

CORPORATE SOCIAL RESPONSIBILITY: AN INNOVATIVE TOOL FOR DEVELOPMENT OF SOCIETY

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Abstract

Corporate Social Responsibility ('CSR') is an innovative legislation and it is first of its kind in the Indian history. Many companies are expected to come under the category of mandatory CSR target companies. The Companies Act, 2013 ('the Act') aims at improving the current business scenario by ingraining social responsiveness to the Indian corporate sector. Although, CSR is an excellent measure but there are a few pitfalls in it which needs to be sorted out for the qualitative enforcement of the provisions. The CSR framework has some serious limitations, which, if not rectified, will render the aspiring provisions as futile. What emerges from the provisions is that, spending on CSR isn't mandatory but reporting it is. So, if a company is not spending on CSR, still it is required to submit a report pertaining to the reasons as to why it didn't spend on such CSR activity and if the explanation is found valid, company will be exempted from applicability of CSR but what constitutes "Valid Explanation" isn't defined anywhere. This example of valid explanation is only one of the instances among the pitfalls that are inherent in the act. Thus, there is a pressing need to weed out such ambiguities to make CSR more effective. In this paper, an effort has been made to highlight such loopholes in the act as well as a possible way out to overcome the challenges which have been discussed. Apart from this, the paper provides insights relevant for understanding the concept of CSR as provided in the act.

1. Introduction

CSR is the continuing commitment by businesses to contribute to economic development while improving the quality of life of the workforce and their families as well as of the community and society at large (*WBCSD's definition*). It is a management concept which aids companies to integrate social and environmental concerns with their business operations. CSR can, thus, be aptly described as the impact that businesses have on society at large and the societal expectations from them.

The origin of CSR can be traced back to philanthropic activities of corporations, viz., donations and charity. Over the years, the concept of CSR has evolved and it now includes within its scope, triple bottom line approach (achieving a balance of economic, environmental and social imperatives), corporate sustainability, improving and developing skills for sustainability, to name a few.

A properly implemented CSR concept can bring along a variety of competitive advantages, such as enhanced access to capital and markets, increased sales and profits, operational cost savings, improved productivity and quality, efficient human resource base, improved brand image and reputation, enhanced customer loyalty, better decision making and risk management processes.

2. Different Views On CSR

“Corporate Social Responsibility is a hard-edged business decision. Not because it is a nice thing to do or because people are forcing us to do it because it is good for our business”- Niall Fitzgerald, Former CEO, Unilever

CSR is holistic and integrated with the core business strategy for addressing social and environmental impact of businesses. CSR needs to address the well-being of all stakeholders and not just the company's shareholders. Philanthropic activities are only a part of CSR, which otherwise constitutes a much larger set of activities entailing strategic business benefits. CSR in India has traditionally been seen as a philanthropic activity. In keeping with the Indian tradition, it was an activity that was performed but not deliberated upon. As a result, there is a limited documentation on specific activities related to this concept. However, it was clearly evident that much of this had a national character encapsulated within it, whether it was endowing institutions to actively participate in India's freedom movement and embedded in the idea of trusteeship. CSR in India tends to focus on what is done with profits after they are made. On the other hand, sustainability is about factoring in the social and environmental impacts of conducting business. Hence, much of the Indian practice of CSR is an important component of sustainability or responsible business, which is a larger idea, a fact that is evident from various sustainability frameworks. Since corporate social responsibility and sustainability are so closely entwined, it can be said that corporate social responsibility and sustainability are a company's commitment to its stakeholders to conduct business in an economically, socially and environmentally sustainable manner that is transparent and ethical.

3. Benefits From CSR

- Enhancing corporate reputation
- Attracting and retaining employees
- Receiving license to operate
- Communities as suppliers
- Enhancing corporate reputation

4. Companies Act, 2013 Vis-À-Vis CSR

Mandatory CSR obligations under section 135:

- Every company, listed or unlisted, private or public, having a -
 - net worth of Rs.500 crores or more [Net worth criterion]; or
 - turnover of Rs.1,000 crores or more [Turnover criterion]; or
 - a net profit of Rs.5 crores or more [Net Profit criterion].

During any financial year to constitute a CSR committee of the board;

- CSR committee has to formulate CSR policy and the same has to be approved by the board;
- Such company to undertake CSR activities as per the CSR policy.
- Such company to spend in every financial year, at least 2% of its average net profits made in the immediately three preceding financial years, on the CSR activities specified in Schedule VII to the Companies Act, 2013.
- Such company to make appropriate disclosure in the report of board of directors' and on the website of the company

5. CSR In India

In an effort to properly position, the Indian economy for the remainder of the century, India has replaced its fifty-seven-year old Companies Act of 1956 with the Companies Act, 2013 (the Act). The act is important from the view point that the impact of Section 135 of the act will be felt by those people (*i.e.*, community,

viz., members/creditors/directors, etc.) who are in no way connected with the act itself. Section 135 and its rules require targeted companies to spend a prescribed formula based amount on CSR for the applicable fiscal year, report on these activities or explain why they failed to spend it, in the annual board's report. It is estimated that these provisions are going to impact 6, 00,000 companies in India, including over 7,500 publicly listed companies and multinational companies and there will be spending of around over U.S. \$ 2 billion on CSR.

Expected Contribution

No.	COMPANY'S NAME	PROPOSED CONTRIBUTION IN CSR (2% OF THE AVERAGE PROFITS) (Rs. MILLIONS)
1.	GAIL	690.32
2.	HINDUSTAN UNILEVER	479.96
3.	INFOSYS	1,381.07
4.	LARSEN & TOURBO	852.66
5.	NTPC	1,803.63

CSR is to be implemented through establishment of CSR committees whose members must comprise of three or more directors, out of which at least one director shall be an independent director.

Board	CSR Committee
<p>The board of every company referred to above after taking into account the recommendations made by CSR Committee:</p> <ol style="list-style-type: none"> i. Approve the CSR Policy for the company and disclose contents of such policy in its report and also place it on the company's website. ii. Ensure that the activities as are included in CSR policy of the company are undertaken by the company; and iii. Ensure that the company spends in every financial year at least 2% of the average net profit. Average net profit shall be calculated in accordance with the provisions of section 198 of the 2013 Act. 	<p>The mandate of the said CSR committee shall be:</p> <ol style="list-style-type: none"> i. To 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. ii. To recommend the amount of expenditure to be incurred on the activities referred to above. iii. To monitor the Corporate Social Responsibility Policy of the company from time-to-time.

If the company fails to spend such amount, the board must, in its report specify the reasons for not spending the amount.

5.1 The Activities in Schedule VII Include :

- (i) Eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation including contribution to the Swachh Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water;
- (ii) Promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects;

- (iii) Promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centers and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;
- (iv) Ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga;
- (v) Protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;
- (vi) Measures for the benefit of armed forces veterans, war widows and their dependents;
- (vii) Training to promote rural sports, nationally recognised sports, Paralympic sports and Olympic sports;
- (viii) Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;
- (ix) Contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government
- (x) Rural development projects;
- (xi) Slum area development.
Explanation. For the purposes of this item, the term 'slum area' shall mean any area declared as such by the Central Government or any State Government or any other competent authority under any law for the time being in force

5.2 Vital Provisions under CSR :

Net Profit is as per financial statements. Any dividend received from other companies in India which are covered under and complying with the provisions of Section-135 of the Act are not be included for calculation of net profits.

Every company which ceases to be a company covered under section 135(1) of the act for three consecutive financial years shall not be required to –

- (a) Constitute CSR committee, and
- (b) Comply with the provisions contained under section 135(2) to (5)

Till such time when it meets the criteria specified under section 135(1):

- The CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with Section-135 of the act.
- Companies may build CSR capacities of their own personnel as well as those of their implementing agencies through institutions with established track records of at least 3 financial years, but such expenditure shall not exceed 5% of the total CSR expenditure of the company in one financial year.
- Contribution of any amount directly or indirectly to any political party under Section- 182 shall not be considered as CSR activity.
- Requirement of Independent Director for the purpose of Section-135 shall not be required of those classes of companies who are not required to have independent directors in their CSR Committee. Those private companies who are having only 2 directors shall constitute their CSR committees with only 2 directors. Foreign Companies covered under CSR shall form CSR committee with minimum of 2 persons out of whom 1 should be person resident in India.

6. Shortcomings in Extant CSR Provisions :

There are certain flaws in the extant provisions that will pose challenges in meeting the objectives of the

provision. So, it is important that all the grey areas seeking clarifications are made clear and provisions with shortcomings are accordingly amended to formulate a better CSR policy regime that can be properly executed to serve the purpose.

The areas which require clarifications in respect to the concept of CSR in the 2013 Act are as under:

I. Constitutional Validity

- i. Section 135 of the 2013 act makes a classification of companies and divides the existing companies in India into two categories:
 1. Companies having a net worth of five hundred crore rupees or more, or a turnover of rupees one thousand crore rupees or more or a net profit of rupees five crore or more.
 2. Companies not falling under the above category.
- i. Now when the section is making such a categorization then it becomes imperative to see that it passes the test of Article 14 of the Indian constitution. The Apex Court has laid down two important norms to be satisfied for passing the Article 14 (AIR 478 SC) validity test-
 - a) The classification must be based on an intelligible differentia i.e. the groups created through the classification and must be easily distinguishable from each other.
 - b) The classification created must have a rational nexus to the object sought to be achieved by the Act. While the former test could be easily satisfied by Section -135 but when it comes to the latter, it fails. The Ministry for Corporate Affairs has already stated that the main aim of this section is to ensure that corporate entities contribute meaningfully towards the advancement of the nation. Similarly, the Standing Committee (Companies Bill, 2009) on Finance has also raised concerns regarding this issue (*Aneel Karnani*).
The legislature has failed to explain as to why only such particular companies have been subjected to such an obligation plus what is the basis of such categorization? What emerges from the language of this section is that only big companies have been subject to such a mandate but again what the definition of a big company is remains unanswered. The question is why not the companies having net worth of four hundred crores or more but less than five hundred crores are termed as big companies? (Standing Committee Report)

II. No Stringent Penal Provisions

If Section-134(8) is read with Section 135(5) it can be very well made out that the penal provision is only for the non-compliance of submitting the report and not for the failure to spend with respect to CSR. The penalty provision would be in fructuous as the companies are smart enough to mould things in their favour to escape the liability.

III. Company Satisfying Net Worth Criteria Might not Necessarily be Profit Making Company

There may be instances when the companies are not enthusiastic in making such CSR spending because of the reason that the companies are not such colossal profit making companies but they do fall under the Section-135 category mainly due to triggering net worth and turnover criteria. Although, then the companies have the option of reporting as to why they will not make CSR spending by giving valid explanation but, what constitutes a valid explanation has not been defined so the companies might give excuse of not making enough profit so as to contribute to CSR in spite of falling within the category. In that case the purpose of CSR will stand defeated (*Grant Thornton*).

IV. Scheduled Activities

Although the act provides a list of CSR activities but this list is not an exhaustive list. It is unfortunate that the legislature has not provided more detailed and less ambiguous list as to what all constitutes CSR (*National Foundation for India*). Apart from this, with corruption spreading its roots in companies, the list needs to be clearer so as to prevent the companies from misusing the provisions by carrying on some other profitable activities in the garb of CSR.

V. Return on Investment

Calculating the return on investment on initiatives undertaken in the name of CSR like the benefit to the environment by adoption of cleaner fuels, allocating funds for the scholarship purpose and things like that may have a long time period for return which makes these areas of CSR less attractive.

VI. Voluntary Vs Mandatory

CSR which has largely been a voluntary contribution by corporate has now been included in law and made mandatory (*The Economic Times*). But, having binding rules means there will be fraud and the temptation to break the rules can be high. Making CSR mandatory will make sure that companies are undertaking social responsibilities but the problem is that the companies might implement CSR activities just for the sake of implementing and it further might show the way to fraudulent practices in the corporate world to getaway CSR spending (*TOI*). However, the companies which were voluntarily taking CSR activities even before 2013 Act will continue to take up the same but the corruption in other companies to escape CSR and to refrain from departing from their profits might lure companies to avoid doing CSR voluntarily to be in the league of most profitable companies.

VII. Number of Directors in CSR Committee

Section-135 of the Act requires that CSR committee should consist of a minimum of 3 directors. Now it is important to note that a private company has only 2 directors. So it is a point of clarification that if a private company fits in the category of Section-135 Company's category then will it be required for the private company to increase its board strength to make the number of directors three? Because if it is so, it is a stringent provision and private companies must constitute an exception to it (*TOI*).

VIII. Double Taxation

The 2% of three years average profit is the profit before tax (PBT). So the target companies will have to in a way pay double tax. Firstly, they will have to part with the 2% of the three years average profit which is profit before tax and thereafter they will have to pay tax on the remaining profit after deducting that 2% profit. So this CSR is actually imposing double taxation on the companies falling under the purview of the act.

This concept of CSR is one of the ways of imposing tax and this will result in increasing the already very high corporate tax (*The Hindu*). Present taxation rate in India for companies are amongst the highest in the world and stands at a level where number of payments are also quite elevated as compared to the global average (*Business Today*). Yet another problem is that some of the activities enlisted in Schedule VII are exempted (*TOI*) from tax but the remaining CSR activities have not been exempted. This will generate an attitude in the companies to take up the CSR activities that are tax exempted over the other activities (*Lok Sabha*).

IX. Cash Flow Issues

It might happen that the cash and liquidity position of the companies falling the target company' category may be much less than the average profit in the preceding three year average profit. So in that case, it will not be possible for the companies to engage in CSR and spend an amount of 2% of three years average profit, which is a considerable amount of money for companies dealing with cash flow issues or liquidity problem (*Sanjay K. Sharma*).

X. Challenges posed To SMEs

With the enforcement of Section-135, many small and medium enterprises (SME) are expected to qualify. Since, they are engaged in smaller business activities (*The Economic Times*) therefore, the quantum of profits available for CSR with SMEs will not constitute a sizable CSR fund which will not contribute a lot to the improvement of society and it will be of great hardship for SMEs to contribute even this insignificant amount (*Business Standard*).

7. Way Forward

Since 2 per cent of a company's average profits are a significant chunk of money, it is important to ensure that it is spent wisely. The Provision of CSR in 2013 Act mainly suffers from the problem of vagueness. So in order to cure this problem which is paralyzing the Act, it is important to provide certain clarification to make the provisions clear and free from any ambiguities, otherwise in future, it will pose significant challenges in the execution of the new provisions. In order to ensure that the purpose of this CSR provision in 2013 Act is served, a well planned and structured body is required which will be regulating the CSR activities and related issues of companies. Forming a team of experts and professionals for the purpose of constituting CSR committee is a must. But all these efforts will be in vain if policies and guidelines are not made clear. So making a good law is not the end of the story. In fact a new story starts from here and presents a further challenge to ensure that the law or legislation is properly followed or executed.

Following are the solution to some of the major problems that the 2013 Act is confronted with:

I. Explaining "Valid Explanation"

Suppose, a company does not make CSR spending and so has to prepare a report giving explanations as to why it is not adhering to such CSR mandate, it is first of all important to explain as to, what constitutes a "Valid Explanation"? Because in absence of such clarity, companies might give any random explanations and contest that it should be considered as to be valid due to the reason that there is no definition of validity. So in order to avoid such circumstances, curative actions must be taken to make sure that no such confusion occurs.

II. Stringent Penal Provisions

Although, 2013 Act has a provision of penalty, but in case of non-compliance of the mandate to make 2% CSR spending, not spending and submitting a report explaining the reasons, it does not invite any penalty. But this it is not going to be very effective because it gives companies all the possible chances to save itself by taking advantage of the ambiguity in the provisions laid down in the act. So it is important to make such penalty provision more deterrent and there should be no scope to escape the punishment.

III. Expanding the Area of CSR

If the Government wants the companies to spend on government approved CSR activities then the list of activities should be made more exhaustive giving companies ample number of choices. Also, reference can be taken from circular (*SEBI*) issued by SEBI concerning the list of CSR activities which listed down a broader area as to what constitutes responsible business practices.

IV. Homogeneous CSR Development

Further, the act also requires the companies to give preference to the local area where the companies operate but this concept is not a well thought concept as it may lead to the development of areas where companies but the rest of the areas where there are not many companies may remain underdeveloped. It might happen that there might be an area where many companies operate then if every company operating in that area start giving preference to that area then it will not be very useful because many companies focusing on small area and ignoring rest of the areas will not contribute to the uniform advancement of society and will give birth to disparity.

V. Independent CSR Committee

In the 2013 act, it is mentioned that CSR requires companies to form a “CSR committee” within the board of directors consisting of three or more directors, at least one of which must be an “independent director” (defined in Section 149(6) of the Companies Bill). But it is recommended that CSR committee must be entirely an independent committee with no person from the board of the committee so as to ensure the efficient and effective working of the committee.

VI. Number of Directors

Furthermore, this provision of CSR committee consisting of 3 directors must be relaxed for private companies because if it is not done then it would mean that private companies will be required to increase their board strength to fulfill the condition laid down in the provision. This completely does not make any sense (*Grant Thornton*).

VII. Tax Sops Should be Given

Legislations should exempt CSR activities from tax as this will not only generate company’s interest in CSR but will also benefit the society simultaneously (*Grant Thornton*). Imposition of tax on CSR activities is implying that government has got a means to collect revenue and when the government imposes tax, it need not identify a specific benefit accruing from the same (*AIR 2550 SC*). This is defeating the rationale behind Section-135 of the 2013 act.

VIII. Better to Define CSR

If we want to have a better policy to regulate the CSR activities, firstly it is important to define CSR to develop an idea of the concept and to create a parameter to measure different CSR activities so as to check whether a particular activity falls under the category of the defined CSR concept or not.

IX. Consideration of Cash and Liquidity Position

It is important that the CSR provision takes note of the problem of tax and liquidity related issues so as to prevent company’s interest from getting hampered. Identifying the current liquidity position of the target companies which is required to take up CSR initiatives is a must. So CSR committee must consider this point and if the liquidity position of the company is found to be in adverse situation it must be exempted from CSR spending (*Sanjay K. Sharma*).

8. Conclusion

To conclude, the purpose of CSR, we must comprehend that it is only one among a number of diverse liability approaches that can control behavior in and around corporations, with an objective of benefitting the society. As highlighted, stringent provisions are called for in case of non-compliance with the CSR provision, as a just punishment embraces the ethical condemnation of the society. Instead of serving just as a sheer supplement to corporate fines, ground breaking corporate sentences should be the key objectives of CSR of serving the society. One step forward has been taken by Indian Institute of Corporate Affairs (*The Economic Times*) (IICA) in this regard. The Institute is planning to initiate a certificate program on Corporate Social Responsibilities activities for working executives (*Indian Institute of Corporate Affairs*).

The implementation of mandatory CSR provision in India is acting as a global watch. India is at the forefront of CSR law with the passing of 2013 act. As such, India is an experimenting ground for CSR laws of this kind. Indeed, a drift is already evident in CSR law as the European Union is making an allowance for a commandment that would entail CSR reporting and disclosure for certain companies, something the European Union calls on-financial information (*European Commission*). Also, legislative measures are also being contemplated in Canada, where the current bill C-300 would regulate the behavior of Canadian mining companies in developing countries (*CEO Council*).

Companies squabble that setting up minimum standards stops innovation (*Corporate Watch*). Considerable debate surrounds the corporate world that force tends to increase corruption (*EJDR*) and current CSR law will act like the same force. However, CSR is only in its inception stage and this makes the area available for constant review and up gradation. Lastly, the authors firmly believe, it is necessary to slot in the proposed recommendations through necessary amendments and serious strides are called for at the earliest in order to put off the corporations from indulging into corporate misconduct and fabrication of corporate profits by the corporate agents (*Amy Chua*).

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