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Subir Gokarn: Leveraging the CSR mandate

Some institutional arrangements that can maximise the collective impact of individual contributions

Subir Gokarn **November 15, 2015** Last Updated at 21:50 IST

The Companies Act of 2013 mandates a contribution of two per cent of post-tax profits of companies to corporate social responsibility (CSR) activities. There was much debate about the merits of this mandate, with critics seeing it as a back-door tax. While it is in a way, the fact is that a tax would go into the government's larger kitty, the consolidated fund of India, whereas this pool of funds is, in theory, dedicated to activities that are presumably in the larger public interest. The motivation for the requirement, clearly, is to bring in doses of commitment and corporate groups' efficiency into the delivery of public and welfare services to the extent possible.

It is with reference to this objective that the mandate should be judged. Can corporate groups' participation in the form of a large number of individual companies contributing what might be variable amounts of money each year to activities that have been prioritised by a wholly internal process add up to a macro-level impact?

The worst case scenario here is that many companies, representing a large proportion of the resource pool, will each spend money in isolation, doing commendable things, but at scales that are too small to make much of an impact and with no guarantee of competence and efficiency because these activities are completely outside their domains. Further, because there is no guarantee that they will each make profits each year, each initiative will always be vulnerable to a funding crunch.

So, the policy question is: what kind of mechanisms are necessary to maximise the impact of the mandate and to protect its functioning from the risks emanating from fragmentation, lack of domain competence and funding uncertainties?

The solution is, conceptually, obvious. First, any mechanism that is put in place must create opportunities for aggregation of expenditure, allowing several companies to pool their contributions for a common cause. A small number of initiatives being run at very large scales are more likely to have a macro-level impact than numerous efforts being made in isolation.

Second, these initiatives need to be run by institutions and people with the most appropriate expertise. Some individual companies may have it, but most, particularly the smaller ones, will not. Delivery expertise in any domain is more likely to reside in several non-governmental organisations, which have built up this capacity over years. What corporate participants can do is to bring governance and accountability mechanisms into the picture, increasing the likelihood that the funds are being used appropriately and effectively.

Third, public-private partnership in this domain must have a financial dimension. Each initiative beyond a certain size must be given some comfort in the form of contingent budgetary support, so that it does not run the risk of withering when corporate profitability slumps, as it typically does in the trough phase of the business cycle.

Moving from concept to execution, each problem has some reasonable solutions. The aggregation objective is best served by giving companies choices of large initiatives to which they can contribute both funds and expertise. Such an approach was proposed in an article on this page last year ('Companies and Cities', Jyotsna Bapat, March 31, 2014), in the context of urban development strategies. The same approach is feasible at the national level as well. The launching of several major missions by the government potentially provides a platform for CSR contributions.

Budget provisions made by the government can be enhanced and reinforced by resources through the CSR mandate. In fact, this could be built into the mission design as it evolves over the years. Also, specific domain expertise that corporate contributors bring to the table can be explicitly built into the mission design and execution. In short, this aggregation approach will allow for substantial corporate participation in the public service and welfare priorities that the government articulates through missions.

The issue of expertise calls for an arrangement that separates execution from governance. Within a broad mission framework, specific activities can obviously be identified and, in turn, organisations that provide the best prospects for efficient execution. As I said earlier, some of these may be the corporate groups themselves, but these skills are most likely to reside in entities that receive rather than contribute money. A practical arrangement would involve three components.

One would be a "certificate"; proof of an activity having been carried out - say, a Swachh Bharat certificate representing a cluster of toilets. This certificate could be "bought" by corporate groups as evidence of their fulfillment of their CSR mandate. A second would be an audit mechanism that actually authenticates and validates the activity represented by the certificate. This could cover multiple domains and also be funded and run by corporate groups as part of their CSR mandate. A third would be impact assessment, also across multiple domains and financed the same way.

Finally, on the issue of minimising funding risks, I wrote about the issue of budgeting for missions in my previous column ('A fiscal framework for missions', November 2, 2015). One key to success is the assurance of funding over the life-cycle of the mission. Obviously, both corporate profits and tax revenues - and hence, government spending capacity - are subject to the same cycle, the former being the base for the latter. But, contributions from corporate profits have an added dimension of risk because individual companies can do badly even in a benign macroeconomic environment.

This problem cannot be fully solved. One way to at least partially offset the risk is to design the initiative in a modular way, so that some baseline activities - particularly, those relating to maintenance - are always going to be funded, even in lean periods, while others can be financed subject to the funds situation. A pecking order for allocation of funds needs to be laid out for each initiative, so that, as long as it has a positive impact, it does not die from lack of funds.

In short, the CSR mandate may be seen as a necessity, but there are mechanisms that can convert it into a virtue.

The author is director of research at Brookings India and former deputy governor of the Reserve Bank of India These views are his own