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## RESEARCH ARTICLE

### ETHICAL DIMENSIONS IN CORPORATE SOCIAL RESPONSIBILITY AND NEED FOR REGULATION

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#### ABSTRACT

Ethics in business decisions has been implied and accepted in all areas of business operations. Social responsibility of corporates had been considered as the ethical domain of business. Over the years the corporates have been responsible for unethical activities like financial and business scams, adulteration of food stuff, climate change, pollution, deforestation and ecological imbalance, etc. These alarming instances of unethical acts by corporates have led to the need for regulation and legislation. This paper focuses on CSR being one dimension of ethical code for corporates to follow and how their failure to comply with this ethical discharge of social responsibility lead to regulation and legislation.

#### INTRODUCTION

The dimensions of Ethical Business have been left for interpretation by spectators and stakeholders in business but Social responsibility has been considered as one dimension of ethical business. Ethics has been understood as a standard of right behaviour in the eyes of right thinking men crossing the boundary of morality. In the era where business units are allowed to undertake profitable ventures with no consideration for ethics defining the contours of ethical business is the need of the hour. Instances of unethical behaviour are instrumental in recognising CSR as one dimension of ethics in business decisions. This paper attempts to discuss the conventional notions of ethics recognising CSR as part of business ethics and the replacement of voluntary CSR with legislation and regulation in the wake of scams and controversies surrounding the business world.

**Understanding of Ethics in Business:** According to Kaptein and Schwartz (2008) Business codes of ethics are written and formal documents which include a set of moral standards and corporate principles - rules of conduct or company philosophy concerning the responsibility to stakeholders and shareholders which help guide corporate behaviour and employees conduct.

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Linnhoff *et al.* (2015) suggest that businesses are expected to do what is right in all activities, such as financial reporting, protection of the environment, treatment of employees and dealing with customers. Such activities fall under the umbrella of corporate social responsibility (CSR). Goel and Ramanathan (2014) recognise that business ethics and social responsibility have distinct identities but while identifying ethical practices the territory of morality is crossed. Business ethics cover the area of moral principles and decision making, governance issues and code of conduct for business. Bhanu Murthy (2007) suggests that ethical structure has implication for good governance, which means better profit. There is a shift in psychology of investors they are not only curious to know how much profit the company has booked but also how this profit has been earned, ethically or unethically. A review of literature reveals different writers have added different facets to the code of ethics prominent among them are the three generation of ethical codes. First generation is permeated by legal considerations of corporate behaviour. Second generation extends to codes to enhance the well-being of its internal stakeholders especially employees. The third generation of ethics accounts for interplay between corporate activities and the socio-economic, natural and global environment (Linnhoff *et al.* 2015, Calderon *et al.* 2012). Calderon *et al.* (2012) uses five dimensions in his seminal work on ethics which include ethics and corporate culture, regulation and compliance, stakeholder and internal organisation, community and

implementation. According to Bhanu Murthy (2007) Ethics has three dimensions, good governance, CSR and environmental accountability. He suggested that leaders (top management) must realise the importance of putting the people and planet at par with the profit if not before it. Additionally Linnhoff *et al.* (2015) suggest that objective of business is to increase the wealth of its owners, doing so requires the public's trust and in the long term that trust depends on ethical business practices. Profits of business following unethical practices are short term as nobody would do business in long term with people who are unethical and untrustworthy. Thus the impact of ethics moves from individuals to organisation to society at large. In context of funding by banks or financial institutions Geoffrey (2004) discusses the Equator principle (2003) which is a commitment of signatory banks to finance only projects that meet the social responsibility criteria. This principle uses a screening process based on IFC's environmental and social screening process.

**Social Responsibility as Ethical Value:** Goel and Ramanathan (2014) recognise CSR as part of ethical and responsible business practice for long. Considering the normative stakeholder theory of Freeman *et al* (2004) they propose that CSR is a sub set of business ethics. Freeman's stakeholder theory assumes that values are necessarily and explicitly a part of doing business. It is not an overemphasis that the right of the firm to operate its business carries with it the duty and obligation to the environment of which it is a subset. With the finiteness of resources and multiplicity of human needs business has duties and reciprocity towards the environment for continued sustainable existence for itself and the environment. Vives Antonio (2007) shares two interpretations in relation to CSR. One, the corporation is attributed responsibility that goes beyond the purpose for which it is created, such as becoming involved in the welfare of the population (thereby addressing some of the failures of the government). Second, the corporation is responsible for the impact of its activities and these activities must be carried out with respect towards those affected. The second interpretation is accepted by various authors Locke, Michael Hopkins (2004), Geoffrey (2004), Fortuna *et al* (2011), Goel and Ramanathan (2014) and European Commission. The essence of CSR is self-regulation in compliance with ethical standards and norms urging corporates to take responsibility of their activities affecting the society.

Michael Hopkins (2004) and Joshi *et al.* suggest that CSR is concerned with treating the stakeholders of the firm ethically or in a responsible manner. Geoffrey (2004) associated CSR as an action program taken to reduce the externalised cost or to avoid distributional conflict. Nick Lin Hi and Karsten Muller (2013) link CSR to the idea of doing good and avoiding bad. They suggest avoiding bad aims to prevent corporate social irresponsibility and delivers corporate social responsibility. Considering businesses incorporate the plan of doing good the World Business Council on Sustainable Development (WBCSD) in its publication 'Making Good business Sense' linked CSR to ethics while defining CSR as the continuing commitment by business to behave ethically and to contribute to economic development while improving the quality of life of the workforce and their families as well as local community and society at large. Carroll (1999) recognises four layers to CSR- legal, ethical, economic, philanthropic. Bowen (1953) and Johnson (1971) propagate CSR as the interest of multi-stakeholders disregarding the interest of shareholders alone as advocated by Milton Friedman (1970). Gandhi's trusteeship

model also emphasises on management of wealth by the leaders for the benefit of common man. Freeman (1984) and Goel and Ramanathan (2014) define stakeholders as "those groups without whose support the organisation would cease to exist." Recognition of multi- stakeholders like employees, customers, public, suppliers, dealers, environment, etc. in the wake of incidents of negative social behaviour presented in past in cases like Bhopal gas tragedy, Walmart case of discrimination, etc. provides an eye opener for business units to include the well-being of all concerned to facilitate its survival. In fact the concern for people and environment need integration with the economics of business. Social responsibility was discharged in the name of religious duty by giving grants in charity for education, health and welfare of poor by big industrialist for community development. Prior to conceptualisation of cooperate social responsibility, Philanthropist like Jamsetji Tata, Bill Gates, Warren Buffet, Melinda Gates etc. rose to address the social concern as felt unaddressed by the governments. Subsequently studies were conducted to understand the relation between firm's performance and discharge of social responsibility. Studies by Supriti Mishra and Damodar Suar (2010), Swati and Amit (2011), Haslinda Yusoff *et al* (2013), Dolores and Isabel (2014), Gordon and Michael (2014) affirmed that there is a positive relation between financial performance and CSR. Leonardo *et al* (2009) confirmed that the stock market is sensitive to corporate social responsibility news. The benefit of CSR extend to enhancing the competitive strength (Bryan and David 2007, Cornel and Mihaela 2012, Dolores and Isabel 2014), build positive image and reputation, create favourable relations with employees (Eun Mi Lee *et al* 2013, Levente Bakos 2014), consumers (Magdalena *et al* 2013), public and others (Supriti Mishra and Damodar Suar 2010) and provide legitimacy (Fortuna *et al* 2011) to the corporation. The benefits of CSR could not inspire the corporate to follow ethics in business and discharge their social responsibility. Instances like Bhopal gas Tragedy (1984), Cadbury - worm controversy (2006), Johnson's baby power containing asbestos (2015), Maggie - Lead spark (2015), Volkswagen – defeat device (2015), Satyam Scam (2009), etc. reflect the priority of ethics in doing business and trigger the need for legislation in this arena.

### **Role of Judicial Activism in promoting Ethics in Business Decisions**

Even the judiciary understood the existence of corporate entities for provision of utility in form of goods and services with the objective of making profit. Social welfare had no place in the list of objective for which corporates existed. This philosophy was reflected in the Michigan Supreme Court's decision in *Dodge v Ford Motors* in 1919. It stated "A business corporation is organised and carried on primarily for the profit of the stakeholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes." The concern for earning profit was reflected in the operation of all business units until recently. Judicial activism caught the unregulated and unethical acts of corporate giants and urged them to discharge their duty responsibly. Coco-cola, for instance, was reported for causing social cost due to externalities it produced in its operation in the community of Plachimada, Kerala. The

company over exploited the ground water for production, let the waste water to flow in rivers and field surroundings the plant and produced beverages containing elevated levels of pesticides. In *Perumatty Grama Panchayat v State of Kerala* (2003) these issues were mooted requesting for relief for the community living in the vicinity. Modern day business enterprises inherently disregarded social obligation especially towards employees for profiteering was their main goal. Walmart was accused of practicing discriminatory treatment towards female employees in pay and promotion. In a class action suit, on behalf of 1.5 million female employees in *Walmart Stores Inc. v Dukes et al* (2011) contentions were made against gender bias practiced by the managers. An aftermath of the incident was reform in the policy of treatment among employees in Walmart. Employee welfare was debated yet again in *Herald v Seawell* which finally recognised that concerns of employee could not be compromised. It provided that the discretionary power vested in board of directors includes the power to act in the public interest at potential financial cost to the stakeholders. *Herald* and *Perumatty* case make it amply clear that business had social obligations and interests of all stakeholders needs to be addressed.

The Indian Supreme Court evolved environmental jurisprudence to address the need to protect the environment from indiscriminate practices like deforestation, creation of landfills, contaminating water bodies, climate change and disturbing the ecological balance. Besides recognising the polluter pays principle, precautionary principle, intergenerational equity principle, Environmental assessment and audit, etc. the court insisted the Central Government to teach lessons on protection and improvement of natural environment in educational institutions. In addition the court recognised the applicability of public trust doctrine in *M.C Mehta v Kamal Nath* (1997) and stated that certain common properties such as rivers, sea-shores, forest and the air were held by the Government in trusteeship for the free and unimpeded use of the general public. These natural resources have great importance to the people as a whole that it would be wholly unjustified to make them subject to private ownership. The doctrine enjoins upon the Government to protect the resources for enjoyment of the general public rather than to permit their use for private ownership or commercial purpose. While recognising the need to make the polluter compensate for the damage done to the environment the Supreme Court in *M.C Mehta v Union of India* (1987) evolved the deep pocket theory in relation to the compensation amount. It stated that the measure of compensation must be correlated to the magnitude and capacity of the enterprise because such compensation must have a deterrent effect. The larger and more the prosperous the enterprise, greater must be the amount of compensation payable by it for the harm caused on account of the accident in the carrying on of the hazardous or inherently dangerous activity by the enterprise.

**Regulation and Legislation in the area of CSR:** The aftermath of the unethical, negative corporate behaviour as seen in various business and financial scams was deliberation for creation of standards of ethical responsibility at International arena for corporation to follow on voluntary basis. Deliberation at various platforms on the concern of social aspects of business transformed the philanthropic and ethical content to social responsibility of business with dimensions covering all stakeholders like public, society, employees, environment and shareholders. The announcement of

aspirational goal of sustainable development in 1987 marked the beginning of discussion for social responsibility reporting of business. Different initiatives globally in form of standards or even code of conduct urged the business groups to voluntarily think in terms of social responsibility. For instance, Global Reporting standard was the initiative of Global Sustainability Standard Board (GSSB) which encouraged organisations operating across the globe to prepare sustainability reports which highlighted the economic, environmental and societal impact of operating business. These standards were applicable to all organisations regardless of size, sector and boundary of operation. International Standard Organisation published ISO 26000 in 2010 to assist all business operations to adopt socially responsible behaviour. Another such initiative was by United Nations which gave ten guiding principles structured at the UN Compact emphasising the businesses to take up responsibility at four levels which covered human rights, labour, environment and anti-corruption. India was an active member to the discussions relating to socially responsible business. The Ministry of Corporate Affairs took an initiative to draft and publish National Voluntary Guidelines on Social, Environmental and Economic responsibility of business in 2009 which were revised after considering the interest of stakeholders in 2011. These guidelines urged the business units to embrace the triple bottom line approach whereby the financial performance is harmonised with the expectations of the society, the environment and many other stakeholders. Every business entity including small and medium sized enterprises is required to follow nine guiding principles which form a part of the National Voluntary Guidelines. This scheme was highly voluntary until Securities and Exchange Board of India made Business Responsibility Reporting a mandate for top 100 listed companies. Business Responsibility Reporting was to form a part of annual reports which was meant to disclose the steps taken in Environmental, Social and Governance perspective of an entity.

India witnessed its first attempt in making corporate social responsibility mandatory under Section 135 of the Companies Act 2013 to ensure discharge of social responsibility by companies. The mandate of social responsibility is applicable for corporates having a net worth of five thousand crore or more, or turnover of one thousand crore or more, or a net profit five crore or more during any financial year. The mandated companies are required to formulate a CSR committee engaging in the task of formulating, recommending and monitoring a CSR policy to the board of directors of the company. The board of directors on the other hand are required to ensure that at least 2% of the average net profits of the company made during three immediately preceding financial years is spend in CSR activities as specified in Schedule VII of the Act. The companies are required to prepare CSR reports and display the CSR activities undertaken by them on their websites. In addition the Companies (corporate social responsibility policy) Rules 2014 elaborate on the process of implementation to be followed by the companies.

**Conclusion and Suggestions:** The side effects of the profit driven corporates are visible in the environment which could not be contained by the deliberations at various platform or by judicial activism. Big brands like Johnsons were caught in the net of socially irresponsible behaviour as their baby products contained cancer producing element. The recent reported case of Volkswagen, presents another instance where the company

sought environmental clearance by attaching a defective device to its car engine which reduced the level of pollution when tested in laboratory. The pressure to comply with voluntary corporate social responsibility principles from social groups and International bodies has not been able to create a dent in the corporate philosophy. To make companies more responsive to ethics and responsible towards the society the amendment of Companies Act is a landmark step. The amendment act made discharge of social responsibility mandatory for companies specified in a category. Though the Companies (Amendment) Act has been the primary legislation in ensuring ethical discharge of social responsibility from the companies apart from pressure from the International bodies but in order to make a substantial dent in this arena the following suggestions are made.

Social responsibility of business is just one dimension of Ethical business. In order to ensure ethics in business there is a need for a clear understanding of the term ethics in business decisions and its contents. The wide range of literature on this area reveals different connotations of the term that it lacks a uniform standard of measurement. The Companies Amendment Act has been able to capture only one aspect relating to corporate social responsibility for only specified category of companies.

The question of ethics arises only when consequences of the business operations on the society, environment, public, etc. are analysed to answer whether business is ethical or not. There is a need for a binding code of ethics for corporates to follow which includes a backward approach. A backward looking approach would ensure restructuring the production process so that impacts generated from the operations of business are not undesirable and unethical. Thus analysis at both levels backward and forward would ensure ethical practices from the inception.

Ethical business practices can be ensured if the environment which provides support to the business ensures that ethics are followed by the business by small but valuable steps. For instance, the Equator principle ensures that banks fund only socially responsible projects and whistle blower option ensures that companies comply with legal framework. Thus each stakeholder needs to be vigilant, conscious of ethics and unite to fight their battles against ethical codes of conduct.

Legislation and regulation is not always the answer for non-compliance, unethical negative profiteering behaviour of business tycoons. Ethical practice should be viewed as voluntary self-regulation and understanding the distinction between right and wrong.

Provision of CSR committee for planning and executing the CSR obligations of a corporation has been a valuable step in this direction but it leaves some questions unanswered. Assuming the companies were not discharging social responsibility prior to the Amendment Act it is clear that companies do not have qualified professional in this area which needs substantial attention. The legislators have forgotten to foresee this situation and provide a description of the qualifications both educational and experience for CSR professionals. Broadly it also calls for inclusion of ethics in business and CSR in course curriculum of business schools.

Establishment of an authority to monitor the corporate operations and providing rating for their ethical practices including CSR activities can go a long way in ensuring ethics in business. To secure a good image the corporates would aspire a good rating which might motivate them to operate ethically.

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