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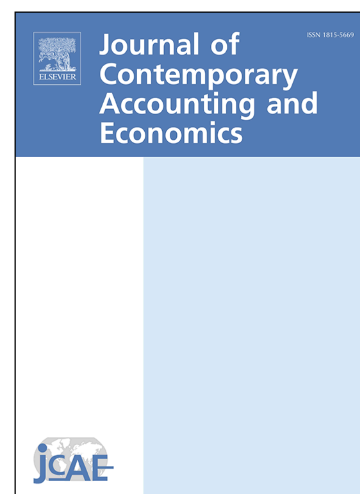

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Abhishek Mukherjee, Ron Bird, Geeta Duppati

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Mandatory Corporate Social Responsibility: The Indian Experience

Abhishek Mukherjee*

Ron Bird **,†

Geeta Duppati *

* Freedom Institute of Higher Education

** Finance Discipline, Waikato School of Management

†Director, IMR Program, University of Technology Sydney

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Abstract: The question we raise is what to do when companies fail to keep pace with societal expectations with respect to their corporate social responsibility (CSR). The response of the Indian government was to make it mandatory for large corporations to spend funds on CSR activities. In this paper, we investigate the success of this legislation both for the companies and the intended beneficiaries. We find that the impact of the legislation has fallen short of expectations both in terms of the volume of CSR expenditure generated and the activities to which it has been directed. In particular, we find that the legislation has had a negative corporate profitability which can impact on the willingness of companies to spend in this area. We conclude that greater care must be taken when implementing mandatory CSR if it is to be effective.

Key Words: Corporate Social Responsibility (CSR), Mandatory, Indian Legislation, Corporate Response, Impact on Profitability

JEL Codes: G38, M14

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1. Introduction

Corporate Social Responsibility (CSR) is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society as a whole (Holme & Watts, 2000). One of many important questions this raises is whether corporations are expected to voluntarily make this commitment or whether they need encouragement to do so. The European Commission (2016) was clear on this matter when they described CSR as a "concept whereby companies decide voluntarily to contribute to a better society and a cleaner environment." However, several governments have lost patience with the willingness of corporations to make sufficient voluntary contributions to CSR and have taken steps to mandate such expenditures.

The focus of this paper is on gaining insights into the effectiveness of making CSR expenditure[i] mandatory and it implications for corporate profitability. A scattering of nations including India, Indonesia and the Philippines have undertaken national-level legislative initiatives that mandate CSR expenditures by corporations (Congress, 2013; Gowda, 2013; Waagstein, 2011). The analysis in this paper is based on the Indian experience where legislation was passed in August 2012 that mandated all publicly listed Indian companies and private enterprises whose net worth exceeds INR 5000 million, whose annual turnover exceeds INR 10000 million, or whose profit exceeds INR 5 million during any financial year, must spend two per cent of their profits, averaged over the past three years, on CSR expenditure[ii]. The companies are required to disclose such expenditures in both their financial statements and a separate individual CSR report (Subramaniam, Kansal, & Babu, 2017). The approach taken with the CSR provisions is best described as "comply or explain" where if a company is not in a position to spend the prescribed amount on CSR, the board is required to disclose and report the specific reasons for not doing so. Failure to report CSR spending, or the reasons for failing to spend the required amount, constitutesk a violation of Section 134 of the Companies Act, and the company shall be punishable with a fine that shall not be less than INR 50 000 but which may be as much as INR 2.5 million and every officer of the company who is in default shall be punishable by imprisonment for a term which may not exceed three years, or by a fine which shall not be less than INR 500 000, or both (Ernst & Young, n.d.).

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2. Background

Despite a long history of CSR spending in India (Chapple & Moon, 2005; Jose, Bandi, & Mehra, 2003) the Indian government became dissatisfied with the extent of such expenditures undertaken by corporates. Thus, the Government took steps to make CSR spending mandatory through changes in the draft of the Companies Bill 2008. One year later the Indian government relented under pressure from business and issued voluntary guidelines proposing that companies should allocate 2% of their net profits to CSR expenditures. However the Indian government found the response to these voluntary guidelines unsatisfactory and two years later indicated its intention to introduce legislation to make CSR expenditure mandatory (Press Trust of India, 2011). In August 2012, this legislation became law with large Indian companies being required to spend 2% of their net profits on CSR activities.

There have been numerous criticisms of the practice of employing a mandatory mechanism to enforce CSR practises (deSouza, Weffort, Peleias, & Goncalves, 2007; O'Laughlin, 2008; Waagstein, 2011). In India, large private sector companies were highly reticent about mandatory contributions to CSR, with strong pushback in some cases (Karnani, 2013). As highlighted by Prasad (2014), some Indian corporate leaders expressed concern that the policy simply would be seen as forced philanthropy, and that it may encourage ‘tick box’ behaviours, tokenism, inefficient resource usage and even corruption. This uneasiness displayed by Indian companies suggested that they would not embrace the greater commitment to CSR expenditure as hoped for by the government. Indeed, the first sign of this came with the introduction of an amendment to the legislation introduced in February 2014 that now also mandated the exact areas to which the CSR expenditure must be directed:

- eradicating extreme hunger and poverty
- promoting education
- promoting gender equality and empowering women
- reducing child mortality and improving maternal health
- combating the human immunodeficiency virus, acquired immune deficiency syndrome, malaria or other diseases
- ensuring environmental sustainability
- employment enhancing vocational skills

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- social business projects
- contributing to the Prime Minister's National Relief Fund.

Despite the perceived need by the Indian government to mandate CSR expenditure, there were a significant number of companies, both large and small, already undertaking CSR expenditures prior to the legislation being introduced. After the legislation became effective, the firms neatly fall into four categories

1. Category A: Companies that were spending funds on CSR activities prior to the passing of the Act, and for whom the Act made CSR compulsory (henceforth A companies)

2. Category B: Companies that were not spending funds on CSR activities prior to the passing of the Act, and for whom the Act made CSR compulsory (B Companies)

3. Category C: Companies that were spending funds on CSR activities prior to the passing of the Act, but were not required to spend on CSR under the new Act (C companies)

4. Category D: Companies that were not spending funds on CSR activities prior to the passing of the Act and were not required to spend on CSR under the new Act. (D companies)

One consequence of the legislation that was never been given serious consideration by the Indian government is the impact that it would have on the profitability of large Indian companies. As (Jensen, 2001) pointed out spending on CSR activities is not necessarily inconsistent with maximising profit. Further, the empirical evidence on the relationship between CSR and corporate profits is mixed, albeit that the weight of evidence suggests a positive relationship. However, previous studies have been conducted in an environment where management has the discretion as to how much to spend on CSR activities. Hence, this study is the first to investigate the impact on corporate profits of introducing a regime that makes it mandatory for companies to spend on CSR activities. In particular, the Indian legislation provides us with the means to conduct a natural experiment into the relationship between CSR expenditure and corporate performance.

The legislation to require large Indian companies to spend on CSR activities was introduced to increase the amount that Indian companies spend on CSR activities. In this paper, we provide some insights into the level of compliance in the early years of mandatory CSR expenditure. Mukherjee & Bird (2016) surveyed 223 Indian companies drawn from each of the four categories (i.e. A, B, C and D companies) to investigate their attitudes to mandatory CSR

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expenditure and to throw light on the likely impact that it would have on their behaviour. They concluded that that making of CSR spending mandatory for large corporations was unlikely to elicit the forecasted increase in the level of spending largely because of the negative attitude to mandatory CSR expenditure from those large Indian companies that had previously not spent in this area but would now be required to do so (i.e. B companies). In this paper, we provide evidence on the actual expenditures of each of our four categories of companies, both before and after the introduction of the legislation.

It is interesting to speculate on the incentives for the four categories of companies to spend on CSR activities subsequent to the introduction of the legislation. A companies had already been undertaking significant expenditures on CSR activities prior to the introduction of the legislation. As one might expect, , the managers of these companies were strongly of the opinion that this CSR expenditure makes a positive contribution to company profitability (Mukherjee & Bird, 2016). Further these authors found these managers were driven to make this expenditure because of their concern for the community, and their desire to have a good public image and good relations with both the community and government. Clarkson, Li, Richardson, and Vasvari (2011) found that it is the better resourced companies that benefit most from voluntary environment-driven expenditure. On this basis, it is not surprising that A companies are those that voluntarily undertook the greatest CSR expenditures as they are typically the much better resourced Indian companies (Mukherjee & Bird, 2016).

Almost half of A companies were spending less than 2% of profits on CSR expenditures (Mukherjee and Bird, 2016). If these companies increase their expenditure to at least 2% of profits and the others maintain their current level of CSR expenditure, then one might expect at least a small increase in the percentage of profits that A companies allocate to CSR expenditure. The only possibly qualification that we would place on this is that Bird, Duppati, and Mukherjee (2016) found that the investors' attitude towards CSR expenditure had turned from positive to negative over the extended period it took the Indian government to make CSR expenditure mandatory, perhaps reflecting an expectation that CSR expenditure would futuristically have a negative impact on corporate performance. Further, the managers' of A companies may consider that some of the goodwill they attach to CSR expenditure may be diluted when it is required of all large Indian companies.

B companies are the large Indian companies that had not previously chosen to spend on CSR activities. The managers put forward a lack of resources (both cash and know how) and a lack of government support as reasons for not undertaking such expenditures (Mukherjee and Bird,

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2016). This is consistent with these managers believing that a lack of resources will prevent them converting CSR expenditure into increased profitability (Clarkson et al., 2011; Hart & Ahuja, 1996). None of this has changed with the introduction of mandated CSR expenditures for these companies. Hence one would not be surprised to observe a degree of non-compliance by B companies, especially given the "comply or explain" option given under the legislation. Further, there is no reason to expect that the CSR expenditure will add to the profitability of B companies.

C companies are small Indian companies that were allocating resources to CSR prior to the introduction of the legislation. The main reason they put forward for undertaking these expenditures is that they will lead to improvements in labour productivity (Mukherjee and Bird, 2016). Further, the managers of C companies unanimously associated these expenditures with increased profitability. The environment of these companies has not changed at all with the introduction of the legislation which suggests that we would expect to see their behaviour being largely unaffected. However, we would note that C companies are not resourced to a level where one would expect them to benefit most from CSR expenditures. Further, we previously noted a change in investor attitude which suggested a worsening relationship between CSR expenditure and corporate profitability.

Finally we have the D Company managers, who previously put down their lack of CSR expenditure to a lack of resources and a perception that such expenditures would not result in increased profits (Mukherjee and Bird, 2016). Nothing has changed for these companies, but one might expect that the fact that the government has mandated CSR expenditure for larger Indian companies might stimulate a small amount of such expenditure by some of these companies.

In the remainder of the paper we will seek to throw more light on the impact of making CSR expenditure mandatory on the spending behaviour of Indian companies and on the relationship between CSR expenditure and profitability. In the next section we will provide a summary of the previous studies that have addressed the impact of CSR expenditure on, and consider the implications of mandatory CSR regulation for, a firm's financial performance. We go on in Section 4 to describe the data and methods used in this study and then report our findings in Section 5. Section 6 provides us with the opportunity to summarise our major findings and provide suggestions for possible future extensions of work in this area.

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3. Literature review

Through time there have been numerous motivations proposed for why companies might spend resources on CSR activities and the impact that this expenditure would have on corporate profitability. Some early writers saw social responsibility as a "donation" from shareholders to stakeholders that reduce profits (Aupperle, Carroll, & Hatfield, 1985; Freedman & Jaggi, 1982; Friedman, 1970; Vance, 1975; Waddock & Graves, 1997). Others saw CSR as a social commitment by management driven by their social preferences and/or their desire to establish friendly relationships with specific stakeholders (Donaldson & Preston, 1995; Jensen & Meckling, 1976; Sethi, 1979). This later view is encapsulated in Freeman's (1984) stakeholder theory that argues that companies should consider the interests of everyone who can considerably affect, or be affected by, the welfare of the company. The instrumental stakeholder theory argues that CSR efforts are actions taken to benefit stakeholders with the ultimate goal of benefiting shareholders; i.e., CSR is "instrumental" to firm performance (Jones, 1995). Companies may engage in CSR to improve their competitiveness, e.g., their reputation, brand, and trust (Barney, 1991; Hart, 1995; Porter, 1996; Porter & Kramer, 2006; Russo & Fouts, 1997). In turn, such actions may draw new customers (socially conscious customers, "green" consumers, etc.), increase the companies' profitability(Cai, Jo, & Pan, 2012; Harjoto & Jo, 2011; Rodgers, Choy, & Guiral, 2013; Saleh, Zulkifli, & Muhamad, 2011), enhance their competitiveness (Flammer, 2015), reduce firms' cost of capital (El Ghoul, Guedhami, Kwok, & Mishra, 2011; Mahoney & Roberts, 2007) and reduce firms' risk (Jo & Na, 2012). A third group consider that there is no reason to expect a relationship to exist between CSR and corporate performance, except possibly by chance. Nelling and Webb (2009) and Garcia-Castro, Ariño, and Canela (2010) have argued that CSR is driven by unobservable firm characteristic, and the link between CSR and performance is overwhelmed by endogeneity problems.

Numerous scholars have examined the direct relationship between CSR expenditure and corporate performance without there being any unanimity in their findings (Margolis & Walsh, 2003; Mishra & Suar, 2010; Vogel, 2005). Many are of the opinion that CSR expenditure enhances reputation and reduces both a firm's risk and its cost of capital leading to superior financial performance (Galbreath & Shum, 2012; Lin, Yang, & Liou, 2009; Luo & Bhattacharya, 2006; Mahoney & Roberts, 2007; Orlitzky, Schmidt, & Rynes, 2003; Rettab, Brik, & Mellahi, 2009; Russo & Perrini, 2010; van Beurden & Gössling, 2008). These findings are somewhat balanced by other researchers who have found either a negative or no

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correlation between CSR expenditure and performance (Aupperle et al., 1985; Lima Crisóstomo, de Souza Freire, & Cortes de Vasconcellos, 2011; Smith, Yahya, & Marzuki Amiruddin, 2007). Finally, other scholars have commented on the numerous biases and problems in the model used to evaluate the relationship which they believe contribute to these contradictory findings (Galbreath & Shum, 2012; Garcia-Castro et al., 2010; Griffin & Mahon, 1997; Nelling & Webb, 2009).

Empirical evidence from India rooted in the pre-mandatory setting also found mixed evidence on the impact of CSR expenditure on performance and valuation. Mishra and Suar (2010), using perceptual data found a positive relationship when examining the implications of CSR for primary stakeholders. Mittal, Sinha, and Singh (2008), assessed the influence of CSR on financial performance as measured by Market Value Added (MVA) and Economic Value Added (EVA) and found strong evidence of a negative relationship between CSR initiatives and financial performance. (Vasal, 2009), found no effect when examining the social performance impact on shareholder returns by comparing Environmental, Social and Governance (ESG) portfolios with a market portfolio of Indian firms. Subramaniam et al. (2017), conducted a study of CSR within Indian Government-owned firms and concluded that CSR implementation in India was still nascent, fraught with bureaucratic hurdles, insufficient human and knowledge resources, and limited stakeholder analysis

Studies both in India and globally have been unable to establish a definitive answer as to the impact that CSR expenditure on corporate performance in an environment where management has the discretion as to how much it spends on CSR activities. There is no reason to think that the findings relating to a voluntary CSR expenditure regime will extend to a situation where the decision relating to the magnitude of CSR expenditure is largely taken out of the hands of management. Hence the introduction of legislation in India to make CSR spending mandatory for large companies provides us with an ideal opportunity to test the incremental impact on company profits of forcing them to spend on CSR.

4. Data

4.1. Sample

In this study, we have collected data from Centre for Monitoring Indian Economy Pvt Ltd (CMIE) Prowess data base for firms listed on the Bombay Stock Exchange (BSE) from 2008 to

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2015. The database is built from Annual Reports, quarterly financial statements, Stock Exchange feeds and other reliable sources. The database is normalised to enable inter-company and inter-temporal comparisons.

4.2. Variables

There may be a time lag in the implementation of corporate social activities and consequently improved financial performance in the form of increased sales revenue and profits (Blackburn, Doran, & Shrader, 1994). Hart and Ahuja (1996) have studied the impact of emission reduction on financial performance (ROE). They suggested that it takes two years before the financial performance is impacted. The findings of the study performed by Callan and Thomas (2009), suggest that the direct effect of lagged CSP on current CFP is positive. This finding of a positive relationship may suggest that the benefits of a firm investing in CSR outweigh the costs of doing so (Russo & Fouts, 1997; Waddock & Graves, 1997). Based on the previous findings we have lagged the CSR expenditure variable by one, two and three years, in order to allow us to better understand the longer-term impact of CSR on firm performance.

We use return on equity (ROE) as our proxy for profitability and it is the dependent variable in all our analysis. ROE measures a firm's efficiency in generating profits over a fiscal year (Kang, Lee, & Huh, 2010; Tsoutsoura, 2004). Following the studies by McWilliams and Siegel (2000) and Tsoutsoura (2004), the control variables used in the study are firm size, the lag of ROE, capital structure, efficiency ratio, quick ratio, ownership and age. The last control factor, as widely practised in the financial literature, is a year dummy variable to control for any year effect. Table 1 provides more details on the variables used in this study.

Table:1 Definition of variables used in the study

Dependent Variable	
ROE	Net Income/Shareholder's Equity
Independent Variable	
CSR (Category A) (t - 1), (t - 2), (t - 3)	Dollar value of CSR spending for A companies lagged by one, two, and three years
CSR (Category B) (t - 1), (t - 2), (t - 3)	Dollar value of CSR spending for B companies lagged by one, two, and three years
CSR (Category C) (t - 1), (t - 2), (t - 3)	Dollar value of CSR spending for C companies lagged by one, two, and three years
CSR (Category D) (t - 1), (t - 2), (t - 3)	Dollar value of CSR spending for D companies lagged by one, two, and three years
Control Variable	
ROE (t - 1)	Return on equity lagged by 1 year.

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Firm size (t - 1)	Average of current and lagged one year firm size (log of total sales)
Leverage (t - 1)	Average of current and lagged one year leverage (Total Debt/total equity)
Efficiency Ratio (t -1)	One year lag of (operating expenses/sales)
Quick Ratio (t - 1)	Average of current and lagged one year quick ratio (current assets – inventories/ current liabilities)
Ownership	Dummy variable; 1 if Government owned otherwise 0.
Age	Current age of firm in years

We report summary statistics in Table 2 for the variables used in this study as outlined in Table 1. The first observation that we make is that the average CSR per firm has actually fallen in the post-legislation period. The two groups that were previously spending on CSR have marginally increased their expenditure by about 5% but the introduction of both B and D companies spending smaller amounts have diluted the average CSR spend across the whole sample. We would make a similar observation with respect to CSR expenditure to profits with the average falling by almost 50%, post the introduction of the legislation. We see that both categories of companies that were previously spending on CSR (A & C) have reduced their expenditure as a percentage of profit by in excess of 10%. B companies who were not spending previously on CSR activities but are now mandated to do so have at least partially complied with the legislation but interestingly their average spending is less than the minimum 2% of profits specified by the government. Finally, we see that some D companies have begun minimal expenditure on CSR activities in the post-legislation period. It was estimated that 140 billion rupees would be spent on CSR during 2014-15 as a result of the legislation (E T Bureau, 2014). However, it can be seen from the information contained in Table 2 that none of our four groups enthusiastically reacted to the government making such expenditure mandatory which explains why the expenditure has fallen well short of the targets. This is confirmed by a recent article in the Indian Express which reported that more than half of Indian companies failed to meet their mandatory spending requirements on CSR (Singh, 2016). The report stated that there were a total of 266 non-compliant companies that accounted for an aggregate under-spending of USD 38.6 million in the financial year 2014-15.

In previous discussion, we highlighted several reasons why the level of CSR expenditure in the post-legislation period might fall short of expectations. A starting proposition is that well-resourced large Indian companies most likely to benefit from CSR expenditure are already undertaking such expenditures. They may see that the benefits might be somewhat eroded by

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making CSR expenditures mandatory for all large Indian companies and actually reduce the extent of their expenditure. Likewise, the less well-resourced large Indian companies that are less likely to benefit have chosen not to undertake CSR expenditures in the past. Little has changed for them post-legislation so it is not surprising to see that they have not embraced CSR expenditure with a relatively high level of non-compliance. Then we have the smaller companies that are exempt from compulsory CSR expenditure. One would not expect to see any significant growth in CSR expenditure from these companies, especially seeing that market participants have slowly changed to having a negative attitude towards such expenditures (Bird et al, 2016).

We also observe that the mean figure of ROE for our sample is high, particularly for the larger companies. Bhupta (2015) reported that the ability to provide high ROEs is a characteristic of the Indian market. Companies like Hindustan Unilever, Colgate Palmolive, and Britannia Industries are known for providing ROEs in excess of 50%. Bhupta (2015) suggested that "India's ROEs are relatively higher compared to the rest of the emerging markets pack not because of sparse competition but because margins are higher relative to others." Further India has a higher representation than other countries to industries that have higher ROEs such as technology and financial services. A recent article in the Economic Times reported that the top 500 companies of India have reported very high ROE in the FY 2017 (Shinde, 2017). Kumar (2004) researched the Indian manufacturing companies using CMIE prowess as their data source and reported an average ROE of 155%. We believe that the available evidence supports an uniqueness in the Indian market when it comes high ROEs, particularly for the larger companies and this is especially highlighted when we have split our data into four categories.

Table 2: Summary Statistics

Item	Sample	Legislation		
		Pre-	Post.	Diff.
Average CSR Spending per firm ($US M.)	Total	14.49	10.71	-3.82
	Cat. A	24.15	25.56	1.41
	Cat. B		11.47	
	Cat. C	5.81	6.12	0.31
	Cat. D		4.56	
CSR Spend/Profit (%)	Total	4.24	2.19	2.05
	Cat. A	4.83	4.26	-0.57
	Cat. B		1.85	
	Cat. C	3.87	3.53	-0.34
	Cat. D		1.12	
	Total	4.67	5.08	0.41***
	Cat. A	6.44	6.91	0.47***

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Log Sales ($US M.)	Cat. B	6.33	6.70	0.37***
	Cat. C	3.42	3.79	0.37***
	Cat. D	3.84	4.02	0.18***
Leverage	Total	1.78	1.71	-0.07
	Cat. A	1.63	1.22	-0.41
	Cat. B	1.31	1.16	-0.15
	Cat. C	1.41	1.32	-0.09
	Cat. D	2.14	2.23	0.08
Quick ratio	Total	1.93	1.80	-0.13
	Cat. A	2.54	2.12	-0.42
	Cat. B	1.88	1.43	-0.45
	Cat. C	1.68	1.76	0.08
	Cat. D	1.95	1.98	0.03
Age (years)	Total	29.94	33.99	4.05***
	Cat. A	34.74	39.18	4.44**
	Cat. B	32.96	36.97	4.01***
	Cat. C	32.68	34.63	1.95
	Cat. D	27.01	32.21	5.20***
ROE (%)	Total	73.54	56.70	-19.16***
	Cat. A	98.46	67.16	-29.33***
	Cat. B	76.71	56.40	-20.31***
	Cat. C	26.82	19.49	-6.33**
	Cat. D	36.63	26.32	-10.31***

4.3. Methodology Panel

4.3.1. Regression Analysis

We use panel regressions to test the impact of CSR expenditure on financial performance at the firm level. First, we conduct the tests, with and without yearly fixed effects, over the pre-legislation period (i.e. 2008 – 2013). Then we repeat the same analysis over the post-legislation period. We use the following regression model for our analysis:

$$ROE_{it} = \beta_0 + \beta_1 CSR_{A,t} + \beta_2 CSR_{A,t-1} + \beta_3 CSR_{A,t-2} + \beta_4 CSR_{A,t-3} + \beta_5 CSR_{B,t} + \beta_6 CSR_{B,t-1} + \beta_7 CSR_{B,t-2} + \beta_8 CSR_{B,t-3} + \beta_9 CSR_{C,t} + \beta_{10} CSR_{C,t-1} + \beta_{11} CSR_{C,t-2} + \beta_{12} CSR_{C,t-3} + \beta_{13} CSR_{D,t} + \beta_{14} CSR_{D,t-1} + \beta_{15} CSR_{D,t-2} + \beta_{16} CSR_{D,t-3} + Control\ Variables + e_{it} \quad \text{(i)}$$

where all variables are as defined in Table 1.

After conducting the panel regression analysis over pre- and post-legislation period, we tested for whether there had been changes in the regression coefficients of the CSR variables across the two time periods (Bruin, 2006). This analysis allows us to comment on the impact of the

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mandatory legislation on the relationship between CSR expenditure and financial performance for A and C companies. We also conducted a Chow test to identify if there was a structural break from the pre- to the post- legislation period (Chow, 1960). This testing procedure splits the sample into two sub-periods, estimates the parameters for each sub-period, and then tests the equality of the two sets of parameters using a standard F statistic (Hansen, 2001).

4.3.2. Difference-in-Differences

The Indian compulsory CSR legislation provides us with a natural setting to apply the DiD regression to test the impact of mandated CSR on financial performance. DiD is a tool to estimate pre- and post-treatment differences for a treatment and a control group. For example, both A and C companies were voluntarily spending on CSR prior to the introduction of the Act (the treatment) but post the legislation A companies are required to do so (the treatment group) and C companies are not required to do so (the control group). Similarly, with B and D companies, B companies are the treatment group and D companies are the control group.

The equation that is used is as follows:

$$ROE = \beta_0 + \beta_1 D^{post} + \beta_2 D^{Tr} + \beta_3 D^{post} * D^{Tr} + Control\,Variable + \varepsilon \quad \text{(ii)}$$

Where:

- D^{post} = Time dummy = 1 if the year of observation is after 2013, 0 otherwise.
- D^{Tr} = Treatment group dummy = 1 if A (C) companies, 0 otherwise.
- $D^{post} * D^{Tr}$ = Interaction variable = Time dummy * Treatment group dummy.
- Control Variables = Firm size (t - 1), Leverage (t - 1), Efficiency Ratio (t -1), Quick Ratio (t-1), Age.

The coefficients of each of the individual variables are calculated as shown in the Table 3 below:

Table 3: Description difference in differences regression coefficient calculation

	Post- Treatment	Pre- Treatment	Difference
Treatment	$\beta_0 + \beta_1 + \beta_2 + \beta_3$	$\beta_0 + \beta_2$	$\beta_1 + \beta_3$
Control	$\beta_0 + \beta_1$	β_0	β_1
	$\beta_2 + \beta_3$	β_2	β_3

The important coefficient being β_3 which measure the differential effect of the treatment (i.e. mandatory CSR) on both the treatment group (i.e. those impacted by the legislation) and the

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control group (i.e. those not impacted).

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5. Results

5.1. Panel Regressions

We conducted the regression analyses over both the six-year pre-legislation period from 2008 to 2013 and the two years post-legislation period of 2014 and 2015. Our findings based on equation (i) are reported in the first (pre-) and second (post-) columns of Table 4. The final column provides information on a test of the significance of any changes in the impact of each of the variables between the pre- and post-mandatory CSR periods.

We find that in the pre-compulsion period CSR expenditure has a significant positive impact on the profitability of A companies both in the year in which the expenditure is made and in the subsequent year. When we revisit this relationship in the post-legislation period, we find that the impact of CSR spend on profitability remains positive over both periods. Indeed, a comparison of the coefficients in the two models suggests that little has changed between the two periods with CSR expenditures by A companies translating into high profits. As we have seen these companies have increased their absolute level of expenditure on CSR activities post the introduction of the legislation. However, the anticipated increase in CSR expenditure as a result of making it compulsory for A and B companies has not been realised substantially due to the fact that A companies have actually reduced the percentage of their profits that they direct to CSR expenditures while B companies have fallen short both in terms of those numbers complying and levels expended. To some extent this reduction may be a due to a turnaround in the attitude of Indian investors towards CSR expenditure. Bird et al. (2016) found that Indian investors reacted very positively to the initial announcement by the Indian government in 2008 that they were going to make it mandatory for Indian companies to spend on CSR. However, they found that the attitude of investors gradually changed as time went by and was clearly negative by the time that the legislation was enacted. Hence, the falloff in the proportion of earnings that A companies devote to CSR activities may be a result of taking a lead from investors as to the likely long-term impact that any additional investment in CSR would have on company profits.

C companies were the only others that spent resources on CSR activities prior to the legislation. We find that the immediate impact of their expenditures on profitability is positive in the pre- legislation period but, in contrast to A companies, this impact completely reverses in the subsequent year. The introduction of the legislation weakens the previous relationship between CSR spend and profitability with the contemporaneous impact still having a positive

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sign but no longer being significant while the impact lagged one year is still negative and significant but slightly weaker than it was in the pre-legislation period. Post-legislation C companies are not required to undertake any expenditure and given that their previous experience suggests that such expenditure was not rewarding in terms of increased profits, it is not surprising to find that many of them took the opportunity to reduce their expenditure on CSR activities.

Neither B companies nor D companies spend on CSR in the period immediately prior to the introduction of the legislation. B companies are of particular interest to us as they are companies that have been forced by the government to spend on CSR activities. Mukherjee & Bird (2016) found they were reticent to undertake the spending after it became mandatory for them to do so and this seems to be borne up by the evidence of non-compliance. We find the expenditures for those who do (partially) comply have no impact on their profits in the year in which they are incurred but a small positive impact in the subsequent year. The fact that CSR expenditures do not work as well for the less well-resourced B companies as they do for belter-resourced A companies is consistent with the findings of Clarkson et al. (2011) and confirms that management of B companies had previously been correct in their assessment that such expenditures would not prove beneficial to their companies. Further, the tardiness of many of them to meet the minimum level expenditure may reflect an attitude towards making such expenditure which inhibited them making such expenditures in prior years. For those D companies that choose to embark on CSR expenditures despite them not being mandatory, we see a mixed outcome with the immediate impact of the expenditure on profits being positive but with this being somewhat reversed in the subsequent year. Their lack of experience in undertaking these expenditures might be contributing to this relatively poor outcome.

Before leaving our discussion of the panel regression result, we should comment briefly on our findings for the control variables. We consistently find that last year's profitability, a company's size, its efficiency and its age all have a positive impact on its profitability. In addition, we find that privately owned entities preform much better than government-owned entities.

In the final column of the Table 4, we report the significance of the difference in the coefficients of pre- and post-legislation period for A and C companies. The significance is measured using the seemingly unrelated estimation test and it allows us to throw light on whether mandatory regulation has an impact the relationship between CSR expenditure and corporate profitability. Our analysis reveals that there is no significant difference for A companies, in

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other words, we can say that there is no evidence to suggest that the mandatory legislation has impacted the relationship between CSR and financial performance for A companies. However, interestingly for C companies we observe a significant Chi2 value highlighting that the pre- and post-legislation coefficients are significantly different for these companies. The suggestion being that the relationship and profitability has worsened in the post-legislation period and this is something that we can further evaluate with the DiD analysis

Table 4: Panel Regression table - In this table we provide the results of regression equation (i). The dependent variable is ROE, with the independent variables being defined in Table 1. The coefficients are reported for the CSR spending lagged several periods for the four categories of companies. Column three provides the difference between the coefficients of pre and post legislation. We also tested significance of the difference in the pre and post coefficient. Here we tested if H0: β (category A & C pre legislation) = β (category A & C post legislation). We conducted a Chi2 test to test the significance.

	Pre-Legislation Period	Post Legislation Period	Change Post - Pre
Dependent Variable: ROE			Chi2
CSR (Category A)	0.123**	0.230*	0.107
CSR (Category A) (t-1)	0.169***	0.261**	0.45
CSR (Category A) (t-2)	0.0748	0.149	0.092
CSR (Category A) (t-3)	-0.0106	-0.0324	-0.0218
CSR (Category B)		0.05	
CSR (Category B) (t-1)		0.02*	
CSR (Category C)	3.11***	0.62	-2.49
CSR (Category C) (t-1)	-3.05***	-0.41*	2.64**
CSR (Category C) (t-2)	-0.29	-0.30	-0.01
CSR (Category C) (t-3)	-0.09	-0.65	-0.56
CSR (Category D)		2.95***	
CSR (Category D) (t-1)		-0.82***	
Control Variables			
ROE (t - 1)	0.297***	0.0565***	
Firm size (t - 1)	8.71***	13.44***	
Age	0.262***	0.438***	
Efficiency Ratio	14.89***	26.43***	
Leverage (t - 1)	-0.0143	-0.0734	
Quick Ratio	0.0241	-0.0027	
Ownership	-16.12***	-39.33***	
Constant	-29.23***	-51.06***	
Time Effect (Chi2)	13.43	8.47	

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N	4256	1860
R-sq	0.6544	0.3912
CHOW TEST (F)	5.92***	

** Sign. < 0.1, ** Sign. < 0.05, *** Sign. < 0.01*

We also conducted the Chow test to see if there is any evidence of a structural break in our data (Cantrell, Burrows, & Vuong, 1991) from the pre- (2008 FY to 2013 FY) to post- (2014 FY and 2015 FY) period. The F value for our Chow test is 5.92 against a critical value of 3.097, which suggests that there has been a significant structural break at the time of introducing mandatory CSR. The conclusion that we can draw from this is that the introduction of mandatory CSR expenditure has had a significant impact on the relationship between CSR spending and firm performance. We will provide evidence on the direction of this change when we report on the DiD analysis in the next sub-section.

5.2 Difference-in-Differences

DiD analysis provides the means to estimate the impact of certain policy interventions and policy changes, such as the legislation of the Indian government to make CSR expenditures compulsory. We applied equation (ii) to separately compare A with C companies and B with D companies, both with and without control variables[iii]. The Did analysis allows us to compare the impact on the performance of the mandatory CSR regulation on the treatment companies that were affected by the legislation (i.e. A and B) as compared to the control companies that were unaffected (i.e. C and D)0. The coefficient of interest is that of the interaction variable, $D^{post} * D^{Tr}$, that captures the difference between the treatment and control companies and so the variation in ROE attributable to the introduction of mandated CSR expenditure.

We can see from the findings reported in Table 5 that the pre- and post-legislation difference in performance of A companies is -10.961, and this is significant at a 1% confidence level. The evidence suggests that the introduction of the mandatory CSR expenditure has had little impact on the profitability of the C companies. Hence the overall deterioration in profitability attributable to the introduction of the legislation has been due to the impact it has had on the profitability of A companies. β_3, the coefficient of the interaction term ($D^{post} * D^{Tr}$) provides us with the DiD factor after controlling for time and firm fixed effects. In this case, the coefficient is -10.05 and significant at 1% confidence level. Hence, we can conclude from the analysis that the legislation has had an overall negative impact on the profitability of the companies.

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In the Table 6, we observe that the legislation also had a negative effect on the profitability of B companies. The difference in performance of these companies between the pre- and post-legislation periods is -13.632, and significant at 1% confidence level, whereas the difference in performance for the control group (i.e. D companies) is not significant. Overall, the mandatory CSR legislation has negatively impacted the performance of this group of companies as indicated by the significant and negative coefficient of DiD (-12.47).

The conclusion that we draw from the DiD analysis is that the legislation to mandate large Indian companies to spend on CSR activities has had a negative impact on the profitability of the Indian companies for whom CSR expenditure is now mandatory. Further, this negative impact has been larger for those companies that had not previously spent on CSR activities (i.e. B companies), a finding that is consistent with the perception of management that such expenditures would only erode profits (Mukherjee and Bird, 2016).

Table 5: Difference in differences (A and C companies) - In this table we provide the pre- and post-legislation coefficients of difference in difference (DiD) regression analysis as set out in equation (ii) and Table 3. The treatment group in this equation is the A companies and the control group is the C companies. The difference column in the table below provides the coefficient that measures the variability caused due to the introduction of new legislation. The third row of the same column provides the coefficient of variable representing product of time dummy and treatment group dummy. This coefficient will allow us to measure the impact of the legislation on the profitability of the treatment group

Dependent Variable: ROE	Post- Legislation	Pre- Legislation	Difference
Treatment Group (Category A)	-34.967^{***}	-24.006^{***}	-10.961^{***}
Control Group (Category C)	-31.961^{***}	-30.95^{***}	-0.911
	-3.106^{***}	6.944	-10.05^{***}

** P < 0.1, ** P < 0.05, *** P < 0.01*

Table 6: Difference in difference (B and D companies) - In this table, we provide the of pre and post legislation coefficients of difference in difference (DiD) regression analysis as set out in equation (ii) and Table 3. The treatment group in this equation is B companies, and the control group is D companies. The difference column in the table below provides the coefficient that measures the variability caused due to the introduction of new legislation. The third row of the same column provides the coefficient of variable representing product of time dummy and treatment group dummy. This coefficient will allow us to measure the impact of the legislation on the profitability of the treatment group (i.e. B companies)

Dependent Variable: ROE	Post- Legislation	Pre- Legislation	Difference

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Treatment Group (Category B)	-48.932^{***}	-35.3^{***}	-13.632^{***}
Control Group (Category D)	-51.202^{***}	-50.04^{***}	-1.162
	2.27^{***}	14.74^{***}	-12.47^{***}

** P < 0.1, ** P < 0.05, *** P < 0.01*

6. Conclusions

If it is deemed desirable for corporations to spend on socially responsible activities, then an important question to ask is whether they are expected to do so voluntarily and in sufficient volume for the appropriate purposes. The Indian government clearly thought otherwise when they legislated in August 2012 to mandate that large Indian companies must spend a minimum of 2% of their profits on CSR activities and then to amend this legislation in February 2014 to more precisely specify the areas where these funds must be allocated. We have used India as a case study of the success or otherwise of taking decisions relating to CSR expenditure largely out of the hands of management.

Reports suggest that the legislation has generated a level of CSR spending that has fallen much below expectation (Singh, 2016).This is consistent with our finding that large mandated companies who were already spending on CSR activities actually reduced their spending as a proportion of profits while those who previously were not spending on CSR activities were somewhat reluctant to do so. The smaller companies who were previously spending on CSR activities actually reduced their expenditure once it was determined they were not required to do so. Finally, some of the small Indian companies who previously had not spent on CSR activities began to make minimal allocations.

A major concentration of the paper has been on gauging the relationship between CSR spending and corporate profitability, both before and after the introduction of mandatory CSR spending for larger Indian companies. We found that there was a structural break in this relationship with the introduction of the mandatory CSR spending. Further, our DiD regression analysis suggests that the overall impact of the introduction of mandatory CSR legislation has been negative for those companies for whom CSR spending has become compulsory. We see that for those large Indian companies that were spending on CSR prior to the legislation (A companies), any change in the previously positive relationship between CSR spending and profitability has been insignificant. For those large Indian companies that were forced to spend on CSR for the first time (B companies), the spending did not seem to have a material impact

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on their profits. The companies whose profits seem to have been affected most by the legislations are the smaller Indian companies who were already spending on CSR (C companies). After the introduction of the legislation, these companies both reduce the level of their expenditures on CSR plus this expenditure has an increased negative impact on profits. Finally, there are the smaller Indian companies who after the introduction of the legislation begin to spend minimal amounts on CSR (D companies) which does not seem to have had any significant impact on their profits.

One might ask why have A companies reduced the proportion of profits that they spend on CSR, especially given that they would seem to have enjoyed higher profitability as a consequence of such expenditure. One possible contributing factor is that Indian companies are taking the lead from Indian investors who have ceased to look favourably on CSR expenditure. Bird to al., 2016) found that investors reacted favourably to CSR spending being made compulsory when it was first proposed. However, this reaction gradually weakened and had turned negative by the time that the legislation was enacted suggesting that investors had come to the view that increased CSR spending would not translate into larger profits. Hence the reduction in the level of CSR expenditure may reflect a concern of management of the impact that such spending will have on their share price. In addition, Mukherjee & Bird (2016) found that the major reason expressed by A companies for spending on CSR was to improve the image of the company. It is possible that the perceived advantage of doing this has been diluted with all large companies now being required to spend on CSR and this may have translated into a reduced level of spending.

The contribution of B companies to increased CSR spending has also fallen short of expectations with many of them spending much less than the required 2% of profits. These companies had not been willing to undertake this expenditure in the past putting forward a lack of cash flow and inadequate know-how as major reasons for not doing so (Mukherjee & Bird, 2016). Hence it may not come as a surprise to find that they use the "comply or explain" option to (largely) escape such expenditure. We find that C companies cut the proportion of their profits that they spend on CSR by a third with it not being compulsory for them under the new legislation while there has been a slight pickup in D companies spending on CSR.

Not only did the impact of the mandatory requirements disappoint in terms of quantity but the Indian government was also unhappy with how the funds were being directed. The fact that the government initially gave no direction resulted in a large proportion of the funds being directly internally with the focus being on improving the productivity in organisations (Mukherjee &

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Bird, 2016). Within a year of the initial legislation being passed, the government introduced amendments to more specifically direct the expenditures on CSR. The lack of success of the Indian legislation to date may not be all that surprising given the indecision displayed by the government whose commitment to the legislation waxed and waned over the four year that elapsed between when it was first proposed to when it was passed. Over this period, the attitude of investors certainly turned negative towards CSR spending and one might surmise that the same happened to corporate management. The indecision of the government can be further seen in the "comply or explain" feature of the legislation which provided an easy escape clause for those that did not want to comply. The inadequacy of the initial legislation can be further seen by the need to the government to amend it within a year to provide increased direction as to where the expenditures can be directed

Undoubtedly governments around the world in the future under pressure from their constituents will give serious consideration to introducing some form of compunction for corporations to spend on CSR activities. The question that we would pose is what can they learn from the Indian experience? The first observation that we would make is that they would need to be more obviously committed than would seem to be the case in India and not include escape clauses that make it easy for companies to avoid the expenditures. Second, they may need to be more prescriptive in how the CSR funds are to be spent as the Indian government soon came to realise. Third, consideration needs to be given to assisting companies required to spend on CSR for the first time to construct the decision-making framework and operational infrastructure as this has been found to be a constraint on spending (Albareda, Lozano, & Ysa, 2007). Most importantly, we have found that the Indian legislation had an overall negative impact on the relationship between CSR and corporate profits which will only discourage companies from spending on CSR. Our findings gain support from a recent study by Manchiraju & Rajgopal (2017) that suggested mandatory CSR activities can impose social burdens on business activities at the expense of shareholders. Their findings indicate that firms, left to their own devices, choose an optimal level of CSR spending designed to maximize their firm value. Hence, governments when framing legislation have to take special care to ensure it does not have a perverse effect on the behaviour of corporations.

Finally, it should be pointed out that the analysis of the impact of the legislation is being undertaken only two years after it became effective. Not only does this limit our sample size but also means that the full impact may yet have work its way fully through the system. Implications for this include that the impact of CSR spending on profits in the post-legislation

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period may yet to become fully apparent although out analysis of the pre-legislation period suggests that this takes no longer than two years. Further, the level of compliance and the evidence on under spending may reflect that those new to CSR spending (B companies) are taking time to come to terms with the new requirement which may result in the level of compliance and spending significantly improving in future years. Hence, it might be fruitful to revisit our findings in a few years' time although we feel that is a useful exercise to provide an early evaluation of the Indian experience with respect to mandatory CSR spending.

List of Abbreviations

CSR: Corporate Social Responsibility
DiD: Differences-in-Differences

Compliance with Ethical Standards

Conflict of Interest: The three authors each declare that she/he has no conflict of interest

Ethical approval: The analysis in this paper is not based on experiments involving h human participants conducted by any of the authors

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[i] In this paper, we make continual reference to CSR expenditure as it is this that is mandated by the Indian government. In much of the literature, reference is made to CSR performance which largely equates to what we call CSR expenditure, which we believe to be a more appropriate description in the context of this article/

[ii] As at the end of 2017, one million INR equated with approximate 15,600 USD.

[iii] As the findings were very similar with and without control variables, we will concentrate our discussion on the analysis that included control variables.