Chapter 1

Introduction

Ethical behavior of businesses around the world is on the radar of all stakeholders. Business refers to economic organizations making economic decisions, whereas decisions based on principles of ethics take into consideration non-economic reasons including rights and justice (Boatright, 2008). The word *ethics* is derived from the Greek word “ethos” meaning character. Ethics is the science of morals, and recognized rule of conduct, (Pojman, 2006). “Morality” refers to a code of conduct put forward by a society. Ethics in the individual context means moral values of the individual but when observed by organizations in decision-making is called as business ethics (Francis, 2009). Ethical behavior of businesses culminates in many forms of which one of most recent is the phenomenon of Corporate Social Responsibility.

During the past decade, Corporate Social Responsibility (CSR) has gained significant importance globally, although responsible behavior of firms has a long history (Sarbutts, 2003). CSR in the present context is seen beyond the philanthropic context. It is not just a buzzword but rather is looked upon as a tool for sustainable business growth. CSR is perhaps as old as business itself and in some societies one cannot do business without being socially responsible (Asongu, 2007).

Businesses in the twenty-first century must not only provide goods and services to satisfy customer needs, they must also satisfy the overall needs of the society. Multiple stakeholders judge companies based on a variety of criteria. Governments want
companies to adhere to all regulations, consumers want companies to supply fair priced and safe products and services, and society wants companies to have sound, sustainable and ethical actions. It is now widely believed that businesses and society are mutually dependent on each other (Porter, 2006).

Today, companies are also required to take into consideration the impact of their actions on society. Companies are certainly required to adhere to regulations relating to environment, health and safety and labor standards. In addition, they are also required to pro-actively support, sustain and give back to the society. Companies today are considered to be responsible for the impact they create on the environment.

Some of the prominent examples include, Wal-Mart which is working towards zero-waste by 2025. General Electric is investing in cleaner-technology research. Coca-Cola is trying to reduce raw materials it uses in packaging and meeting its own water requirement by rain water harvesting. Tata Group of Companies started the Indian Institute of Science, the Tata Institute of Social Sciences (TISS), and the Tata Institute of Fundamental Research (TIFR), for facilitating the development of science and technology in the country.

1.1 Importance of CSR

Businesses are increasingly becoming more proactive to create a positive impact on society by undertaking and managing CSR programs. In a dynamic business world, CSR can also be used as a strategy to gain competitive advantage over competitors, by creating a positive image of the company in the minds of their stakeholders. CSR programs can be
used for enhancing the credibility and visibility of companies in the society. Companies also undertake CSR programs, because of their self-awareness that they are both efficient and effective to create maximum social benefit at the minimum cost. Simon Zadek, 2001, describes the development of CSR broadly in terms of three generations:

1. **The first generation of CSR** showed that companies can be responsible in ways that do not detract from commercial success. The most prominent changes included adoption of a strategic approach to philanthropy, expansion of the geographic focus of corporates and evolving of measurement tools.

2. **The second generation of CSR** is focusing on CSR as an integral part of long term business strategy.

3. **The third generation of CSR**, that is still to come, is expected to make a significant contribution to address issues such as poverty, exclusion and environmental degradation. This will involve both partnerships with civil society and changes in public policy.

Till 1990, business and ethics were considered as oxymoron. It was well accepted that the business of business was only to make profits. Since 1990s, the size of large corporations has grown tremendously. The world's 100 largest economic entities consist of 63 countries and 37 companies, (Nooyi, 2006).

Since the 1990s, a number of developments such as increasing democratization of governments, creation of newer social and economic institutions, rapid growth of volunteerism in the form of non-profit organizations, increasing consumer awareness,
focus on the need of reducing poverty, dealing with the human rights issues, among others, have reinforced the need to articulate policies and actions to include corporate social action and emphasize the concept and practice of corporate responsiveness. Since corporations have social obligations, the concept of corporate social performance has been advocated which would enable corporations to focus on the required content of corporate social action, (McWilliams, 2001).

Modern companies have considerable influence on civil society and the economy of nations. Since 1990, there is tremendous change in the way companies operate. The markets are more global, and large companies procure their supplies from different countries of the world. The world indeed is becoming boundary-less and flat as described by Thomas Friedman (2005) in his book ‘The Flat World’. There is fierce competition among companies globally and that tends to pressurize some companies to adopt shortcuts at the cost of ethical values and welfare of the society. In recent times ethical behavior of the companies is becoming significant to all stakeholders. Sales graphs of soft beverages companies like Pepsi and Coke’s took a nosedive for the period when both these companies were accused of exploiting underground water for their bottling plants, without being responsible towards the society for the quality of water, which was deprived of water resources.

Businesses, which are insensitive towards societal issues, suffer financially as well as their goodwill and brand image get negatively affected. Johns- Manville Corporation, an asbestos producing company, paid $500 million to people who got affected by lung disease in 2004. Pacific Gas and Electric paid $333 million, the largest settlement ever paid in a direct action lawsuit in the U.S. history, to people who got affected in the
southern California town of Hinkley in the year 1996, as they consumed drinking water in that area which was contaminated with poisonous chromium (VI). The company eventually spent more funds in later years in order to rectify its image by sponsoring events for protection of the environment. Decision-making processes of companies has an impact not only on shareholders but also on consumers and society at large. An increasingly boundary less world has made it all the more necessary for multinational companies to be ethical in their operations and to affect the societies in which they operate positively.

Ethical business practice in today’s globalised world is called by many names such as socially responsible behavior (SRB), corporate citizenship (CC), corporate social responsibility (CSR), corporate sustainability (CS) and the most recent is Triple Bottom line (TBL).

TBL mainly addresses the issue of ESG - environmental, social and governance - issues in the organizations. Businesses are viewed with respect to these parameters for judging ethical decision making in their operations.

One of the most well-known and commonly utilized triple bottom-line reporting models is the Global Reporting Initiative (GRI) Guidelines. The GRI’s specific goals, as stated in their Guidelines document, are to offer report formats to account for sustainability; to assist corporations in presenting a balanced picture of their organizations to stakeholders; to promote the comparability of corporate sustainability reports; to stimulate benchmarking and the verifiable assessment of sustainability performance; and to facilitate stakeholder engagement, (Hartman, 2007).
Tata Consultancy Services (TCS) became the first company in India to go for GRI certification and got an A+ rating, which is the top grade a company can get under GRI. This was followed by companies like L&T, Infosys and Reliance. Many businesses also go for ISO 26000, getting certified as socially responsible companies.

Of the 250 largest multinational corporations in the world, 64% published CSR reports in 2005, either within their annual report or as separate sustainability reports. In 2005, 360 different CSR related shareholder resolutions were filed on issues ranging from labor condition to global warming, (Porter, 2006). More than 80% of the Fortune 500 companies specifically cite CSR spending in their annual report (Bhattacharya, 2004).

1.2 CSR by Large Corporations

Philip Kotler and Nancy Lee, (2005) in their book on Corporate Social Responsibility have mentioned that large companies undertake CSR in mainly six ways.

a. Cause Promotion
Corporates may undertake persuasive advertisement of a particular cause, provide statistics about the cause or create informational website where the public can get the information about the cause and contribute to it. The intention is to create awareness about the cause among people. Tata Tea’s Jago Re campaign is very good example of cause promotion. The campaign encouraged voting behavior among the citizens during election times and also took up the issue of eradicating bribes from the system.

b. Corporate Philanthropy
It is a very traditional method of giving by corporates whereby they directly contribute to the cause or charity by giving cash grants and donations. The selection of the project typically depends upon the cause chosen by the company and its management. Cash
resources provided by corporates in the form of philanthropy is very essential for survival and operations of a number of NGOs. It also includes awarding scholarship, donating products as well as services.

c. Corporate Social Marketing

Corporate Social Marketing is about influencing the behavior of the general public for getting the positive outcome, e.g. it can be for actions like promoting family planning or vote in election, get rid of tobacco habit or about keeping a city clean.

d. Cause-related Marketing (CRM)

The company takes up social cause and undertakes to pay for the cause out of revenue generated by selling their product for. CRM was started in 1983 by American Express Bank with their campaign to restore Statue of Liberty. American Express would donate a penny for any credit card transaction and a dollar for each new card issued. CRM is defined as “as the process of formulating and implementing marketing activities that are characterized by an offer from the firm to contribute a specified amount to a designated cause when customers engage in revenue providing exchanges that satisfy original and individual objectives”, (Varadarajan, 1988).

e. Socially Responsible Business Practices

There are consumers who buy products only from companies known for socially responsible business practices, which are in the interest of the society and not only for generating profits. Some companies use only clean energy in the manufacturing process, others use only organic food ingredients so that use of chemicals and fertilizers is minimized.
f. **Community Volunteering**

Many companies encourage their employees, their distribution channels and also their vendors to give volunteer time for specific project undertaken by company. Companies like Infosys and Wipro motivate their staff to do voluntary work on weekends, to undertake projects in the rural areas which are in proximity to their locations. This also helps in inculcating an attitude of giving to society among the employees.

### 1.3 CSR and Small and Medium Enterprises (SMEs)

There is research done on large businesses and their CSR practices but very little research has been done on CSR within the SME sector which contributes more than 7% of India’s GDP. As per the Third All-India Census of Small Scale Industries conducted in 2004, the number of SMEs has increased from about 80,000 units in the 1940’s to about 10.52 million units by 2004. The total employment by SMEs is about 25 million. They constitute 90% of the industrial units in the country and also contribute to about 35% of India’s exports (Pandey, 2007). SME sector is a thriving sector of India’s economy contributing in the form of innovation, employment and entrepreneurial activities.

World over, the SME sector is seen as an emerging sector not only in terms of the economic impact they have on an economy of any country but also the social impact it create on the local societies in which they operate.

Small and Medium enterprises make up more than 90% of the businesses worldwide and account for 50 to 60 % of employment. European Union estimates for 2003 indicate that more than 20 million SME’s account for over 80 million jobs. In the United States 99.7 percent of all firms fall into the “small business” category accounting for half the nation’s
job and contribute more than 50% of non farm GDP, (Vives, 2005). Almost half of the European SMEs are, to different degrees, involved in socially responsible activities, (Perrini, 2006).

The CORE Bill 145 (2002) has introduced following requirements on the companies operating in UK:

A. Mandatory Reporting: Companies with a turnover greater than 5 million pounds would be required to produce and publish reports on their economic, environmental and societal impact.

B. Stakeholders Dialogue: Companies would have to consult affected stakeholders before launching major projects.

C. Directors: Directors would be required to better consider the impact of their business on the environment and society.

There are also views against this bill as it will create additional burden on the small and upcoming businesses. As David Frost, Director General of the British Chambers of Commerce, for instance, argued that Bill 145 in the UK presented a threat to small and medium-sized enterprises (SMEs) and that it did not adequately take into account the huge burden that this would place on SMEs, who he estimated were already struggling under £21bn of extra regulations since 1997.
1.4 Small and Medium Enterprises

Small firm ethics and corporate social responsibility emerged in the business literature in the USA during the 1970s and 1980s. In the beginning, this literature was mainly concerned with moral issues of employee behavior and other areas of social responsibility (Spence 1999). Small and Medium Enterprises (SMEs) have played a significant role in India's economic growth since Independence. The positive impact of the SME sector on the Indian economy and society may be summarized as follows:

Almost 7% of India's gross domestic product (GDP) is contributed by SMEs, which account for the largest employment base of around 20 million persons, next only to Agriculture. It has been estimated that every Rs 100,000 of investment in fixed assets in the small-scale sector generates employment for 4 persons. During the period 1991 – 1997, the increase in jobs per annum for the SME sector was 3.5% whereas it was 0.8% in case of the organized sector (including government).

The SME sector plays a major role in India's current export performance. 45%-50% of the Indian Exports is contributed by SME sector. Direct exports from the SME sector accounts for nearly 35% of total exports. Besides direct exports, it is estimated that small-scale industrial units contribute around 15% to exports indirectly.

The SME sector fosters an entrepreneurial environment in the country by encouraging individual initiatives which in turn helps both the individuals undertaking risk and the country as a whole.

SME enterprises are found in all part of the India, thereby helping in reducing regional disparities and ensuring well balanced growth in the whole of India.
Due to the large employment base, SMEs serve as good training ground for managerial as well as technical talent in the country.

SMEs are typically less capital intensive than large industries.

SMEs are different from the large companies in many ways, for example:

a. Most SMEs in India are family-owned and managed. Large percentages of enterprises are proprietorships or partnerships, fewer percentage represent private companies and still lesser number of organizations are public companies.

b. As SMEs are closely-controlled by the family of the entrepreneur, starting a, SME, owning and managing it rests in the hands of the family.

c. In case of CSR, the decision making processes of the enterprise is very strongly affected by the values, education and, attitudes of the entrepreneur who started it. Thus philanthropy or decisions for social welfare is also influenced by the characteristics of the person who started it.

d. In SMEs, the profit may not be the sole motive behind starting an enterprise.

e. The passion of an entrepreneur who undertakes manufacturing of products or rendering of services which may satisfy his intellectual need with definitely reasonable profit. For example Arvind Eye Hospital of Madurai started by Dr. Govindappa Venkataswamy developed contact lenses that cost half of what were imported at that time. This reduced their cost of operations and in turn helped them to cater to more people at the bottom of the pyramid, (Rangan, 2007).
1.5 Growth of SMEs in India

After independence, India’s industrialization was more dependent on large scale businesses. Mahatma Gandhi had espoused the importance of developing Small scale Industries but his focus was more on craft and cottage industries and development of rural area through these small scale industries which would make villages in India self-sufficient and would also solve the problem of migration.

In the Second Five Year Plan it was Prof. Mahalanobis who gave boost to the Small Scale Industry (SSI) as supplier of consumer goods to the workers working in the large scale sector. For many years, small scale industries were non-competitive and technologically obsolete.

The Industrial Policy of 1985 focused on small scale and ancillary industries with the view to enhancing the development of rural and backward areas. It made incremental changes like investment ceilings, which was raised to Rs. 3.5 million for small scale industries (SSI), and to Rs. 4.5 million for ancillaries. (Venkataramanaiah et al, 2007).

From 1990 to 2007, the SME sector has seen a sea change, due to numerous reasons. The protected businesses in India faced very strong competition when the Liberalization process was undertaken in the year 1991. It was followed by implementation of policy as directed by the World Trade Organization in the year 1995 onwards. The Indian market saw final change when domestic economy policies also had to be changed to keep pace with the process of liberalization and globalization. All these lead to fierce competition in
the country making it unavoidable for the SMEs to change themselves in this ever changing and dynamic business environment.

During 1991-2005, there was increase in the flow of FDI into India across all the sectors, due to which cost of transportation and communication decreased substantially. This made inflow of goods, services, knowledge and capital very easy for the domestic SME sector. With the increasing flow of FDI in the country, competition and the possibility of more and more outsourcing work coming to India also increased thanks to the cheap labor which keeps production costs very competitive among other developed countries of the world. The protection given to SME sector till 1990 from participating in the open market was further diluted by the government reducing the number of items kept as reserved for SMEs, which was gradually brought down from 842 in 1991 to 675 in 2003 and in 1999 the list was further reduced to 358 items. Reservation of items was phased out substituting with promotional support to strengthen their globalization efforts Those SMEs who have strong technological base, international business outlook, competitive spirit and willingness to restructure themselves shall withstand the present challenges and come out with shining colours to make their own contribution to the Indian economy. (http://www.dsir.gov.in/reports/mitcon/chap2.pdf)
Table 1.1  Growth of SMEs from 1990 to 2008

<table>
<thead>
<tr>
<th>Years</th>
<th>No. of Units in lakh</th>
<th>Fixed Investment in crore</th>
<th>Production in crores Current price</th>
<th>Production in crores Constant price93-94</th>
<th>Employment in lakh</th>
<th>Export in crore</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-91</td>
<td>67.87</td>
<td>93555</td>
<td>63.518</td>
<td>68.295</td>
<td>158.34</td>
<td>9,664</td>
</tr>
<tr>
<td>1991-92</td>
<td>70.63</td>
<td>100351</td>
<td>80615</td>
<td>87355</td>
<td>165.99</td>
<td>13,883</td>
</tr>
<tr>
<td>1992-93</td>
<td>73.51</td>
<td>109623</td>
<td>84413</td>
<td>92246</td>
<td>174.84</td>
<td>17,784</td>
</tr>
<tr>
<td>1993-94</td>
<td>76.49</td>
<td>115795</td>
<td>98796</td>
<td>98796</td>
<td>182.64</td>
<td>25,307</td>
</tr>
<tr>
<td>1994-95</td>
<td>79.60</td>
<td>123790</td>
<td>122154</td>
<td>108774</td>
<td>191.40</td>
<td>29,068</td>
</tr>
<tr>
<td>1995-96</td>
<td>82.84</td>
<td>1,25,750</td>
<td>1,48,290</td>
<td>1,21,649</td>
<td>197.93</td>
<td>36,470</td>
</tr>
<tr>
<td>1996-97</td>
<td>86.21</td>
<td>130560</td>
<td>167805</td>
<td>134892</td>
<td>205.86</td>
<td>39,248</td>
</tr>
<tr>
<td>1997-98</td>
<td>89.71</td>
<td>133242</td>
<td>187217</td>
<td>146262.9</td>
<td>213.16</td>
<td>44,442</td>
</tr>
<tr>
<td>1998-99</td>
<td>93.36</td>
<td>135482</td>
<td>210454</td>
<td>157525.1</td>
<td>220.55</td>
<td>48,979</td>
</tr>
<tr>
<td>2000-2001</td>
<td>101.10</td>
<td>1,47,348</td>
<td>2,61,289</td>
<td>1,84,428</td>
<td>239.09</td>
<td>69,797</td>
</tr>
<tr>
<td>2001-2002</td>
<td>105.21</td>
<td>1,54,349</td>
<td>2,82,270</td>
<td>1,95,513</td>
<td>249.09</td>
<td>71,244</td>
</tr>
<tr>
<td>2003-2004</td>
<td>113.95</td>
<td>1,76,726</td>
<td>3,57,733</td>
<td>2,28,730</td>
<td>271.36</td>
<td>97,644</td>
</tr>
<tr>
<td>2004-05</td>
<td>118.59</td>
<td>1,78,699</td>
<td>4,18,263</td>
<td>2,51,551</td>
<td>282.57</td>
<td>1,24,417</td>
</tr>
<tr>
<td>2005-06</td>
<td>123.42</td>
<td>1,88,113</td>
<td>4,76,201</td>
<td>2,77,668</td>
<td>294.91</td>
<td>NA</td>
</tr>
<tr>
<td>2006-07</td>
<td>128.44</td>
<td>213219</td>
<td>585112</td>
<td>471663</td>
<td>312.52</td>
<td>177,600</td>
</tr>
<tr>
<td>2007-08**</td>
<td>133.68</td>
<td>238975</td>
<td>695126</td>
<td>532979</td>
<td>322.28</td>
<td>NA</td>
</tr>
</tbody>
</table>

Source: *Annual Report 2008-2009 Ministry of SSI**Projected

The above table shows Growth of SSI/SME sector from 1991 to 2008. The number of units has increased from 67.87 lakhs to 123.42 lakhs in this period, growing at the rate of 5.84 annually. Fixed investment has also increased many fold from 93.55 crores in 1991 to 1,88,113 crores in the year 2006. In terms of employment generation, this sector is next only to the agriculture sector with a total employment potential of 295 crores. This sector contributes to 39% of the gross industrial value added to the economy. Around 34% of total manufactured exports of the country are directly credited to the SME sector. The service sector emerged as the dominant component of the total SME sector with a share of 44% of the units (Kulkarni, 2008).
SMEs have maintained an overall higher growth rate compared to the industrial growth rate in our country. This is very clearly seen from the table given below.

In 2002-03 the growth rate in the SME sector was 8.68% p.a. compared to 5.7% of industry. However the difference had substantially come down in 2006 where the SMEs growth rate was only 1% higher than that of the industry. But in 2007-08, the growth rate of SMEs is projected to be double than that of the industry.
Chapter 1

Introduction

Fig. 1.1 Increase of employment from 1991 to 2008

Source: Annual Report 2008-2009 Ministry of SSI

It is very clearly seen from fig.1.1. that there is continuous and steady increase in employment in the sector, in 1990 it generated employment for 158 lakh people in India which doubled by the year 2000 and in 2008 this sector had provided employment to around 322 lakh people.

Table 1.4 Contribution of SMEs (%) at 1999-2000 prices in Gross Domestic Product.

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Industrial Production</th>
<th>Gross Domestic Product(GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999-00</td>
<td>39.74</td>
<td>5.86</td>
</tr>
<tr>
<td>2000-01</td>
<td>39.71</td>
<td>6.04</td>
</tr>
<tr>
<td>2001-02</td>
<td>39.12</td>
<td>5.77</td>
</tr>
<tr>
<td>2002-2003</td>
<td>38.89</td>
<td>5.91</td>
</tr>
<tr>
<td>2003-2004</td>
<td>38.74</td>
<td>5.79</td>
</tr>
<tr>
<td>2004-05</td>
<td>38.62</td>
<td>5.84</td>
</tr>
<tr>
<td>2005-06</td>
<td>38.56</td>
<td>5.83</td>
</tr>
<tr>
<td>2006-07</td>
<td>38.57</td>
<td>5.94</td>
</tr>
</tbody>
</table>

Source: Annual Report 2008-2009 Ministry of SSI
It is very clear from Table 1.4 that contribution of SMEs is 6 times that of industry consistency, thus the SME sector has a great impact on the GDP of the country.

**Policy support by Government to SMEs sector in the recent years**

The government policy of providing special incentives to the SME units, by way of reservation in terms of items exclusively for the manufacturer of SSIs, supply of raw materials through State Small Industries Development Corporations (SSIDCS), provision of finance on concessional terms to micro and tiny units, fiscal relief in terms of excise duty, assistance in marketing their products and provision of price preference have no doubt, helped in the rapid growth of the SME Sector.

To further accelerate the pace in the small-scale sector, the Government of India initiated certain important measures through the budgets. These measures are as follows:

a. Increase the limit of composite loan scheme from Rs. 2 lakh to Rs. 50 lakh to ease the operational difficulties of the small borrowers. In addition, the provision of term loans and working capital through a single window.

b. Consider lending by banks to non-banking financial companies or other financial intermediaries for the purposes of lending to the tiny sector as priority sector lending.

c. Formulate a new credit insurance scheme for small-scale units to provide adequate security to banks and improve recovery.

d. Enable flow of funds to micro enterprises through the coverage of at least 50,000 SHGs at the behest of SIDBI and NABARD. The government will provide grants to SIDBI to augment its Portfolio Risk Fund for this purpose.

e. Credit-linked scheme for technology upgradation.
f. Rationalization of customs duty.

g. Increase in project limit under National Equity Fund (NEF) to Rs. 50 lakh.

h. Upgrade schemes for industrial estates.

i. Market Development Assistance (MDA) scheme for SSI.

j. Task force for strengthening, factoring and bill culture.

k. In order to promote the agro-processing industries, 100% deduction of profit for five years and 25% of profit for the next five years will be allowed in case of new agro-processing industries set up to process, preserve and package fruits and vegetables.

l. The Ceiling for eligible loan limit under credit-linked capital subsidy for technology up gradation has been raised from Rs. 40 lakh to 1 cr and the quantum of subsidy was raised from 12% to 15%.

m. Manufacturing competitive program has been announced, which will help SMEs to strengthen their operations and sharpen competitiveness.

(SME White Paper, 2009)

In addition to the above policy initiatives, the Government of India has created a Rs. 10,000 crore SME fund, through which direct assistance is being provided to SMEs at an interest rate of 2% below SIDBI’s Prime Lending Rates (PLRs). Refinance to State Financial Cooperation (SFCs) is available in the interest band of 7.5 to 8.0% and to banks; it is available at an even lower rate. (SME White Paper, 2009)