
THE EVOLUTION OF CSR IN INDIA: EXAMINING THE AGENCY PROBLEM THROUGH THE LENS OF CORPORATE REGULATION THEORIES

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ABSTRACT

Corporate Social Responsibility (CSR) in India has undergone a significant transformation in India, starting from the voluntary guidelines on Corporate Social Responsibility in 2009 to the Mandatory Provision of CSR under Section 135 of the Companies Act, 2013 effective since 2014. This paper explores the evolution of CSR practices in India and critically examines whether the mandated CSR activities lead to an Agency problem, where the interests of corporate managers diverge from those of shareholders. By employing various theories of corporate regulation, including contractual theories, communitarian theories, and concession theory, the research delves into the complex interplay between corporate governance, regulatory frameworks, and social responsibilities.

Contractual theories, which emphasise voluntary agreements between stakeholders, are juxtaposed with communitarian theories that advocate for a broader societal role for corporations. Concession theory, which views corporations as entities created and regulated by the state, further enriches the discussion by highlighting the regulatory implications of CSR mandates. The analysis reveals that while CSR initiatives in India have fostered greater corporate accountability and societal benefits, they may also exacerbate the Agency problem by diverting resources and attention away from shareholder value maximisation.

This paper contributes to the ongoing debate on the effectiveness of CSR as a tool for sustainable development and the potential conflicts it may create within corporate governance structures. The findings suggest a need for a balanced approach that aligns corporate social objectives with shareholder interests, ensuring that CSR efforts are both impactful and strategically integrated into business operations.

Keywords: Corporate Social Responsibility, Companies Act 2013, Agency Problems, Shareholder, Manager, Contractual theories, Communitarian theories, Concession theory

I. INTRODUCTION: HISTORICAL FOUNDATIONS OF CSR IN INDIA

Corporate social responsibility (CSR) in India has deep historical roots that date back to ancient times. India has been a significant centre of international trade since ancient times,¹ where ethical behaviour played a crucial role in the success of Indian businesspeople.² In ancient India, business was conducted with a strong adherence to personal values, establishing a robust business ethics infrastructure that led to the prosperity of the Indian economy until the early nineteenth century.³

Religious traditions such as daan (charity), seva (service), and zakat (almsgiving) have been integral to Indian society for centuries, shaping the relationship between the privileged and the dispossessed. Historically, the majority of philanthropy in India has been directed towards religious institutions, a practice that continues today. The earliest industrialists of the 19th century pioneered corporate giving through trusts and endowed institutions managed by business families.⁴

The formalization of CSR in Indian law is a relatively recent development. The 11th Five Year Plan of 2007 highlighted the need for appropriate corporate social responsibility practices.⁵ As a first step towards mainstreaming the concept of business social responsibilities, the Ministry of Corporate Affairs issued 'Voluntary Guidelines on Corporate Social Responsibility' in 2009 which was further refined in 2011 as "National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business." Finally, in 2013 Mandatory provisions of CSR were introduced under Section 135 of the Companies Act, 2013 which became effective from 1st April 2014.⁶ With this landmark legislation, India became the first country in the world to mandate CSR implementation, marking a significant shift in the business landscape.

II. THEORETICAL FRAMEWORKS OF CORPORATE

a. Contractual theory of corporation

¹ Chakraborty, S.K., 1997. Business ethics in India. *Journal of Business Ethics*, 16, pp.1529-1538.

² Kanagasabapathi, P., 2007. Ethics and values in Indian economy and business. *International Journal of Social Economics*, 34(9), pp.577-585.

³ Das, D.K., 2006. The Chinese and Indian economies: comparing the comparables. *Journal of Chinese Economic and Business Studies*, 4(1), pp.77-89.

⁴ Nandini Deo, A brief history of Indian CSR - Gateway House, Gateway House (July 30, 2015), <https://www.gatewayhouse.in/a-brief-history-of-indian-csr/>.

⁵ Planning Commission, Eleventh Five-Year Plan (2007-2012), 27 (2006).

⁶ Companies Act, 2013, s. 135, No. 18 Acts of Parliament, 2013 (India).

The “contractual theory” of the corporation views the corporation as a network of agreements, also called a "nexus of contracts", between its various stakeholders. These stakeholders include shareholders, managers, employees, and creditors.⁷ Unlike the legal entity theory, which sees corporations as state-created entities, the contractual theory emphasizes the role of stakeholders as key participants in a set of voluntary agreements that define the corporation's functioning.

In this framework, shareholders are recognized as the primary risk-bearers of the corporation. They hold residual claims, meaning they receive profits only after all other stakeholders, like employees and creditors, have been paid.⁸ Due to this risk-bearing role, shareholders are naturally incentivised to see the corporation succeed and maximize profits.⁹

Managers, including directors and officers, act as agents of the shareholders. They are entrusted with making decisions and managing the corporation's resources to generate profits for the shareholders.¹⁰ However, this separation of ownership (shareholders) and control (managers) creates the potential for conflicts of interest, commonly referred to as agency costs.¹¹ These arise when managers are tempted to prioritize their own interests over maximizing shareholder value, which can lead to inefficiencies or reduced returns for shareholders.¹²

b. Communitarian Theory

The “communitarian theory” of corporations presents a unique perspective on corporate structure and responsibility. This theory views a corporation as a separate legal entity with obligations extending far beyond its shareholders. According to Michael Bradley et al., corporations are accountable to a wide range of stakeholders, including employees, creditors, suppliers, customers, competitors, and even society at large.¹³ This approach stands in contrast to more traditional, shareholder-centric models of corporate governance.

Under this model, the corporation is not solely focused on maximizing shareholder wealth but

⁷ Williamson, O.E., 1985. Firms, markets, relational contracting. The economic institutions of capitalism.

⁸ Butler, H.N., 1988. The contractual theory of the corporation. *Geo. Mason UL Rev.*, 11, p.99.

⁹ Fischel, D.R., 1982. Corporate Governance Movement, *The. Vand. L. Rev.*, 35, p.1259.

¹⁰ Lee, J.C.H., 2004. Minority shareholder protection in takeovers: private actions (Doctoral dissertation, University of London).

¹¹ Manne, H.G., 1964. Some theoretical aspects of share voting. An essay in honor of Adolf A. Berle. *Columbia Law Review*, 64(8), pp.1427-1445.

¹² The modern corporation and private property (Means Gardiner Coit 1896- ed., 1991).

¹³ Bradley, M., Schipani, C.A., Sundaram, A.K. and Walsh, J.P., 1999. The purposes and accountability of the corporation in contemporary society: Corporate governance at a crossroads. *Law and Contemp. Probs.*, 62, p.9.

is also accountable to a wider set of interests.¹⁴ At its core, the communitarian theory emphasizes the idea that businesses have a broader purpose than merely generating profits. As outlined in Ridley-Duff's work, communitarians believe that individuals and organizations should prioritize the well-being of the community over their own self-interest.¹⁵ This philosophy translates into a corporate model where businesses are expected to contribute to the common good and take on significant social responsibilities.¹⁶

However, while the communitarian model aims to address some of the shortcomings of shareholder-centric approaches, it introduces its own set of challenges, particularly in terms of agency issues between shareholders and managers. One significant concern is the potential for managerial entrenchment. Managers might use communitarian principles to justify actions that strengthen their positions, such as building strong relationships with employees or local communities, which can make it more difficult for shareholders to replace underperforming managers.

Other agency issues arise from the divergent objectives that can emerge between shareholders and managers under this model. While shareholders may primarily seek financial returns, managers operating under communitarian principles might prioritize other stakeholders' interests or long-term sustainability, leading to potential conflicts. The complexity of balancing multiple stakeholder interests also creates challenges in measuring managerial performance, as traditional financial metrics may not fully capture the broader impacts of corporate actions. Additionally, conflicts can arise over the allocation of corporate resources, with shareholders potentially disagreeing with managers' decisions to use resources for community or environmental initiatives that don't directly contribute to profitability.

These agency issues underscore the complexity of implementing communitarian principles in corporate governance while still meeting shareholder expectations.

c. Concession Theory

“Concession theory” presents a distinctive perspective on the nature and governance of

¹⁴ Fort, T.L. and Schipani, C.A., 2000. Corporate Governance in a Global Environment: The Search for the Best of All Worlds. *Vand. J. Transnat'l L.*, 33, p.829.

¹⁵ Ridley-Duff, R., 2004. Communitarian governance: the development of management, governance and ownership models.

¹⁶ Ridley-Duff, R., 2004. Communitarian governance: the development of management, governance and ownership models.

corporations. At its core, this theory posits that a corporation is an artificial legal person created by the state. This fundamental premise implies that corporations do not exist independently of the state and only enjoy the rights and privileges specifically granted by it.¹⁷ This view of corporate existence has far-reaching implications for how we understand and regulate corporate activities.

The theory's emphasis on state creation provides a strong justification for government regulation of corporate activities.¹⁸ Under this framework, the state has the right to impose restrictions on incorporation and limit corporate activities that may harm society, even if these activities are not explicitly illegal.¹⁹ This regulatory power extends beyond mere legal compliance, potentially encompassing broader societal concerns.

One of the most significant implications of concession theory is its support for mandating corporate social responsibility. By viewing corporations as creations of the state, the theory provides a theoretical foundation for requiring companies to consider stakeholders beyond just shareholders. A prime example of this in practice is Section 135 of the Companies Act of India, which mandates “corporate social responsibility” activities for certain companies.²⁰

Concession theory also emphasizes the importance of balancing the state's interests in promoting the general welfare with the private interests of shareholders.²¹ This balancing act challenges the shareholder primacy model, which views shareholder wealth maximization as the sole objective of corporate governance.²² By reducing the emphasis on shareholders as the exclusive beneficiaries of corporate activity, concession theory opens the door for consideration of broader stakeholder interests, including those of employees, consumers, and the community at large.²³

The implications of concession theory for corporate governance are profound. It justifies a more comprehensive approach to corporate regulation based on public interest, potentially

¹⁷ Hardman, J., 2024. The Making of Corporate Legal Concession Theory. *Oxford journal of legal studies*, 44(1), pp.181-199.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ Companies Act, 2013, s. 135, No. 18 Acts of Parliament, 2013 (India).

²¹ Ciepley, D., 2019. Can corporations be held to the public interest, or even to the law?. *Journal of Business Ethics*, 154(4), pp.1003-1018.

²² Bratton, W.W. and Wachter, M.L., 2008. Shareholder primacy's corporatist origins: Adolf Berle and the modern corporation. *J. coRP. l.*, 34, p.99.

²³ Mitchell, L.E., 1991. Theoretical and practical framework for enforcing corporate constituency statutes. *Tex. L. Rev.*, 70, p.579.

redefining corporate purpose beyond pure profit maximization. This shift in perspective provides a legal and theoretical basis for requiring corporations to engage in socially responsible activities and to actively consider a broader range of stakeholders in their decision-making processes.

Moreover, concession theory promotes the alignment of corporate activities with broader public interests and societal goals. It suggests that corporations, as creations of the state, have an inherent responsibility to serve not just private interests but also the public good. This view can significantly influence how we conceptualize the role of corporations in society and the expectations we place on them.

III. CSR INITIATIVES IN INDIA: POTENTIAL AGENCY PROBLEMS AND CORPORATE GOVERNANCE CONFLICTS

a. Resource Allocation Conflicts

The mandatory Corporate Social Responsibility (CSR) provisions under Section 135 of the Companies Act, 2013,²⁴ require certain companies to allocate a minimum of 2% of their average net profits toward CSR activities. This statutory requirement can lead to conflicts between shareholders and managers due to differing perspectives on resource allocation.

Shareholders adhering to the contractual theory of corporations may perceive CSR expenditures as a diversion from profit-maximizing activities. For shareholders, the primary objective of the corporation is to generate maximum returns, and any allocation of funds toward social causes may be seen as reducing potential profits. They argue that these funds could instead be used for business expansion, research and development, or returned to shareholders as dividends. Friedman famously articulated that the social responsibility of businesses is to maximize profits while conforming to societal laws and ethical norms.²⁵ As such, shareholders may view CSR initiatives as detracting from core business objectives, causing tension between shareholders and managers.

Managers, however, might view CSR initiatives as an opportunity to build the company's reputation or pursue personal interests under the guise of social responsibility. This managerial

²⁴ Companies Act, 2013, s. 135, No. 18 Acts of Parliament, 2013 (India).

²⁵ Friedman, M., 2007. The social responsibility of business is to increase its profits.

discretion can create potential agency conflicts, where managers prioritize CSR projects that enhance their personal image or entrench their positions, rather than projects that align with shareholder interests. Donaldson and Preston highlight that under communitarian theory, managers may justify CSR initiatives by appealing to broader societal obligations, even if these projects do not contribute directly to profit maximization.²⁶

b. Performance Measurement Challenges

Mandatory CSR complicates the measurement of managerial performance, particularly when CSR outcomes are difficult to quantify using traditional financial metrics.

Shareholders typically rely on traditional financial indicators, such as profitability and market share, to evaluate managerial performance. However, CSR activities often yield intangible benefits like improved corporate reputation, employee morale, and customer loyalty, which may not immediately contribute to the bottom line. Eccles, Ioannou, and Serafeim suggest that these intangible outcomes of CSR are difficult to measure and may not align with short-term shareholder expectations.²⁷

Another source of tension is the time frame over which CSR initiatives deliver results. CSR activities often produce long-term societal benefits, such as environmental sustainability or community welfare, but may not generate immediate financial returns. Shareholders focusing on short-term profitability may be resistant to CSR initiatives that lack measurable financial benefits in the short term. Managers, however, might argue that these initiatives are crucial for long-term value creation and corporate sustainability. The divergence between short-term and long-term priorities can thus complicate the relationship between shareholders and managers.²⁸

c. Stakeholder Prioritization Dilemmas

The communitarian theory of corporate governance emphasizes that corporations have responsibilities not only to shareholders but also to a broader range of stakeholders, including employees, customers, suppliers, and the community. However, this stakeholder approach can

²⁶ Donaldson, T. and Preston, L.E., 1995. The stakeholder theory of the corporation: Concepts, evidence, and implications. *Academy of management Review*, 20(1), pp.65-91.

²⁷ Eccles, R.G., Ioannou, I. and Serafeim, G., 2014. The impact of corporate sustainability on organizational processes and performance. *Management science*, 60(11), pp.2835-2857.

²⁸ Kramer, M., *Strategy and Society: The Link between Competitive Advantage and Corporate Social Responsibility*. Harv. Bus. Rev. Available online: <https://pdfs.semanticscholar.org/77e9/9d84c1574c79cdbf15f1723637f7b24869c1.pdf> (accessed on 23 October 2019).

lead to conflicts in corporate governance when there is a misalignment between shareholder expectations and the interests of other stakeholders.

Shareholders adhering to the shareholder primacy model expect the corporation to prioritize their interests, especially in terms of financial returns. However, CSR initiatives often focus on improving conditions for other stakeholders, such as employees and communities. This divergence in priorities can lead to agency conflicts, as managers may be seen as favoring non-shareholder interests over those of the shareholders. Jensen argues that the conflict between shareholder primacy and stakeholder governance is a fundamental tension in modern corporate governance, and CSR initiatives often highlight this tension.²⁹

Managers face the complex task of balancing the competing interests of various stakeholders. For example, investing in environmentally sustainable practices might increase costs in the short term, reducing profitability. However, it can also enhance the company's reputation and reduce long-term risks associated with environmental harm. Striking the right balance between these competing interests requires sophisticated governance mechanisms that can accommodate both shareholder expectations and the needs of other stakeholders.³⁰

d. Legal and Regulatory Compliance Tensions

The mandatory CSR requirements in India, as laid out in the Companies Act, 2013, introduce a regulatory framework that companies must navigate. However, these regulatory requirements can create additional tensions between managers and shareholders, especially when compliance is prioritized over strategic CSR.

Managers may focus on fulfilling the legal requirements for CSR without necessarily aligning CSR activities with the company's broader strategic objectives. This compliance-driven approach might meet the minimum legal requirements but fail to create significant value for either shareholders or society. Porter and Kramer emphasize that CSR should be strategically aligned with a company's core business in order to create shared value for both the company and society.³¹ The tension between meeting legal obligations and pursuing strategic CSR can

²⁹ Jensen, M.C., 2010. Value maximization, stakeholder theory, and the corporate objective function. *Journal of applied corporate finance*, 22(1), pp.32-42.

³⁰ Freeman, R.E., 2010. *Strategic management: A stakeholder approach*. Cambridge university press.

³¹ Kramer, M., *Strategy and Society: The Link between Competitive Advantage and Corporate Social Responsibility*. *Harv. Bus. Rev.* Available online: <https://pdfs.semanticscholar.org/>

further complicate corporate governance.

The state's involvement in mandating CSR through regulation, justified by concession theory, reflects the idea that corporations owe a responsibility to society in return for their legal status. However, over-regulation can reduce corporate autonomy, leading to concerns that excessive government intervention is limiting the company's ability to make profit-maximizing decisions. This regulatory burden can create additional tension between managers, who must ensure compliance, and shareholders, who may view regulation as an impediment to business success

IV. ALTERNATE VIEWS

Adi Libson's paper, "Taking Shareholders' Social Preferences Seriously: Confronting a New Agency Problem,"³² introduces a new perspective on the traditional agency problem by suggesting that shareholders may prioritize social goals over profit maximization, challenging the assumption that shareholders are solely focused on financial returns. Libson argues that this introduces a new agency conflict, where managers, driven by profit-based incentives, may resist implementing socially responsible initiatives even when shareholders desire them. He suggests that managers' compensation structures, linked to financial performance, make them more sensitive to profit outcomes than shareholders, whose diversified portfolios allow for more flexibility in supporting social initiatives. Libson proposes solutions such as delegating CSR decisions to shareholders via formal proposals or board subcommittees to bridge the gap between managerial actions and shareholder preferences.

This view contrasts with traditional CSR-related agency theory, which typically assumes that managers use CSR initiatives to further personal interests—for reputation building or entrenchment—while shareholders remain focused on maximizing profits. Traditional concerns, especially in emerging markets like India, highlight the potential for CSR to be seen as a resource-diverting activity that diminishes shareholder value, with managers often accused of greenwashing or misusing CSR to enhance corporate image without creating meaningful social impact. While Libson's model offers a fresh approach to aligning shareholder interests with corporate social objectives, it underestimates the diversity of shareholder interests and the

³² Libson, A., 2018. Taking Shareholders' Social Preferences Seriously: Confronting a New Agency Problem. UC Irvine L. Rev., 9, p.699.

challenges posed by information asymmetry and shareholder apathy in making informed CSR decisions.

V. CONCLUSION

“Corporate Social Responsibility” (CSR) in India has evolved from deeply rooted religious and philanthropic traditions into a legally mandated framework, as defined under Section 135 of the Companies Act, 2013. This evolution reflects a shift in the relationship between businesses, society, and the state. Theoretical frameworks such as the contractual, communitarian, and concession theories provide distinct lenses through which to understand the corporate governance dynamics that CSR introduces. These frameworks highlight the potential for agency conflicts, particularly in the allocation of resources, performance measurement, and the prioritization of diverse stakeholder interests.

The contractual theory underscores the conflict between shareholders, who seek profit maximization, and managers, who may use CSR initiatives to enhance their reputation. Conversely, the communitarian theory emphasizes the corporation's broader obligations to stakeholders, potentially leading to conflicts as managers balance the competing interests of shareholders, employees, and the community. Concession theory justifies the state's right to mandate CSR, given that corporations are creations of the state and thus have obligations beyond shareholder wealth maximization.

Despite these conflicts, CSR offers long-term benefits such as improved corporate reputation, sustainability, and community development. However, challenges remain in aligning CSR initiatives with corporate strategy and ensuring that they create meaningful social value without detracting from shareholder returns. As Libson's analysis demonstrates, CSR can also introduce new agency problems, where shareholders' social preferences may clash with managers' profit-driven incentives. To address these issues, there is a need for robust governance mechanisms, such as greater transparency, better alignment of CSR with business objectives, and increased shareholder engagement in CSR decision-making. By addressing these challenges, Indian corporations can build a more sustainable model that balances the interests of all stakeholders, fulfilling both social obligations and financial objectives.