on ESG issues, including CSR, when making investment decisions. They do more than just invest; they actively engage with companies through voting and discussions with management, encouraging boards to treat CSR as part of long-term strategy rather than just charity.

In India, proxy advisory firms and institutional investors now monitor CSR compliance when evaluating boards. They consider not only whether companies meet the legal spending requirements under Section 135 of the Companies Act, 2013, but also how transparent the reporting is, how effective the projects are, and whether CSR aligns with the company's overall strategy. This puts pressure on boards to take CSR seriously and integrate it into corporate governance, making them accountable to stakeholders as well as shareholders.

Governance Risks and Misuse: Despite the formal CSR mandate under Section 135 of the Companies Act, 2013, many companies initially approached CSR as a mere compliance exercise. Reports[7] highlighted issues such as misuse of CSR funds, diversion of funds for corporate promotion, and a lack of impact measurement. To address these concerns, the Ministry of Corporate Affairs (MCA) notified the Companies (CSR Policy) Amendment Rules, 2021, introducing several key provisions aimed at enhancing transparency, accountability, and effectiveness in CSR activities.

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[6] Companies Act, 2013, s. 135(3).

[7] Ministry of Corporate Affairs, Report of High-Level Committee on CSR (2015).

Mandatory Impact Assessment: The 2021 amendments[8] introduced mandatory impact assessments for certain CSR projects. Companies with an average CSR obligation of ₹10 crore or more in the preceding three financial years are required to conduct impact assessments through independent agencies for projects with outlays of ₹1 crore or more, provided these projects have been completed at least one year before the assessment.

Key Features:

- **Expenditure Cap:** The expenditure on impact assessment is capped at 5% of the total CSR expenditure or ₹50 lakh, whichever is lower.
- **Reporting Requirements:** The impact assessment report must be placed before the Board of Directors and disclosed in the Annual Report on CSR.
- **Objective:** To evaluate the effectiveness and outcomes of CSR initiatives, ensuring that funds are utilised efficiently and objectives are met.

Stricter Fund Utilisation and Transfer Rules: The amendments introduced stricter guidelines for the utilisation and transfer of unspent CSR funds:

Ongoing Projects: Unspent amounts from ongoing projects must be transferred to a separate bank account and utilised within three financial years. If not utilised within this period, the funds must be transferred to a fund specified in Schedule VII.

Other Unspent Amounts: Unspent amounts not related to ongoing projects must be transferred to a fund specified in Schedule VII within six months of the end of the financial year.

Penalties for Non-Compliance: To enforce compliance, the amendments introduced stringent penalties:

Company Level Penalties: Companies failing to disclose unspent amounts or transfer them to the specified funds within the stipulated timeframes are liable to a penalty of the lower of:

- Twice the amount required to be transferred to the fund specified in Schedule VII or the Unspent CSR Account.
- ₹1 crore.

[8] Companies (CSR Policy) Amendment Rules, 2021.

Officer Level Penalties: Every officer of the company in default shall be liable to a penalty of the lower:

- One-tenth of the amount required to be transferred to the fund specified in Schedule VII or the Unspent CSR Account.
- ₹2 lakh

Case Study: Gujarat High Court Ruling: In a significant development, the Gujarat High Court quashed a criminal complaint against KHS Machinery Pvt Ltd[9] for failing to meet CSR obligations for the financial year 2014-15. The company was accused of underspending and insufficient disclosure regarding its CSR activities. The court recognised that CSR-related offences had been decriminalised under the 2020 amendment to the Companies Act, converting criminal liability into monetary fines. Justice J.C. Doshi ruled in favour of the company, stating that the decriminalisation should apply retrospectively, and directed the matter to an adjudicating authority to set an appropriate penalty.

CSR AND FINANCIAL MARKET REGULATION

Integration with ESG: The global rise of Environmental, Social, and Governance (ESG) investing has increased the importance of CSR as a factor influencing corporate valuation and investor decision-making. Investors are no longer evaluating companies solely on financial performance; they increasingly consider how firms address social and environmental responsibilities. In India, SEBI's Business Responsibility and Sustainability Reporting (BRSR) framework institutionalises this shift by requiring listed companies to provide detailed disclosures on CSR spending, project outcomes, and broader sustainability metrics. These disclosures include the types of initiatives undertaken, the amount spent, the number of beneficiaries, and measurable social or environmental impact.

This transparency serves multiple purposes. First, it allows investors to identify companies that are genuinely committed to social responsibility, providing a market signal of ethical and sustainable governance. Second, it enables credit rating agencies and financial analysts to incorporate non-financial risks such as social, environmental, or governance failures into their assessment of a firm's overall risk profile. Third, robust CSR reporting strengthens corporate accountability and incentivises boards to align CSR strategies with long-term business

[9] KHS Machinery Pvt Ltd v. Registrar of Companies, R/SCR.A/9563/2017 (Gujarat High Court).

objectives rather than treating it as a peripheral obligation. Collectively, these developments demonstrate that CSR is no longer merely a regulatory requirement but a strategic component that influences market perception, investor confidence, and corporate valuation.

Market Discipline: CSR non-compliance or poor disclosure attracts reputational penalties, potentially affecting share prices and cost of capital. Conversely, strong CSR disclosure signals responsible governance, attracting long-term capital.

CASE STUDY: RELIANCE INDUSTRIES LIMITED (RIL)

Reliance Industries Limited (RIL), India's largest private-sector company by market capitalisation, provides an illustrative case study.

Scale and Compliance: RIL consistently ranks among the top corporate spenders on CSR, with over ₹1,000 crore allocated annually in recent years. Its initiatives cover rural transformation, healthcare, education, and the environment.[10] In FY 2021–22, RIL spent ₹1,140 crore on CSR, exceeding the statutory requirement.[11]

Governance Structures: RIL has constituted a CSR and Sustainability Committee of the Board. The Committee oversees policy formulation, project selection, and monitoring. Independent directors are part of this committee, ensuring governance oversight.

Market Impact and Disclosure: RIL integrates CSR reporting with its sustainability reporting, disclosing not only expenditure but also project outcomes. Its disclosures under SEBI's BRSR framework highlight ESG alignment. Investor perception studies note that RIL's consistent CSR engagement strengthens its brand and sustains investor confidence, especially among ESG-focused funds.

Critiques: Despite high spending, critics point out that a significant proportion of RIL's CSR is channelled through its own foundation, raising questions of independence and impact assessment.[12] Furthermore, some analysts argue that CSR activities often overlap with brand-building exercises, blurring lines between philanthropy and business strategy.

[10] Reliance Industries Ltd., *Annual Report 2021–22*, CSR Report Section.
[11] Ibid.
[12] K. Balasubramanian, "Corporate Philanthropy or Strategic Branding? An Analysis of Reliance's CSR" (2020) 55(3) *Economic and Political Weekly* 45.

CRITICAL ANALYSIS

Strengths of Mandatory CSR

Integration into Governance: By statutorily requiring board oversight, CSR becomes a part of formal governance structures.

Transparency: SEBI's BRSR framework creates market-facing disclosures, improving comparability and accountability.

Market Validation: Evidence supports a positive correlation between CSR and firm value.[13]

Weaknesses

Compliance Orientation: Many firms aim only to meet the 2% threshold without embedding CSR into their long-term strategy.

Monitoring Difficulties: Regulators face challenges in ensuring that funds achieve intended social outcomes.

Fragmentation of Regulation: Coordination between MCA and SEBI remains incomplete.

WAY FORWARD

Shift to Impact-Based CSR: Move beyond expenditure-based compliance; require structured impact assessments with third-party audits.

Strengthen Board Oversight: Include CSR expertise on boards, expand the role of independent directors in CSR committees.

Harmonise Regulatory Framework: Greater coordination between MCA and SEBI to ensure consistency in disclosure, monitoring, and enforcement.

CONCLUSION

Mandatory CSR represents a pioneering legislative experiment that fuses corporate law, governance, and market regulation. India's framework has expanded board responsibilities,

[13] R. Panwar, P. Nybakk, "Mandatory CSR and Firm Value: Evidence from India" (2021) 103 *Business & Society* 509.

deepened disclosure norms, and provided new tools for investors to evaluate corporate performance.

Ultimately, the future of CSR in India depends on moving from a compliance-driven approach to an impact-oriented framework. Integrating CSR more deeply will ensure that CSR functions not merely as a statutory expenditure but as a driver of sustainable corporate citizenship.