CHAZEN INSTITUTE RESEARCH BRIEF

What Happens When CSR Is Mandated?

KEY TAKEAWAYS

- ✓ Establishing mandates on CSR spending could backfire, resulting in less overall funds for worthy causes.
- ✓ India's mandate has diminished the signaling value of CSR and resulted in a reduction in voluntary CSR spending by 33%.
- ✓ The Indian law has also negatively impacted the overall financial performance of companies that were voluntary high spenders before the mandate.

India is the first country in the world to mandate spending on corporate social responsibility (CSR). In 2014, the Government of India passed a law requiring all companies above a certain profit threshold (INR 50 million) to spend at least two percent (2%) of their average net profits of three years on CSR-related activities.

While NGOs welcomed the move, many business leaders expressed serious concern over what they thought should be a voluntary activity. One senior executive of a large Indian business conglomerate was quoted as saying, "charitable giving used to be a big reputation builder for us... now it's just about legal compliance." Another senior executive stated, "for most organizations, the discussion at the board level is now not about what we do, but does it count as CSR and does it meet the legal requirements." According to new research, their concerns we were well placed.

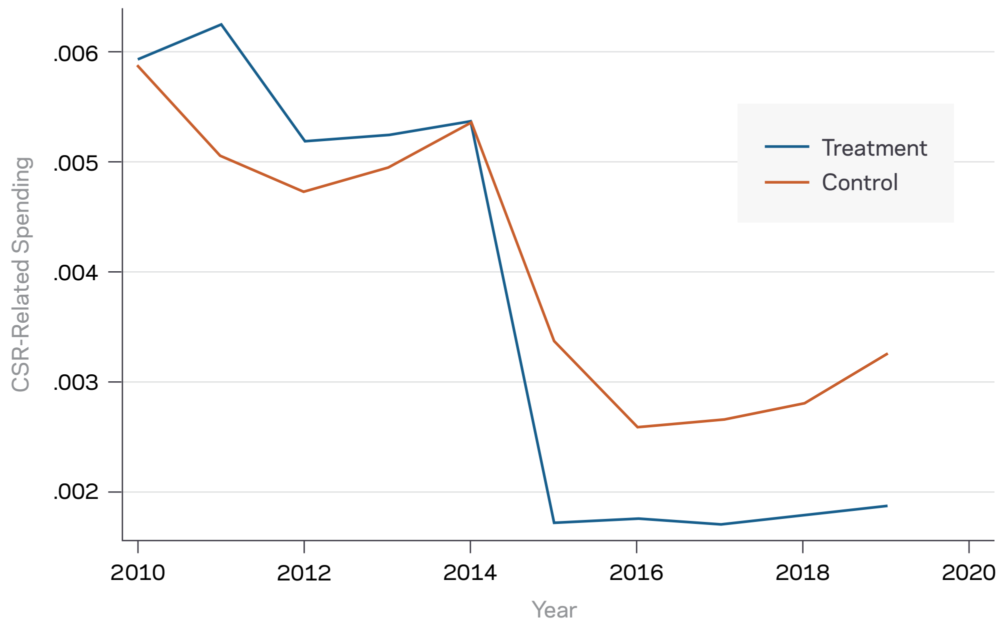
In "Does Mandated Corporate Social Responsibility Crowd Out Voluntary Corporate Social Responsibility?" **Chazen Senior Scholar Shivaram Rajgopal** and Indian School of Business Professor Prasanna Tantri find that the move from a voluntary activity to a compliance exercise has had an unintended effect on corporate philanthropy in India.

Research

With data obtained from the Center for Monitoring Indian Economy and India's Ministry of Corporate Affairs, the researchers analyzed the levels of CSR spending by companies before and after passage of the Indian law. In particular, they assessed the law's effect on overall CSR giving as well as the financial performance of companies in compliance.

The Effect of Mandating CSR

This chart shows what happens when voluntarily high CSR spenders are subject to a mandate. Companies with either INR 50 million in profit, INR 5 billion in net worth, or INR 10 billion in sales (blue line) were required by law to spend 2% of their average profits on CSR. Companies below those thresholds (orange line) were not.



Rajgopal and Tantri first identified companies who were voluntarily spending at levels higher than 2% of their profits pre-regulation. They then charted the impact of the law's minimum requirement on the level of CSR spending for those voluntary high-spenders, and on companies contributing less than 2% or nothing at all pre-mandate. The researchers also compared how sensitive CSR spending levels were to profitability shocks, both before and after the law took effect.

Results

The research shows that instituting a minimum requirement on CSR spending actually does more harm than good. Instead of boosting the total amount of funds available for worthy causes, it is likely did the opposite.

One would expect a mandate to increase projected spending on CSR, particularly in the short run, because it forces a larger number of companies to contribute to CSR-related activities. But the regulation has actually reduced total CSR spending. The reason: higher-spending companies chose to cut back on their contributions to meet the federal minimum. In fact, their total CSR spending declined by 33% over the time period studied.

The mandate had another surprising result. Prior to the regulation, CSR spending was seen as a special form of "signaling" in that it allowed companies to publicly express both the virtue of their business and higher quality of their products simultaneously. The research reveals companies that were voluntary high spenders before the mandate not only reduced their CSR spending, but they also increased advertising outlays, perhaps to compensate for CSR's reduced signaling power.

And despite a substitution of CSR by advertisement, the overall financial performance of these companies declined, with stock prices falling by about one percent (1%) and the return on assets (ROA) dropping by eight percent (8%) on average. According to researchers, this suggests a unique role for voluntary CSR in signaling virtue and product quality.

Download the full paper.

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