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Comments on Stakeholderism and CSR

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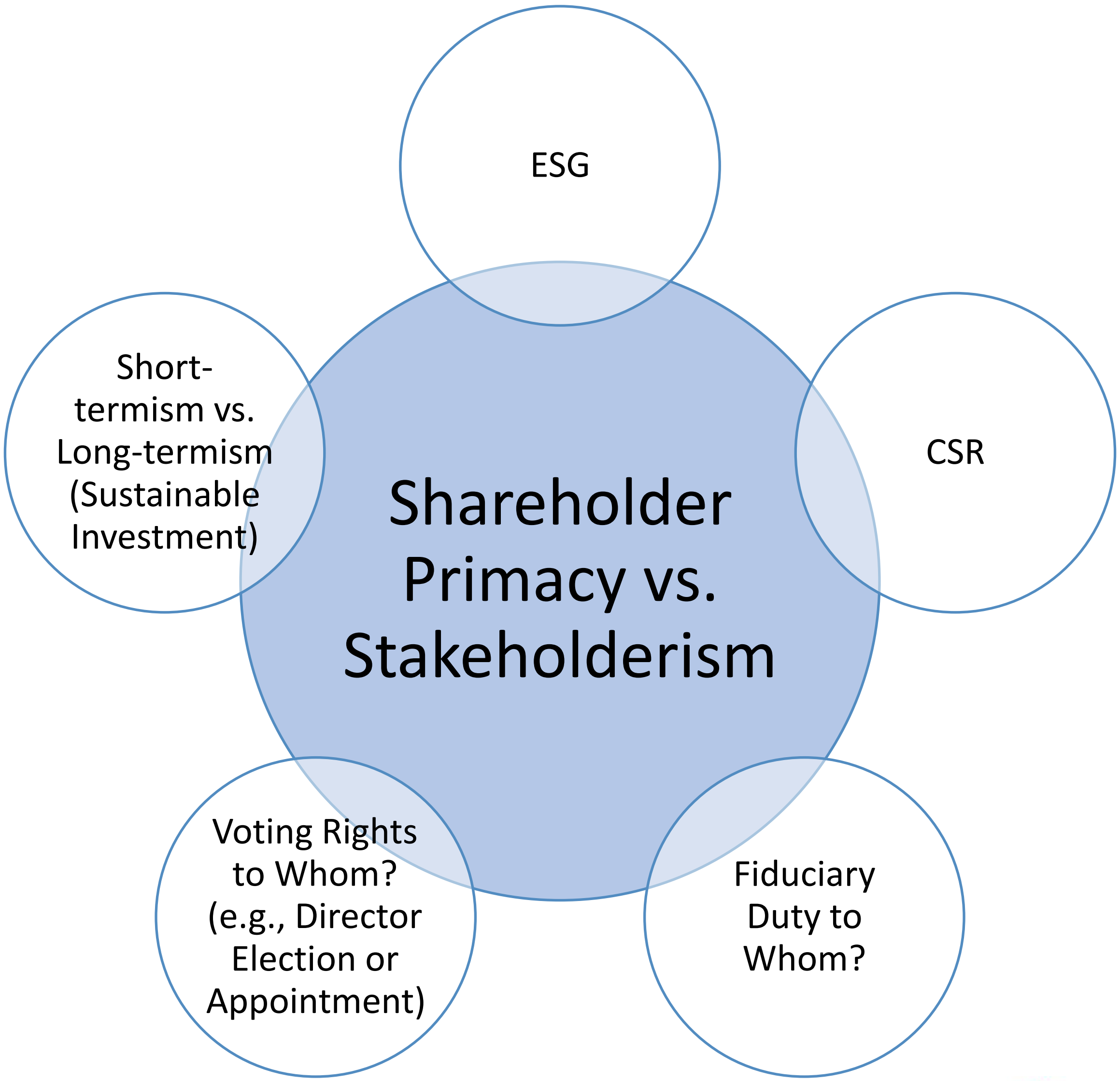
Professor Majumdar's Paper: Excellent Article!

The article critically examines **Section 166(2) of the Indian Companies Act, 2013**, which ostensibly signals a shift to **stakeholder-oriented governance**. The author explores whether this provision genuinely advances stakeholder interests or merely serves a symbolic function. The article explains that Section 166(2) lacks practical enforceability due to following issues:

1. There is <u>no clarity</u> on which stakeholder's interest should prevail during conflicts.
2. <u>Vagueness of "best interest":</u> The ambiguity in key terms allows for inconsistent interpretations.
3. <u>Concentrated shareholding structures:</u> Family-owned or promoter-led firms dominate Indian corporate governance, reducing directors' independence.
4. <u>Weak enforcement mechanisms:</u>

Also, the article explains India's corporate social responsibility (CSR).

Shareholder Primacy vs. Stakeholderism



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Importance of ESG, CSR, and Stakeholderism in India

- **1. Socialism Tradition**
  - Constitutional foundation
  - Nehruvian economic policy
  - Strong state intervention
- **2. Political Background: India = the Largest Democracy in the World**
  - Politically influential labor unions
  - Collaboration between political parties and labor unions
  - A large voter base consisting of employees
- **3. Ingrained Inequality**
  - High Gini coefficient / Stark wealth inequality
  - Deep structural regional and social class (caste) disparities in education, health care, employment, etc.
  - Unequal distribution of growth gains (highly skilled professionals—such as IIT alumni working in Silicon Valley—reaping substantial rewards, whereas informal sector workers have seen only marginal improvements in their livelihoods)
- **4. The Bhopal Gas Tragedy (1984): Watershed Moment of Indian Environment Policies**
  - Environmental and public health catastrophe in Bhopal
  - Methyl Isocyanate gas leak → ~3,000 immediate deaths; long-term fatalities ~15,000+
  - CSR and ESG in India are not merely imported frameworks → Deeply rooted in domestic historical experience
  - Watershed moment [Cf. Chinese government adopted a hardline stance on narcotics following the Opium War (1840–1842)].

CSR Analysis (Not Limited to India)

- **Mandatory CSR**
  - India mandates that certain companies spend at least 2% of their net profits on CSR activities.
- **Mandatory CSR: Akin to Tax But Not Exactly**
  - Companies are required to spend a portion of their net profits on CSR activities. → **Similar to a tax**
  - However, within the prescribed CSR categories and regulations, companies have the flexibility to choose where and how to allocate these funds. → **Not exactly a tax**
- **Corporate Tax Rate: Not That Particularly High?**
  - If corporate tax rate is not that high (compared to other countries), CSR is not quite burdensome.
  - If corporate tax rate is already, high, CSR adds the additional tax rate, which is burdensome.
  - In analyzing CSR, the analysis of a corporate tax rate should also be considered.
- **CSR as PR (Public Relations, i.e., Advertisement)**
  - In this respect, to some extent, ‘mandatory CSR’ can be construed as ‘mandatory PR’ or ‘mandatory advertisement’.
  - It is possible that corporations could reduce their advertisement costs after the enactment of mandatory CSR.
- **Substitution Effect**
  - Prior to the mandatory 2% CSR rule, some corporations—voluntarily or under societal and governmental pressure—spent more than 2% of their profits on CSR. After the mandate, however, they may cap their spending at 2%, resulting in a possible decline in total CSR efforts.

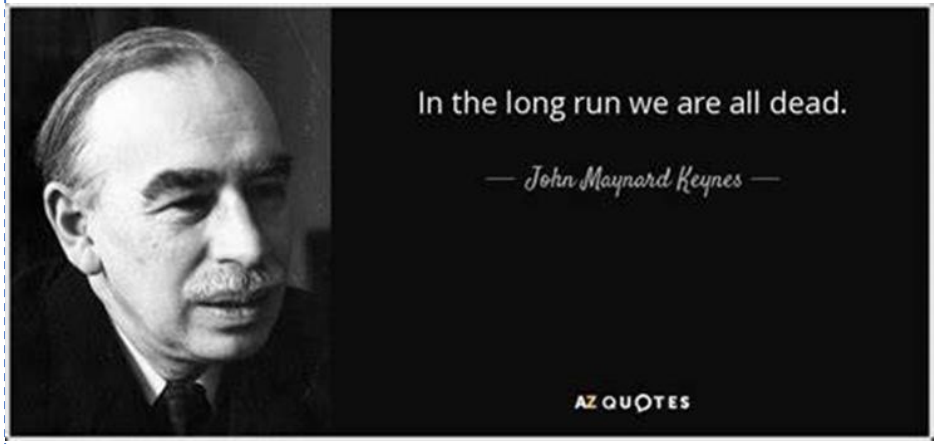
CSR and Controlling Shareholders' Non-pecuniary Private Benefits

- CSR arrangements benefit controlling shareholders, as they can determine, to some extent, where the CSR funds are allocated. [Regarding corporate insiders' (e.g., controlling shareholders') discretion in ESG or CSR, see Sang Yop Kang, Stewardship Presentation at King's College (2019)]
- By directing corporate funds toward CSR activities, controlling shareholders may gain non-pecuniary private benefits—such as enhanced personal reputation or public image. [Regarding the analysis of non-pecuniary private benefits, see Sang Yop Kang, "Re-envisioning the Controlling Shareholder Regime: Why Controlling Shareholders and Minority Shareholders Often Embrace." 16 U. Pa. J. Bus. L. (2013); Sang Yop Kang, "Generous Thieves: The Puzzle of Controlling Shareholder Arrangements in Bad-law Jurisdictions" 21 Stan. JL Bus. & Fin. (2015)]
- This situation reflects an agency problem: controlling shareholders use corporate resources to pursue their own non-pecuniary interests. [Sang Yop Kang, ESG Presentation at Seoul National University (2021)]. The more deeply entrenched a corporation's controlling minority structure (CMS) is, the greater the potential for controlling shareholders to extract such non-pecuniary private benefits.

CSR and Controlling Shareholders: Externalizing Costs and Internalizing Benefits

- For example, suppose a controlling shareholder holds only 10% of a corporation's shares but exercises effective control through voting leverage mechanisms such as a pyramidal structure, circular or cross-shareholding, or dual-class equity structures. Assume the corporation spends $100 million on CSR initiatives. Although the controlling shareholder's discretion over such spending may be constrained by government policies (if CSR is regulated by the government), they retain substantial influence over CSR decisions. As a result, the shareholder may receive public praise and social recognition. From a cost perspective, they effectively externalize 90% of the expenditure while, from a benefit perspective, internalizing 100% of the non-pecuniary private benefits—such as enhanced personal image and reputation. [Sang Yop Kang, The Interplay of Stewardship, Shareholder Activism, and ESG: A Focus on Korea's National Pension Service, 33 S. Cal. Interdisc. L.J. 329 (2023)]
  In other words, by bearing only $10 million in economic cost (in proportion to their 10% ownership), the controlling shareholder enjoys reputational benefits equivalent to a $100 million CSR program.
- By contrast, consider a situation where the controlling shareholder does not utilize a CMS—arguably a more typical structure in jurisdictions like India. Even in the absence of control-enhancing mechanisms, the shareholder may still hold less than 100% ownership and thus externalize part of the CSR costs. For instance, if a controlling shareholder owns 50% of the corporation, a $100 million CSR expenditure results in a personal cost of $50 million, while the shareholder continues to capture the full reputational benefit. In this case, the shareholder externalizes 50% of the cost yet internalizes 100% of the non-pecuniary private benefits.

Problems of Long-termism



In corporate governance scholarship, we often express concern about and criticize the short-termism of companies, portfolio managers, and hedge funds. This perspective is grounded in the widely shared view that **long-term shareholder value** should be prioritized, and it has further evolved into the concept of **sustainable investment (or sustainable growth)** alongside the rise of ESG. However, I believe that **long-termism is not without its own problems**. In particular, it is not uncommon—perhaps even frequent—for top managers or controlling shareholders to pursue corporate policies based on **wishful thinking (but without a solid foundation)**, assuming that their long-term plans will eventually come to fruition.

[Sang Yop Kang's presentation at King's College on Stewardship in September 2019]

Related Issues and Questions

- **Corporations' Other Spending for Employees?**
  - In Korea, employers (corporations) are responsible for covering a substantial portion of their employees' <u>four major social insurance</u> contributions—namely, the National Pension, National Health Insurance, Employment Insurance, and Industrial Accident Compensation Insurance. From the employer's perspective, these contributions function as a form of quasi-tax burden and may also be regarded as a mechanism that reinforces CSR or stakeholderism (particularly in favor of employees).
  - In other words, it can be said that some countries (other than India) are also, <u>in effect</u>, adopting mandatory CSR or mandatory stakeholderism.
  - What about India? To what extent—and how systematically—do corporations in India cover the costs of social insurance for their employees?
- **Unclear Meaning of "Best Interest"**
  - What can we interpret "best interest"?
- **Balancing stakeholders' interests**
  - How can directors balance stakeholders' interests?

The End of Presentation

Thank you