Development Seminar @ Brookings India

Columbia Business School

CSR in India

Shiva Rajgopal

Kester and Byrnes Professor of Accounting and Auditing

Brookings India

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Outline

- CSR in India
  - CSR law in India
  - Some evidence on stock prices around passage of the law
  - Implementation
  - Reading TCS and Infosys’ ESG reports
  - Open questions

Unique CSR mandate

- India is unique in mandating that Indian firms, which satisfied certain profitability, net worth and size thresholds, are required to spend at least 2% of their net income on CSR

- “every company having [(net worth of rupees 500 crore or more, or turnover of rupees 1000 crore or more)] or [a net profit of rupees 5 crore or more during a year] <u>shall be required to formulate a CSR Policy</u> to ensure that every year at least <u>2% of its average net profits</u> during the three immediately preceding financial years shall be spent on CSR activities as may be approved and specified by the company.”

What is CSR as per the Indian law?

- CSR itself is not defined by the Indian Companies Act 2013
- Schedule VII of the Companies Act requires CSR activities of the firm to focus on at least one of the following areas:
  - eradicating extreme hunger and poverty;
  - promotion of education;
  - promoting gender equality and empowering women;
  - reducing child mortality and improving maternal health;
  - combating HIV, AIDS, malaria and other diseases;
  - ensuring environmental sustainability;
  - employment-enhancing vocational skills;
  - social business projects;
  - contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the state governments for socioeconomic development, and relief and funds for the welfare of the scheduled castes, the scheduled tribes, other backward classes, minorities and women; and
  - such other matters as may be prescribed
- Which of these is potentially value-enhancing for the firm?

The board's obligation under the law

- A firm needs to create a CSR committee consisting of three or more directors, at least one of which must be an independent director.
  - The CSR committee is expected to devise, recommend, and monitor CSR activities, and the amounts spent on such activities.

- The firm must
  - publicly disclose an official policy on its CSR activities and
  - document CSR activities implemented during the year in its annual report;
  - give preference to local areas where they operate.

- The companies can carry out CSR
  - by collaborating either with a NGO, or
  - through their own trusts and foundations or
  - by pooling their resources with another company.

How is the law enforced?

- Comply or explain regime:
  - While a company is not subject to liability for failing to spend on CSR, a company and its officers are subject to liability for not explaining such a failure in the annual report of the board of directors
  - Failure to explain is punishable by a fine on the company of not less than INR 50,000 (about U.S. $746) and up to INR 25 lakhs (about U.S. $37,134). Further, officers who default on the reporting provision could be subject to up to three years in prison and/or fines of not less than INR 50,000 rupees (about U.S. $746) and as high as INR 5 lakh (about U.S. $7,462).
- Not sure how non compliance will be policed and enforced.

Reactions to the law

- <u>The left's objection</u>
  - The Government had abdicated its responsibility of building infrastructure and public safety to the private sector
  - Perhaps one plausible compromise, given the corruption and bureaucracy in the public sector
  - A sop to camouflage the corporate sector friendly 2013 Indian Companies Act
  - Passed in response to apparent Government inaction after the Satyam scandal

- <u>The right's objection</u>
  - Indian corporate tax rate is 33% compared to global average of 24%
  - One more tax added via the CSR rule
  - CSR should be voluntary and left to the individual company
  - Wealth transfer from the shareholder to charity or worse corruption by management or politicians

60% of corporate India is affected by the law

Industry	UNAFFECTED	AFFECTED	TOTAL	%
Automobiles and Truck	21	78	99	4.67%
Banking	43	72	115	5.42%
Business Services	84	88	172	8.11%
Chemicals	57	100	157	7.41%
Construction	36	102	138	6.51%
Construction Material	14	35	49	2.31%
Consumer Goods	19	32	51	2.41%
Electrical Equipment	19	33	52	2.45%
Food Products	25	53	78	3.68%
Machinery	26	59	85	4.01%
Non-Metallic and Industrial	20	33	53	2.50%
Pharmaceutical Products	44	63	107	5.05%
Steel Works	27	67	94	4.43%
Textiles	71	58	129	6.08%
Trading	86	40	126	5.94%
Wholesale	100	40	140	6.60%
Other industries with < 2% frequency	191	284	475	22.41%
Total	**883**	**1,237**	**2,120**	**100.00%**
	41.65%	58.35%	100.00%	

Voluntary CSR spending before the law is small

- Only 22% of all firms were spending anything on CSR
  - 458 of the 2120 firms spend something on CSR in 2012
  - 458 of the 1237 <u>affected</u> firms spend something on CSR in 2012

- The average spending is INR 49 mill ($73K), the median just INR 3 mill ($4K)
- As a % of last three years' profits, the average is 1.22%, the median is only 0.37%
- So, there's a lot of potential new spending on tap
- EY estimates about $2 billion new spending per year

Voluntary CSR spending categories

CSR activity	N	%
Community welfare	242	52.84%
Education	212	46.29%
Environment	191	41.70%
Healthcare	178	38.86%
Rural development	44	9.61%
Women empowerment	37	8.08%
Children health	35	7.64%
Donations	31	6.77%
Disaster relief	25	5.46%
Sports	12	2.62%
Support for physically challenged	9	1.97%

Law results in a negative stock price reaction of around 5%

Event	Date	Event description	UNAFFECTED (1)	AFFECTED (2)	Difference (2)-(1)
1	03 Aug 2009	The Bill is introduced in the Lok Sabha (lower house of parliament). There is no mention of CSR is this version of the Bill.	0.003	0.001	-0.001
2	31 Aug 2010	The standing committee on finance submits its report and introduces a clause on mandatory CSR in the Bill.	0.003***	-0.023***	-0.026***
3	28 Feb 2011	The Ministry of Corporate Affairs suggests that it is considering to make only the disclosure and not the spending on CSR mandatory	-0.002	0.004	0.006
4	14 Dec 2011	The Bill is re-introduced in the Lok Sabha with a mandatory CSR clause	-0.001	-0.001	0.000
5	26 Jun 2012	The standing committee on finance submits its report.	0.002***	0.001*	-0.001
6	18 Dec 2012	The Bill is passed in Lok Sabha with mandatory CSR clause	0.006***	-0.016***	-0.021***
7	08 Aug 2013	The Bill is passed in Rajya Sabha (higher house of parliament) with mandatory CSR clause	-0.005**	-0.006	-0.001
8	29 Aug 2013	The President of India signs the Bill	-0.004	-0.003	0.001
		Median CAR for a firm around all eight events	-0.003	-0.008*	-0.005

Law results in a 6-10% fall in long term firm value as well

- When we compare change in Tobin's q (market value of assets/book value of assets) for 2013 between affected and unaffected firms

Δ *Ln(Q)*						
	UNAFFECTED (1)		AFFECTED (2)		Difference in mean	Difference in median
Year	Mean	Median	Mean	Median	(2) – (1)	(2) – (1)
2009	-0.033	-0.078	-0.058	-0.111	-0.025	-0.033
2010	0.203	0.227	0.218	0.243	0.015	0.015
2011	-0.036	-0.030	-0.074	-0.128	-0.038**	-0.098***
2012	-0.010	-0.001	0.025	0.042	0.036**	0.044**
2013	-0.065	-0.062	-0.125	-0.160	-0.061***	-0.098***

Why the negative reaction?

- Mandatory imposition akin to a tax?
  - Forced adopters did not think it was cost-beneficial to spend on CSR
  - Potentially siphoned off/wasted or on management’s pet projects
  - Legal avenue for political patronage (which may help as well!)
  - Huge commitment of management time and effort
- Voluntary spending potentially subject to cost-benefit considerations
  - Recruiting and retaining workers
  - Way to buy “social license” to operate in a community
  - Pollution heavy industries spend more on CSR
  - Potential advertising to attract “green” customers
  - Lighter enforcement from law and order authorities

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How’s the implementation working?

- Spending on CSR has certainly increased
  - One report claims that 2015 CSR spending was INR 250 billion ($3.73 billion)
  - Plausible but sounds high to me

- KPMG found that 52 of the largest 100 firms did not spend 2% in 2015!
- Makes cross-firm comparisons harder
- Sketchy disclosures on where the funds go
- Voluntary disclosure bias
  - Will they reveal bad news? What will make them?
- How might the investor/analyst evaluate outcomes for the business and for society?

Top spenders in fiscal 2014

2013 vs 2014 Rankings

Rank (2014)	Company	Rank (2013)	Company
1	M&M	1	Tata Steel
2	Tata Power Co	2	Tata Chemicals
3	Tata Steel	3	M&M
4	Larsen & Toubro	4	Maruti Suzuki India
5	Tata Chemicals	5	Tata Motors
6	Tata Motors	6	Siemens
7	GAIL (India)	7	Larsen & Toubro
8	BPCL	8	Coca-Cola India
9	Infosys	9	SAIL
10	Jubilant Life	10	Infosys

Rankings (11-25)

11	Reliance Industries
12	ACC
13	Shree Cements
14	Maruti Suzuki India
15	Hindustan Unilever
16	Cummins India
17	Tata Consultancy Services
18	UltraTech Cement
19	Indian Oil Corporation
20	Essar Oil
21	JSW Steel
22	Steel Authority of India
23	Ambuja Cements
24	HDFC Bank
25	Dabur India

For the full list of winners, log onto economictimes.com

Basic questions to ask re: sustainability programs

- Is the ESG spending material or peripheral to the business?
- How can we use these disclosures?
- Are senior executives compensation plans tied to sustainability?
- Are ESG metrics discussed in investor meetings/conference calls?
- Can the ESG metrics be meaningfully benchmarked with competition?
- How confident are we with the credibility of the ESG data presented?
  - Is it audited, can we trust the auditors?
  - Has the sustainability data been restated in the past?

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Sustainable reporting frameworks out there

STANDARD	FOCUS	WHY REPORT	SCORING	WHO REPORTS	REPORTING PERIOD
CDP DRIVING SUSTAINABLE ECONOMIES	Primarily GHG emissions, but has grown to address water and forestry issues as well.	CDP holds the largest repository of corporate GHG emissions and energy use data in the world and is backed by nearly 800 institutional investors representing more than $90 trillion in assets. Its transparent scoring methodology helps respondents understand exactly what's expected of them. CDP was regarded as the world's most most credible sustainability rating in 2013.	Companies receive two separate scores for Disclosure and Performance using a 100-point scale. CDP recognizes top scoring companies in the Carbon Disclosure Leadership Index (CDLI).	Public and private companies, cities, government agencies, NGOs, supply chains.	• Climate Change program: Feb. 1 - May 29 • Supply Chain program: April 1 - July 3 • Cities program: Jan. 1 - Mar. 31 • Water and Forestry programs: Feb. 1 to June 30
Dow Jones Sustainability Indexes	Industry-specific criteria considered material to investors. Equal balance of economic, social and environmental indicators.	Membership in the DJSI is prestigious as it represents the top 10% of the 2,500 largest companies in the S&P Global Broad Market Index. The Corporate Sustainability Assessment (CSA) brings a sector-specific focus and need-to-know simplicity to disclosure for public companies. This index was regarded as the world's second most credible sustainability rating after CDP.	Companies receive a total Sustainability Score is between 0 –100 and are ranked against peers; includes a Media and Stakeholder Analysis; those scoring within the top 10% are included in index.	The 2,500 largest public companies in the world.	April 3 - May 28
Global Reporting Initiative™	Corporate social responsibility with an equal weight on environmental, social and governance factors. Heavy on stakeholder engagement to determine materiality.	GRI was announced as the official reporting standard of the UN Global Compact, making it the default reporting framework for the compact's more than 5,800 associated companies. It's among the oldest, most widely adopted and most widely respected reporting methodologies in the world. Its thorough focus on social and governance aspects of ESG is unparalleled.	Focus is on transparency so no true scoring methodology; new G.4 framework requires entity reporting to choose "Core" or "Complete" reporting.	Public and private companies, cities, government agencies, universities, hospitals, NGOs.	Anytime, but typically integrated into a company's traditional annual report.
GRESB Global Real Estate Sustainability Benchmark	Environmental, social and governance performance in the global commercial real estate sector only. Includes asset- and entity-level disclosures.	Private and public institutional investors look to GRESB's annual survey as the barometer of sustainability performance in the commercial real estate industry. Its niche target audience allows it to give deeper and more accurate insights into industry performance and reveal "investment grade" results.	Responses scored out of a possible 140.5 points distributed across two categories of data. Heavy weighting placed on implementation and asset-level performance.	Commercial real estate owners, asset managers and developers.	April 1 - June 30
SASB SUSTAINABILITY ACCOUNTING STANDARDS BOARD	US public companies only. Industry-specific issues deemed material to investors.	SASB's standards enable comparison of peer performance and benchmarking within an industry. Studies by Goldman Sachs and Deutsche Bank have shown the stock of companies who disclose on sustainability outperforms that of companies who do not. SASB is backed by the likes of Bloomberg LP and the Rockefeller Foundation, giving it extra clout with capital markets.	No scoring system. Instead, SASB is a standardized methodology for reporting sustainability performance through the Form 10-K.	No one yet - they've just released their first sector reporting guidelines.	Integrated into quarterly 10-K filings.

Sustainability report audits

- Global Reporting Initiative (GRI)
  - Most prominent standards
  - All standards cover: Organizational governance • Human rights • Labor practices • The environment • Fair operating practices • Consumer issues • Community involvement and development
- ISAE 3000
  - The International Standard on Assurance Engagements ISAE 3000 is a generic standard for any assurance engagement other than audits of historic financial information
  - This can only be issued by a professional accountant
- AA1000AS
  - The AccountAbility AA1000 Assurance Standard is related to the AccountAbility Principles Standard (AA1000APS 2008), which some organizations use to guide their approach to sustainability.

Mahindra and Mahindra disclosures

- Mahindra and Mahindra have released a 183-page annual report on sustainability
- Interestingly, KPMG actually audits the sustainability report
- The report has detailed targets and progress by each significant division of M&M

This Report has been externally assured by KPMG, India.
Like all previous reports, this Report is also A+ GRI checked.

INDEPENDENT ASSURANCE STATEMENT

KPMG

To the Management of Mahindra Group

INTRODUCTION

KPMG was engaged by Mahindra Group (Mahindra) to provide assurance on its Sustainability Report ('the Report') for the financial year 2014-15 in line with the limited assurance requirements of ISAE 3000 (Revised), Assurance Engagements Other Than Audits or Reviews of Historical Financial Information by International Federation of Accountants' (IFAC) International Standard for Assurance Engagements and Accountability 1000 Assurance Standard (Type II - Moderate).

TARGET 2015-16	ACTUAL 2014-15	BASELINE 2012-13	Parameter	Area
20%	10%	0.380	Specific Carbon Footprint Reduction [GHG Emissions Scope 1+2] (Tonne/eq. vehicles)	ECO-EFFICIENCY
6%	5.61%	0.025	Use of Renewable Power (% of total power)	ECO-EFFICIENCY
25%	14%	2.86	Specific Water Footprint Reduction (kl/eq. vehicles)	ECO-EFFICIENCY
			Waste Impact Reduction	ECO-EFFICIENCY
25%	32%	2.90	• Reduction in Paint Sludge (kg/eq. vehicles)	ECO-EFFICIENCY
			• Reduction in Packaging Waste (kg/eq. vehicles)	ECO-EFFICIENCY
15%	88%	9.76	Wood	ECO-EFFICIENCY
15%	58%	21.82	Corrugated Box	ECO-EFFICIENCY
			Upstream Supply (supplier)	GREEN VALUE CHAIN
400	250		• Capacity Building (no. of suppliers)	GREEN VALUE CHAIN
150	100	0	• Assessment & Green Rating (no. of suppliers)	GREEN VALUE CHAIN
100	#		• Energy-efficient Projects (nos.)	GREEN VALUE CHAIN
5%	9.94%	171	Emission Reduction for M&M Fleet (gm/km)	PRODUCT RESP.
0	9	12	Aim Towards Zero Accident (nos.)	EMPLOYEE CARE & DEV.
			Knowledge Enhancement in Sustainability Parameters	EMPLOYEE CARE & DEV.
75%	100%	40%	• Coverage of Sr. Management	EMPLOYEE CARE & DEV.
90%	67%	30%	• Coverage of Mid. & Jr. Management	EMPLOYEE CARE & DEV.

M&M - AD
Mission: Adopt & enable benchmark sustainable practices to be a top 10 global automotive brand

Reliance Industries disclosures

- Reliance Industries spends most of its CSR budget via the Reliance Foundation
- It is unclear whether Reliance Foundation's audit report is publicly available
- The report covers 20 odd pages

DETAILS OF AMOUNT SPENT ON CSR ACTIVITIES DURING THE FINANCIAL YEAR 2015-16

Sr. No	CSR project or activity identified	Sector in which the project is covered (clause no. of schedule VII to the Companies Act, 2013, as amended)	Projects or programs 1) Local area or other 2) Specify the State and district where projects or programs was undertaken	Amount outlay (budget) project or program wise (₹ in crore)	Amount spent on the projects or programs: Sub Heads (1) Direct expenditure on projects or programs (2) Overheads (₹ in crore)	Cumulative expenditure upto the reporting period, i.e., March 31, 2016 (₹ in crore)	Amount spent direct or through implementing agency
1	Rural Transformation – Reliance Foundation Bharat India Jodo – "Enhancing Rural Livelihoods"	Cl (i) eradicating hunger, poverty and malnutrition; Cl (iv) ensuring environmental sustainability; Cl. (x) rural development projects	Andhra Pradesh- Kurnool, Vizianagram, Srikakulam Telangana - Nizamabad Chhatisgarh- Rajnandgaon Gujarat-Amreli, Rajkot, Aravali, Bharuch, Surat, Patan Jharkhand-Deogarh Karnataka-Gadag, Bidar Madhya Pradesh-Agar, Chhindwara, Seoni, Mandla, Panna, Barwani Hoshangabad Maharashtra-Parbhani, Yavatmal, Nagpur Orissa-Balangir Rajasthan-Jaipur, Sawai Madhopur, Banswara Tamilnadu- Sivaganga, Ramanathapuram	84.35	69.69	171.38	Implementing Agency - Reliance Foundation*
2	Rural Transformation - Information Services - "Enable access to need based locale-	Cl. (i) eradicating hunger, poverty and malnutrition Cl. (iv) ensuring environmental	Andhra Pradesh-Vishakapatanam, East Godavari, West Godavari, Nellore, Krishna, Srikakulam, Vizianagram, Kurnool, Prakasam, Guntur Gujarat-Bharuch, Junagadh,	20.12	14.00	23.65	Implementing Agency - Reliance Foundation*

Comparing Infosys and Tata Consulting Sustainability reports

- Infosys and TCS are both world class companies in the same industry. Let's try and compare the content of their sustainability reports

- Infosys puts out a 148 page sustainability report
- DNV GL, a non audit firm, audits the report
- Tata Consulting puts out a 92 page sustainability report
- KPMG audits the report

- Can we unearth meaningful insights and comparisons from such voluminous data?
  - It's a non-trivial assignment!

How should we think about TCS and Infy's ESG efforts?

- For 2014-15, TCS spends 253 crores, Infosys spends 243 Crores (Infy in AR)

- Spending breakdown for Infy shown in AR on page 51 suggests this is not related to the firm's business.

- A lot of spending is via foundations set up by these firms. All for Infy.

- Are the foundations' accounts public and audited? I could not find them

Consider TCS’s CSR spending

- Of the 220 crores shown here, 153 crores goes to TCS Foundation
- 1.48 crores to PM fund – a political donation?
- Rest don’t seem related to the business. So, it’s a pure expense.

5(c) Manner in which amount spent during the financial year is detailed below:

Sr. No.	CSR Project or Activity identified	Sector in which the project is covered	Projects or programs (1) Local area or other (2) Specify the State and district where projects or programs was undertaken.	Amount Outlay (budget) project or programs wise (₹)	Amount spent on the projects or programs Subheads : (1) Direct Expenditure (2) Overheads (₹)	Cumulative Expenditure upto the reporting period (₹)	Amount Spent : Direct or through implementing agency
1.	Training and educating children, women, elderly, differently-abled, scholarships, special education and increasing employability	Promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently-abled and livelihood enhancement projects	Pan India	43,90,00,000	324,336,801	324,336,801	Direct: ₹ 30,54,17,425 Through implementing agency: ₹ 1,89,19,376
2.	Disaster relief, tech support for hospitals including cancer institutes, financing hygienic sanitation.	Eradicating hunger, poverty and malnutrition, promoting preventive health care and sanitation including contribution to the Swatch Bharat Kosh set up by the Central Government for the promotion of sanitation and making available safe drinking water	Pan India	1,00,00,00,000	1,88,453,684	18,84,53,684	Direct
3.	Childline software support to track missing children	Promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups	Pan India	26,00,000	25,79,011	25,79,011	Direct
4.	Tree plantation drive	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	Velas and Mumbai (Maharshtra) & Chennai (Tamil Nadu)	5,00,000	4,74,300	4,74,300	Direct
5.	Contribution to Prime Minister’s National Relief Fund & other Central Government Funds	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, welfare of the scheduled castes, the scheduled tribes, other backward classes, minorities and women	Pan India	1,59,00,000	1,48,67,748	1,48,67,748	Direct
6.	Contribution to TCS Foundation and other Trusts engaged in socio-economic development and relief work	Various sectors covered by Schedule VII of the Companies Act, 2013.	Pan India	1,50,00,00,000	1,53,93,58,920	1,53,93,58,920	Direct through TCS Foundation
7.	Support for the restoration and renovation of the heritage structure	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	Mumbai (Maharashtra)	4,20,00,000	1,68,00,000	3,36,00,000	Through Implementation Agency
	Sub-total			3,00,00,00,000	2,08,68,70,464	2,10,36,70,464	
	Overhead				9,73,09,442	9,81,49,442	
	Total CSR Spend				2,18,41,79,906	2,20,18,19,906	

How should we think about TCS and Infy's ESG efforts?

- Perhaps we can use the GRI framework at the end to collect and process such data
- Let's start with the environment

Environmental						
Indicator	Disclosure	Level of reporting	Location of disclosure	For partially reported disclosures,	Reason for omission	To be reported in
Materials						
En1	Materials used by weight or volume.	Fully	Carbon & energy UNGC Principle 7 & 8 - page 55			
EN2	Percentage of materials used that are recycled input materials.	Fully	Paper Management Initiative UNGC Principle 8 & 9 - page 66			
Energy						
EN3	Direct energy consumption by primary energy source.	Fully	Carbon & energy UNGC Principle 7 & 8 - page 55			
EN4	Indirect energy consumption by primary source.	Fully	Carbon & energy UNGC Principle 7 & 8 - page 55			

Environmental comparison: How decision relevant is this data?

Environmental Item assessed	Details	TCS	Infosys
CSR INR spent		254 crores	243 crores
Materials used	Scope 1 emissions (‘000 CO2 eq tonnes)	34.2	22.1
	Scope 2 emissions (‘000 CO2 eq tonnes)	423.7	141.7
	Scope 3 emissions (‘000 CO2 eq tonnes)	?	166.8
Recycled input materials/Waste			
	E-waste (tonnes)		138
	Batteries (nos. for TCs and tons for Infy)	5022	140.93
	Lube oil (ltrs for TCS and kl for Infy)	16001	25.44
	Paper (reams/fte/month for TCS and tons for Infy)	50	691
	Computers (nos.)	15500	
	Biomedical waste (tons)		30.09
	Food (tons)		3219
	Garden waste (tons)		2336
	Mixed garbage (tons)		1081
	and many more categories for Infy		
Energy consumption			
	Electricity (kwh/fte/month for TCS; kwh/per capita per month)	188	160
	Water (l/fte/month for TCS, kl/per capita per month)	1112	232

Carbon pricing implications

- Carbon pricing is already a reality in several parts of the world
  - Of course, the big question is whether India will impose a carbon tax?
  - What about TCS' and Infy's North American and European emissions?
- The current price of carbon is roughly $20/ton and expected to go up to $100/ton by 2050
- So, some simple back of the envelope calculations will yield the following results:
  - TCS's P/E ratio is 20 and its market cap of equity is say $100 billion
  - TCS emits 457,000 tons of CO_2/year. At $20/ton, that's an outlay of a modest $9.1 million/year
  - Assuming this expense persists into the future, and assuming this is tax deductible (say at 35%), we are looking an annual post tax outlay of $5.9 million
  - At a P/E of 20, we are looking at $120 million hit to valuation or a very modest 0.12% of current market cap
- Environmental issues hence less important to Infy and TCS than say a power company

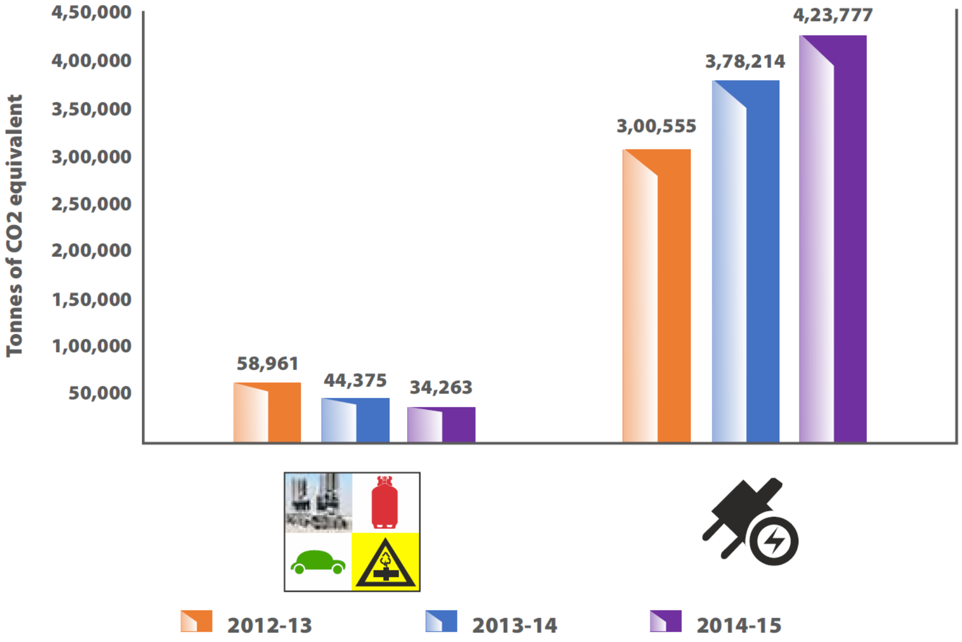
Environmental comparison observations

- How do auditors audit this data?
  - Like an enumeration of transactions without a summary
- Comparability across companies tough
  - For many caption heads, such as bio waste, food etc., Infosys reports data but not TCS
  - The unit of analysis used is different in different cases, hurting comparability
  - Overall numbers v/s tons v/s per FTE, % recycled v/s units of water used
- Even if we had the same unit of analysis, what would we do with the non-carbon data?
  - TCS uses 188 kw/per month per FTE but Infy uses 160 kw/per month/per capita. So?
- Do these data tell us something about the sustainability of future earnings/environment?
  - Lower power bills for Infy? How much did they spend to save 28 kw/per month?

Upside may be that tracking changes behavior: TCS

Scope 1: Diesel operated Generator sets, Company-owned vehicles, Refrigerant gases (fugitive) emissions, cooking gas combustion, fuel combustion for space heating

Scope 2: Purchased Electricity



Social comparison: Observations

- Social disclosures tell us something about corporate cultures
- Lots more data on workforce relative to what the U.S. firms give
- TCS is almost twice as big as Infy in terms of number of employees
  - Per capita compensation cost/employee similar though (TCS $27.8K v/s $27.6K for Infy)
- Most of the workface data is fairy similar except that
  - Infy has a MUCH higher turnover rate that TCS in the < 30 segment
  - TCS has a MUCH higher turnover than Infy in the > 50 segment
  - Much more training for juniors in Infy
- The proportion of millennials to geezers is very high at both firms
- 1/3rd of the workforce is female in both companies
- Foreign workforce creates cultural challenges
  - Glass door ranking for TCS North America of 2.8 < of 3.4 for TCS India!

Board related observations - 1

- TCS is twice as large as Infy but both have similar sized boards (11 v/s 10)
  - Academic work argues bigger boards, controlling for firm size, are bad
  - Why might that be?
- A larger proportion of Infy's board is independent relative to TCS
  - Perhaps it is also listed on NYSE and is less of a family firm
  - Are independent boards always better?
- Infy seems to have very busy directors
  - Seshasayee on 13 boards, Kiran Shaw 15 boards and Rupa Kudva on 8 boards
  - Women's director quota's unintended consequence re: Shaw and Kudva?
- Both TCS and Infy appointed professional women as directors
  - But are they paid as much as male directors?
- Not immediately obvious how many are older directors as age is not in the filings

Board related observations - 2

- Industry expertise seems to be limited to inside directors (the CEO and execs)
- Director pay at TCS far smaller than at Infy
  - Not cross listed, and the Berkshire board phenomenon?
- Highest paid director is usually the CEO or Chairman
  - Sikka of Infy: 4.5 crores + 54K RSUs at INR 3355 each = 18.1 crores = 22.6 crores
  - Chandrasekhar of TCS: 179 lacs + 349 lacs + 1600 lacs = 2128 lacs = 21.28 crores
- The range of director pay is much wider in Infy
  - Kudva gets 0.11 crore which is the lowest at Infosys perhaps due to part year service
  - All directors are paid the same but additional fees for chairing or being a member of important committees
- Board meetings are similar across both companies
  - Are more meetings good or bad?
- Infy's board has more turnover than TCS
  - Why? Perhaps mirrors changing CEOs who bring in their own people

CEO transition/audit observations

- CEO tenure is very stable at TCS
- Infy on the fourth CEO since Narayana Moorthy quit in 2002
  - Narayana Moorthy: 1981 to March 2002 (21 years)
  - Nandan Nilekani: March 2002 to April 2007 (5 years)
  - S Gopalakrishnan: April 2007 to August 2011 (4 years)
  - S D Shibulal: August 2011 to July 2014 (3 years)
  - Vishal Sikka: August 2014 –
- Raises questions on succession planning
- Far fewer audit committee meetings at Infy. Not sure why? 3 auditors?
- Why does TCS have a bank account committee?
- Infy has three auditors. TCS has two but not the IFRS auditor because of no ADR
  - an internal, an Indian external auditor and an IFRS external auditor
- Not much data on auditor tenure to check for entrenchment

Reporting/ownership observations

- Indian companies required to report quarterly though without footnotes
  - Interesting that the UK abolished interim reporting in 2014!
- Investor site visits seem to be freely allowed in India
  - No Reg FD worry unlike the U.S.!
- Both Infy and TCS have all the usual policies
  - No data on whether they “walk the talk”
  - There is a lawsuit filed in an American court accusing Infy of discrimination against employees “who did not speak Hindi”!
- Ownership structure is radically different
  - TCS is a family owned firm (Tata Sons) whereas Infy is closer to a U.S. company in ownership profile
  - Indian domestic institutions (e.g., LIC) don’t have much ownership unlike the U.S.
  - Foreign institutions own much more of Infy than TCS perhaps because of NYSE listing
  - Infy has an ADS arrangement run by Deutsche Bank

Managerial pay/litigation observations

- Given the ownership structure, it is not obvious that minority/retail investors have much clout
- CEO compensation for TCS is similar to that of Infy
  - Sikka: 4.25 crore + 54K RSUs at INR 3355 fair value, vesting over 4 years = 22.6 crores
  - Chandrashekar: 21.28 crores but no equity compensation
- CEO equity holdings in the two companies are interesting as well:
  - Sikka: the above grant
  - Chandra: 88,528 shares * INR 2602 = 23 crores
- Infosys settled claims by the U.S. that I-9 forms were irregular. Settlement of 217 crores
- Highlights challenges of operating abroad
  - E.g., Tata's experience with Jaguar in the U.K.

Outline

- CSR in India
    - CSR law in India
    - Some evidence on stock prices around passage of the law
    - Implementation
    - Reading TCS and Infosys’ ESG reports
    - Open questions

Question 1: Are sustainability numbers rigorously audited? How?

- The Economic Times (Oct 21, 2015) reports use of on-hire charitable trusts to fabricate spending

Question 2: Will CSR spending yield social benefits?

- Can we demonstrate social or developmental benefits from CSR spending by companies in India?
  - To an outside empiricist, it is hard to look for changes in development indices at the local level because CSR disclosures don't specify the exact nature and locations of the spending
  - Plus, disclosure is all voluntary and unaudited

- The company hopefully wants to compute ROI internally on the CSR investments
  - But this is hard to show because payoffs are dispersed, long term in nature and come by way of political benefits, customer or stakeholder goodwill that can be hard to quantify

Question 3: Why CSR?

- Shareholder expense view championed by Milton Freidman (1970)
  - the social responsibility of business is to increase its profits"
  - "the charity perspective"

v/s

- "Stakeholder value maximization" view
- "doing well by doing good"

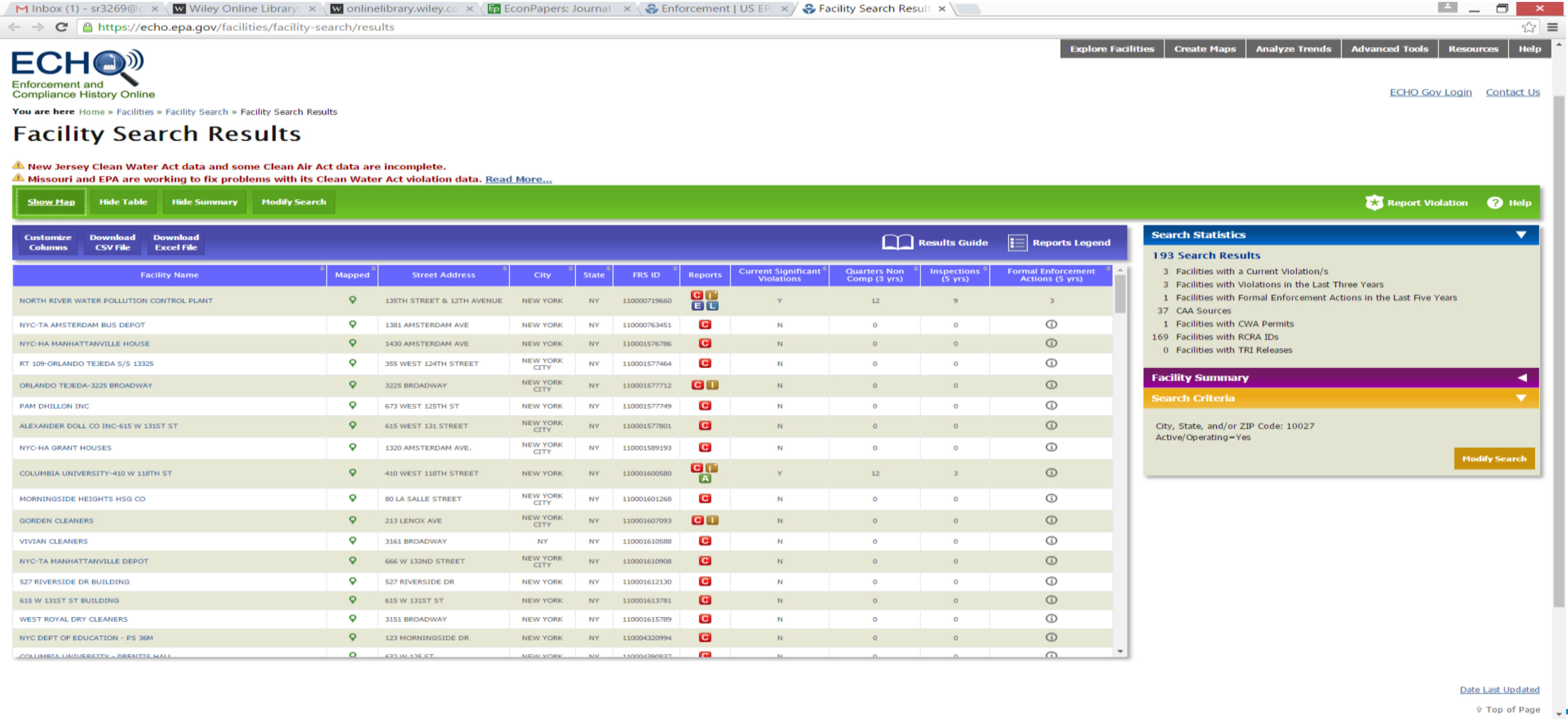
- Which view better describes India's CSR?

Question 4: How to implement stakeholder theory?

- Stakeholder maximization theory says that we cannot maximize long term firm value if we mistreat or ignore any important constituency
  - The theory can give managers a vision to avoid short termism in favor of long term goals (e.g., don't pollute now, otherwise we will pay big lawsuit damages later)
    - Stakeholders include customers, suppliers, employees, legislators, tax collectors, "public interest"
- But for the theory to work, we need
  - Stock markets to reward long term investors
  - An enforcement mechanism to stop firms from getting away with illegal acts
  - <u>Do we have these features in India?</u>

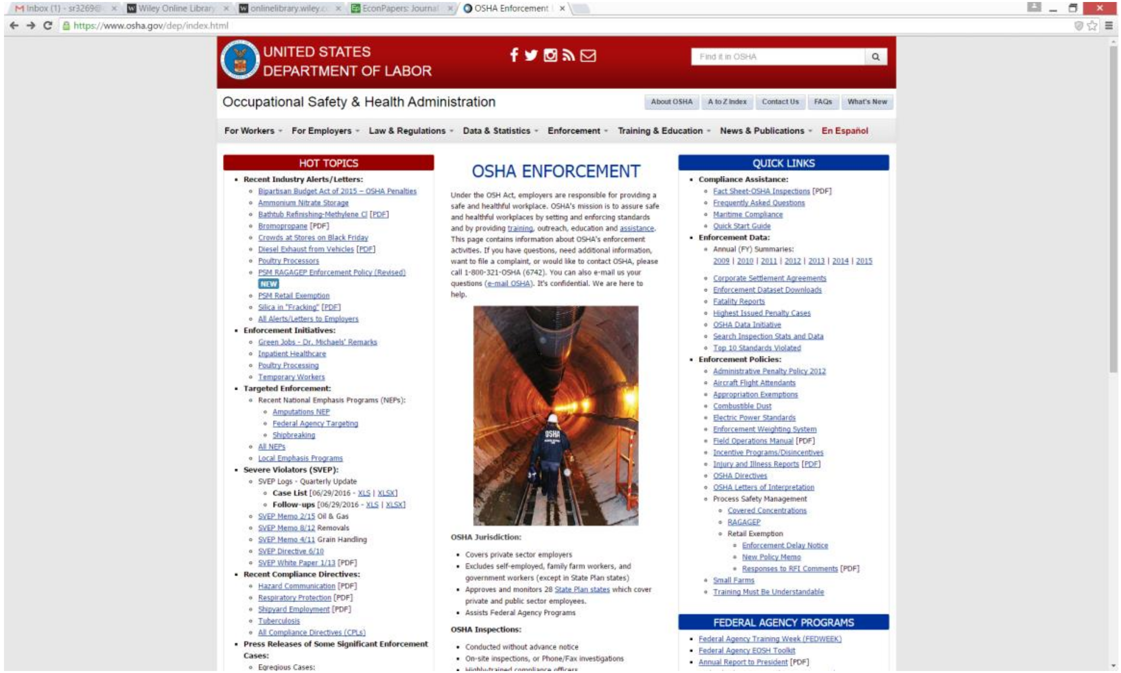
Question 5: Where is the Indian EPA?

- The Environmental Pollution Agency (EPA) monitors emissions and toxic pollutants in the U.S.



Question 6: Where is the Indian OSHA?

- The Occupational Safety and Hazards Agency (OSHA) monitors worker safety in the U.S



Question 7: Can our legal system impose penalties?

- In 2013, there were 31.3 million open cases in India, from the lowest courts to the Supreme Court

- 15.5 judges in 2013 for every million people in India

- If the nation's judges heard 100 cases per hour—without breaks—it would take them 35 years to catch up

- The criminal justice system, that's my belief, is on the verge of collapse."—Ajit Prakash Shah, Law Commission of India (Bloomberg Business week January 8, 2015)

Question 8: Is enlightened self interest the answer?

- <u>Ecological sphere</u>: Investing in CSR that improves operational efficiencies
  - Reducing costs due to energy and materials efficiencies also helps the environment
  - Minimize consumption
    - Shree Cement example: http://www.shreecement.in/sustainable-development.html
  - Substitute resources
    - Toyota cuts reliance on rare earth minerals:
    - http://www.reuters.com/article/us-toyota-rare-earth-idUSTRE80M0JK20120123
  - Replenish resources
    - Zhangzidao Fishery Group uses waste of one species to feed the other and increase earnings along the way:
    - Source: BCG Sustainability Champions Report

Question 9: Can investors drive CSR change?

- CSR leadership can potentially attract long term investors such as pension funds and sovereign wealth funds

- However, this is a challenge for India because most large firms are either family owned (Tatas, Mahindras, Birlas) or are public sector firms (ONGC, NTPC and so on) and hence not dependent on investor capital

- In fact, a cynic might argue that the new rule is one way to get family run firms to contribute some of their profits to social causes

- But, multinationals operating in India are likely to be goaded by socially responsible investors into CSR

Takeaway: How can ensure social ROI to CSR spending?

- Ensure CSR spending is audited

- Make finances of foundations more transparent

- Collect and track CSR non-financial input and outcome metrics
  - Ensure these metrics are comparable across firms and over time
  - Ensure CSR spending can be related to social outcomes

- Can we align firms’ incentives with their CSR spending?

- Consider a carbon tax?

- Expand CSR reporting to the government sector?