

Responsible Corporate Governance

Integrating CSR and Corporate Governance Framework



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1. Corporate business has emerged as the strongest prime mover of economic growth during the last 50 years. The global business has progressively moved towards a much higher proportion in the hands of organized business entities. The world during this period witnessed the demolition of political and trade barriers which allowed greater free movement of factors of production that is material, men, money, machines etc. The free movement of factors of productions and easier access to markets encouraged the business entities to expand their operations beyond national borders. This was also assisted by the establishment of global financial markets that allowed funds to be accessed by business entities any where in the world. This period also witnessed the emergence of very large and complex transnational business corporations. While at the initial stage of such corporations originated mostly from Europe and USA, there was a strong resurgence of such business entities from Japan and South Korea in the last 3 decades. The entry of China in the global business environment during the last two decades changed the corporate business fabric of the world completely. The current decade saw the emergence large multinational corporations from India and other emerging economies like South Africa, Brazil etc.
 2. The fundamental reason of emergence of corporate sector as the most important prime mover of economic growth is its ability to take risk, which is inherent in the corporate business structure due to concept of limited liability. The promoters and managers of companies are able to mobilize large quantum of public funds and invest them while taking a certain degree of risk. This is enabled by the separation of the business as a legal entity by itself from the promoters thereby limiting their liability, in case of failure of the business venture, to their own contribution.
 3. The architecture of corporate business enables different stakeholders to pool in their resources with a view to get higher return from the operation of the business. Therefore, while the companies are seen as generator of wealth of their stakeholders, they are also powerful instruments of distribution of wealth to a larger section of the society and to bring about economic well-being for a greater number of people. The growth of capital markets with millions of people participating in it has been a proof of this income-distributive effect of corporate business. However, there has been a strong argument, backed by sufficient research that corporate business has also resulted in economic disparities. As more and more global economic resources get controlled by lesser number of business entities, the distribution of wealth gets more and more skewed in favour of the 'haves'. Transfer of wealth generated from the resources available with relatively less developed countries through the operation of large multinational corporations has been a matter of debate for a long time. However, this position is slowly changing with the entry of emerging economies and their economic power on the global business environment.
 4. The very nature of corporate architecture centered on the concept of limited liability, calls for an elaborate regulatory framework to control its functioning and also restrict the powers of the managers so that they do not over-step their basic role of being custodian of stakeholders' money. The regulatory framework for corporate sector is as old as the corporate form of business itself. Different jurisdictions in the world have developed their own corporate laws although there is a fairly high degree of similarity in the architecture of these laws. The basic aspects of a company structure with limited liability, governance by democratic principles of shareholders rights, supervision by Boards of Directors, credible Disclosures are some of the features of corporate laws in any national jurisdiction.
 5. With the expansion of the scale of business, companies needed more and more resources to be generated from different stakeholders. This led to the development of the concept of listed companies where the ownership of the company gets spread over a large number of shareholders and the management control gets decided according to the democratic principles. Such companies, some time involving millions of shareholders from across the
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- world, needed a different form of regulatory framework since the public interest involved in these was much higher. On the one hand governments were faced with dilemma of the demand from the shareholders for greater regulation and on the other hand the governments were well aware of their own limited capacity to enforce these regulations. This called for an innovative method by which the government could achieve the fine balance between the two. This was achieved through the instrument of 'Corporate Governance' where the governments prescribed a basic structure of governance of companies and left the supervisory control to the shareholders through the system of voting on the basis of their shareholding. In order to enable the shareholders to exercise the supervisory control, the corporate governance frameworks prescribed for an elaborate system of corporate disclosures.
6. Therefore, all national jurisdictions developed their CG frameworks along with the basic corporate laws to deal with such companies. The development of CG frameworks, and their frequent tilting towards greater regulations (Sarbanes Oxley et al), have been pushed by shareholder activism and often triggered by corporate frauds. However, since the corporate governance movement was largely driven by shareholders activism, this has remain restricted to the listed companies only.; It is a fact that there are very large unlisted companies which have significant public interest by way of employment, control of natural resources and lending by public sector banking institutions. The principles of corporate governance, as understood by most jurisdictions, do not appear to be applicable to unlimited companies. However, this issue is a matter of current ongoing debate and there is a distinct call for separate regulatory framework for companies that are not listed but are 'systematically important'.
 7. In most jurisdictions where corporate governance framework has developed and matured over a period of time, there are two distinct elements of the framework – statutory and voluntary. While the statutory component is a part of the corporate laws which prescribe the minimum expectation of corporate behaviour, the voluntary components indicate the desirable characteristics of the functioning of a responsible business entity. What constitutes the minimum standard of good corporate governance and behaviour is decided by each national jurisdiction although there are forums that promote common minimum standards that should be applicable to all companies across all jurisdictions. In light of the corporate frauds like Enron, Satyam, Worldcom etc. there is also an active debate as to what should be regulated and what component should be left for voluntary observance.
 8. One of the important aspects of corporate functioning is that even with the elaborate system of corporate regulation through the corporate laws, corporate governance framework and corporate disclosures; the element of greed of the promoters and managers could not be curtailed. The occurrence of frauds of the size that impact the entire global business environment has been seen at regular intervals. The misuse of corporate resources, abuse of economic power of business entities and the tendency of corporate business of not allowing the economic benefit of its operation to flow a larger number of people have been a target of civil society organizations and also the governments in certain cases. This has brought the issue of stakeholders' expectations from the business entities into the centre stage which has resulted in a global focus on the subject of corporate social responsibility. While philanthropic activities have traditionally been part of the business operations, the expectations of stakeholders from the corporate sector have increased substantially, especially during the last two decades.
 9. With the emergence of multinational corporations having their operations in different parts of the world, the issue of some companies following different norms of behaviour towards its stakeholders in different countries has become a matter of strong debate. Simultaneously, the customers of products in the developed world have started demanding certain basic standards of responsible behaviour in terms of labour and human rights from the companies. Therefore, the CSR models which emerged in these developed countries had a greater 'obsession' with supply chain behaviour and uniformity of standards and practices of business operations.
 10. While the MNCs were seen as adhering to certain basic principles of responsible behaviour, in their operations in the developing countries, the multinational companies often indulged in demonstrative CSR activities in order to get a greater degree of acceptance. While the civil society in these countries did take the call of voicing societal concerns in this area, the governments were often found hesitant in taking up the issue of CSR as its agenda. Nevertheless, the limited involvement of governments resulted in CSR models in developing countries focusing more on affirmative action for society's developmental aspects. But it remains a fact that CSR models developed by emerging economies and lesser developed countries originated in their own national situations and challenges.
 11. But globally, the CSR movement has not been as organized as the CG movement. Therefore, a large number of CSR initiatives, driven by various multi-lateral organizations and interest groups, have emerged in the last three decades. These initiatives
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can be broadly categorized in two distinct categories, one related to prescribing certain standards of behaviour and second related to greater non-financial disclosures of effect of business operation to people, society and environment. With the environmental issue taking the centre stage, the subject of sustainability has been incorporated into the CSR movement in the current decade. At the apex level, we have the United Nation Global Compact, United States Principle of Responsible Investments and the UN Initiatives of Business and Human Right are the global multilateral initiatives. The OECD has its pan-European CSR Guidelines which it is attempting to extend to other parts of the world also. The International Standards Organization is almost ready with the release of the ISO 26000 Guidance Standards on CSR. There are about six dozen sectoral initiatives and sustainability which have been piloted by various organizations. In terms of disclosures framework, the Global Reporting Initiative, with its G-3 version of reporting guidelines, is one of the most active platform.

12. One of the main reasons for such a large number of multilateral initiatives of CSR is the absence of governmental focus on this subject in a centralized manner as in the case of CG frameworks in various national jurisdictions. Typically in any national government, minimum standards of behaviour and expectations from the business sector in their performance in the area of labour standards, environment, human rights etc. are enshrined in separate legislation administered by separate regulatory authorities. Therefore, in most of the national governments, there is an absence of a nodal Ministry/Authority which focuses on the subject of CSR. Amongst the developing nations, India appears to be the only exception where the subject of CSR is being looked at by the Ministry of Corporate Affairs.

13. While the national governments appear to be having a pragmatic response to CSR and sustainability, the corporate sector is faced with increasing expectations from an expanding set of stakeholders through a large number of multilateral initiatives as indicated in the previous paras. Therefore, the companies are often faced with the dilemma as to whether they should pursue their own CSR philosophy or reorient their thinking on the lines of the multilateral initiatives and if yes, then which one of these initiatives. Therefore, there is a strong case for convergence of the multiple CSR initiatives and also bring CSR into the focus of national government as a single subject.

14. The CSR and CG frameworks in various national jurisdiction and multilateral forums have largely remained independent of each other as the former has been driven by the societal concerns and the latter has been the forte of regulatory authorities and shareholders activism. There is a distinct global concern about the impact on operation of business entities on the society and environment which is encouraging the business to look inwards as well as the stakeholders to voice their expectations in a louder manner. The Governments are also becoming more or more concerned about the societal impact of failure of CG frameworks especially in systematically important business organizations. Thus, there appears to be a distinct need and possibility of the corporate governance oriented shareholders and the CSR oriented stakeholders to come together and develop a new code of conduct for responsible business governance.

15. In this background, the leadership position taken by the Indian Government needs to be highlighted. The Ministry of Corporate Affairs has taken the responsibility of mainstreaming corporate responsibility by providing the governmental focus on the subject. The Ministry released the Voluntary Guidelines on CSR in December 2009, which represented the first-of-its-kind step by any major national government in the world. These are now sought to be replaced by a more comprehensive set of guidelines that take into account the social, economic and environmental responsibilities of corporate business. Draft Guidelines (available at www.iica.in), prepared by the Indian Institute of Corporate Affairs through a wide stakeholder consultation process, have been submitted to the MCA. While taking into account the international best practices, these draft guidelines not only formulate an 'Indian' concept of business responsibilities but also seek to connect the CG-CSR framework.

16. After these draft guidelines are released by the MCA, India will become the only country where the government has prescribed comprehensive voluntary norms of corporate behaviour beyond what is enshrined in law. Simultaneously, MCA is also incorporating some of the business responsibility aspects in the proposed new Act to replace the existing Companies Act. With these developments, what is emerging an integration of the CG-CSR frameworks that will enable and guide the corporate behaviour towards generating maximum good for the stakeholders, something that is their ultimate objective.