BOARD DECISION-MAKING AND STAKEHOLDER PROTECTION

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Abstract: *The article deals with CSR regulation from a company law perspective. It considers mechanisms for better protection of stakeholder interests in the context of both hard and soft law, by evaluating the extant frameworks in the UK and India. The lack of proper consideration of stakeholder interests in companies' decision-making processes emphasises the need to secure accountability for stakeholders. Unequal access to information and a lack of mechanisms for participation in board decision-making means that stakeholders do not have the same opportunity as shareholders to influence board decisions. Therefore, the principal question is how to regulate CSR to protect stakeholder interests and compel companies to behave ethically and responsibly*.

This article relates to the law as at January 2023.

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I. INTRODUCTION

The notion of corporate social responsibility ('**CSR**') emphasises the way directors manage companies. It focuses on how a company takes responsibility for its impact on various stakeholders, extending the corporate purpose beyond the narrow shareholder-primacy framework. Stakeholders are extremely important for companies as they affect or can potentially affect a company's success or failure. It is consequently important for companies to strengthen their relationships with stakeholders.[2] Companies must recognise the various stakeholder interests and have a healthy corporate culture serving the needs of the wider society. Accountability[3] is based on the rationale that a company is powerful and capable of causing harm or breaching another's rights and is therefore accountable to them. In the case of stakeholders, accountability is even more important as unlike shareholders, they cannot monitor the board or have a say in decision-making.[4]

The remarkable rise in Environmental, Social and Governance ('**ESG**') investment has shifted the focus on the impact of ESG issues to the financial performance of companies.[5] Although an overlap can be seen between CSR and ESG, ESG is primarily a financial technique for portfolio selection and engagement by investors. It supports shareholder primacy as it reinforces the perception that shareholder interests come first, when there is a contest between social or environmental interests and those of the shareholders.[6] The collective effect all these factors constrain any inclination on the part of boards to act in the interest of stakeholders.

The main objective of this article is to examine how CSR should be regulated from a company law perspective to achieve effective and sustainable corporate conduct. Regulation of CSR can be viewed from two distinct but interrelated dimensions: 'substance' and 'process'.[7] The

[2] 'The Corporate Social Responsibility Report and Effective Stakeholder Engagement' (*Harvard Law School Forum on Corporate Governance* 2020) <https://corpgov.law.harvard.edu/2013/12/28/the-corporate-social-responsibility-report-and-effective-stakeholder-engagement/> accessed 7 March 2021.

[3] Accountability refers to 'a situation in which someone is responsible for things that happen and can give a satisfactory reason for them', See Cambridge Dictionary, 'Meaning of Accountability' <https://dictionary.cambridge.org/dictionary/english/ accountability > accessed 2 May 2023. In that sense accountability envisages giving an account for how responsibilities have been discharged.

[4] Andrew Keay and Joan Loughrey, 'The Framework for Board Accountability in Corporate Governance' (2015) 35 Legal Studies 252, 259.

[5] Iain MacNeil and Irene-Marie Esser, 'From a Financial to an Entity Model of ESG' (2022) 23 EBOLR 9.

[6] Jessica Strine, *et al*, 'The Age of ESG' (*Harvard Law School Forum on Corporate Governance* year) <https://corpgov.law.harvard.edu/2020/03/09/the-age-of-esg/> accessed 12 March 2020. On national level, the release of the Stewardship Code 2020 in the UK and India are important evidence of growing institutional investor interest in monitoring companies.

[7] The article is based on the theme 'substance v process', which is in line with the approach taken by Chalaczkiewicz-Ladna,*et al* and adapted for the purpose of this article. They conducted their analysis in the context of 'outcome v control' and 'process v disclosure' themes to evaluate the early stages of the implementation

substantive aspect deals with directors' duty and is linked to the goals set for the company. Directors' duty allows directors a wide discretion in applying their judgement to realise these goals. The process is concerned with 'how' to achieve that goal, ie, by focusing on the internal decision-making process of directors. Directors' duties – eg, as provided for in section 172(1) of the Companies Act 2006 ('**CA 2006**') in the UK and section 166(2) of the Companies Act 2013 ('**CA 2013**') in India – give directors a wide discretion to integrate stakeholder interests in the decision-making process but do not tell them how to do this. Further, the approach in section 135 of the CA 2013 (providing for companies that meet a size threshold to establish a CSR committee and engage in CSR activities) is narrow, rigid and does not give stakeholders a voice in the board decision-making process.[8] However, the UK has introduced stakeholder engagement mechanisms through Provision 5 of the UK Corporate Governance Code,[9] ('**UKCGC**') which addresses engagement with stakeholders (the workforce) in the decision-making process.[10] Thus, the UK and India have adopted different approaches to the role of substance and process: we evaluate the merits of each approach in terms of their potential to integrate CSR into corporate governance.

We start with and overview of the CSR regulatory frameworks in the UK and India. Following on from this, Part 3 develops the 'substance vs process analysis', focusing on how the two jurisdictions focus on outcomes and identifying possible solutions for better stakeholder protection. It argues that there is a need to implement the substantive duty through complementary mechanisms focusing on the process of decision making; in other words to emphasise process more in the approach to CSR. With that in mind, several reforms are recommended in both countries for better stakeholder protection, followed by conclusions. Underpinning our approach is the overarching view that company law may be a better way to

of Provision 5 of the UK Corporate Governance Code (UKCGC). While their analysis was based on limited set of stakeholders (workforce) in the UK, this article is broader in the application with evaluation of various potential techniques for protection of stakeholders in the UK and India. See the discussion in III and Katarzyna-Chalaczkiewicz-Ladna, *et al*, 'Workforce Engagement and the UK Corporate Governance Code' [2021] Thomson Reuters Aranzadi, II International Conference of Corporate Governance proceedings <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3834387>.

[8] Under section 135 of the Companies Act 2013, there is no communication between the stakeholders and company. The board needs to address the key concerns of the stakeholders but in doing that it is important to consult them to understand their concerns, listen to their voice and how this impacts the decisions made in a company.

[9] The Code is applicable to all companies with a premium listing of equity shares. It took effect from 1 January 2019. See The UK Corporate Governance Code 2018.

[10] Stakeholder engagement sensitises directors to the key concerns and issues facing stakeholders and allows the directors access to more comprehensive information. Directors should use the information to change company's strategy in a way that benefits all stakeholders and allows directors to act proactively to address any issues and risks.

integrate CSR into corporate governance than external regulation. This is because it offers the potential to adjust to the context in which each company operates.

II. CSR FRAMEWORK

This section starts by evaluating the key provisions of stakeholder protection. It analyses the extent to which the substantive duty in the two jurisdictions promotes CSR followed by a discussion on the role of soft-law regulation in this arena. Limitations of the disclosure are also highlighted, indicating a need to shift to a more process-based regulation. After considering the position in both jurisdictions, various comparative conclusions are drawn on the different approaches adopted in the two countries. Given the divergence in law and culture between the UK and India, the comparison will present a clearer picture of how the regulation of CSR is contextualised and shaped by different factors.

A. Substantive Duty

The generally accepted view in the UK and India, have traditionally been that directors should act in the best interest of the shareholders collectively.[11] Both jurisdictions have revised directors' duty to include stakeholder interests as a factor in promoting the interests of the company. In section 172(1) of the UK CA 2006, directors are required to promote the success of the company for the benefit of its members, as a whole, with reference to various matters such as the interests of employees, suppliers, customers and the environment. It allows directors a wider discretion in integrating stakeholder interests by stating 'what' directors are required to do – ie, consider the interests of stakeholders in their decision-making processes. However, the ultimate beneficiaries of directors' duties are still the shareholders.[12] Therefore, the section is highly criticised as it creates a hierarchy putting shareholder's interests above those of the stakeholders.[13] The practical importance of this section, in the context of protecting

[11] The interest of the shareholders was paramount, and the interests of stakeholders were considered provided they brought some benefits to the shareholders. See *Lee Behrens & Co Ltd, Re* [1932] 2 Ch 46 ; *Parke v Daily News Ltd* Citation ; *Hampson v Price's Patent Candle Co* Citation; *Re W & M Roith Ltd* [1967] 1 All ER 427. For India, see *Dikshit And Co Ltd v Mathura Prasad* AIR 1925 All 71 [7]; *Albert Judah Judah v Rampada Gupta And Anr* AIR 1959 Cal 715 [35-A].

[12] Irene-Marie Esser and Iain MacNeil, 'Shareholder Primacy and Corporate Purpose' (*Oxford Business Law Blog*, 21 December 2022) <https://blogs.law.ox.ac.uk/blog-post/2022/12/shareholder-primacy-and-corporate-purpose> accessed 5 February 2023 .

[13] Andrew Johnston, 'The Shrinking Scope of CSR in UK Corporate Law' (2017) 74 Washington and Lee Law Review 1001, 1012; Snehita Singh, 'Regulating Corporate Social Responsibility in the UK and India – An Analysis from the Perspective of Stakeholder Protection' (*University Of Glasgow* 2022) Ch 4 Pt 2.2 <http://theses.gla.ac.uk/id/eprint/83333> accessed 5 February 2023.

stakeholders, is unclear as the stakeholders are not entitled to take any legal action against directors.

Section 172(1) of the CA 2006 is compared with section 166(2) of the CA 2013, which states that directors are required, to act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, and its employees, the shareholders, the community and for the protection of the environment. The approach adopted by the CA 2013 is a pluralist approach as directors have to give equal importance to the interest of the shareholders and other stakeholders.[14] However, similar to section 172, the practical importance of this section to stakeholders is unclear as they have not been provided with any formal remedy for abuse by the directors.[15] The Indian section further complicates the decision-making process as the government has failed to provide any guidance on how director's can balance various conflicting interests. The CA 2013 also makes provisions for 'mandatory CSR' under section 135, which requires certain companies to spend 2% of their net profit on CSR activities. Companies above a certain threshold are required to have a CSR Committee in place, which formulates, monitors and reports on the CSR activities carried out by the companies.[16] Merit is seen in the CSR Board Committee as when programmes are managed at board level they are more likely to lead to real change in corporate behaviour.[17] The government released the CSR Rules 2014 as a supporting guideline for companies.[18] After the 2021 Amendment to the Act, the unspent CSR amount, if any, must be transferred by the company to any fund listed in Schedule VII to the Act.[19] If the company fails to report on CSR activities it is liable to a penalty ranging from Rs. 50,000 to Rs. 25 lakh.[20] The overall framework in section 135 has the potential of imposing a higher level of board

[14] Pluralist approach advance interests of a number of groups without the interests of a single group (shareholders) being overriding. It envisages circumstances in which some sacrifice of the interests of shareholders will be needed in favour of some other interest. Robert Monks, *Modern Company Law for a Competitive Economy, The Strategic Framework* (CLRSG, DTI 1999) [5.1.11] and [5.1.2].

[15] However, the pluralist view is strongly supported by the Indian judiciary and the importance of CSR has been recognised in several cases before and after the reform of CA 2013, see: *TS Arumugham vs Lakshmi Vilas Bank Ltd And Others* 1994 80 CompCas 814 Mad [22]–[26]; *National Textile Workers vs PR Ramkrishnan And Others* AIR 1983 SC 750; The Supreme Court recently upheld the principle of sustainable development in *MK Ranjitsinh vs Union Of India* 2021 SCC OnLine SC 326. The court ordered to mitigate the environmental impact, irrespective of the cost factors to protect the 'near extinct' birds.

[16] Most of these activities have been aligned with the Sustainable Development Goals, such as protection of the environment, eradicating poverty, promoting education and rural welfare.

[17] See generally on CSR committee, Singh (n 12) 178.

[18] The Companies (Corporate Social Responsibility Policy) Rules 2014

[19] The Companies (CSR Policy) Amendment Rules, 2021, Rule 10 .

[20] Additionally, every officer in default is punishable with up to three years' imprisonment, a fine, or both. See the Companies Act 2013, s 134(8).

accountability to stakeholders in that it places a positive duty on the board to improve social and environmental conditions in India. However, the section does not encourage companies to integrate stakeholder issues in the core of their business. Moreover, CSR funds are often misused.[21] The section is restricted to philanthropic model of CSR rather than a broader stakeholder model.[22] The rigid approach leaves little room for moral and ethical behaviour[23] and may lead to merely 'ticking the boxes'.

B. Soft Law

From the legal perspective, debate around CSR is strongly influenced by whether CSR should be regulated by hard law or soft law.[24] Those who argue for soft law regulation of CSR point out that it has behaviour-influencing capacity.[25] It can be very effective in influencing corporate practice as it is flexible, making it easier for companies to respond to different problems and circumstances. This is especially desirable in an area where government is reluctant to make a binding commitment.[26] For example, the softer approach of the UKCGC is believed to be establishing best practice by allowing some flexibility in implementation.[27] The Cadbury Report states: 'We believe our approach, based on compliance with a voluntary code coupled with disclosure will prove more effective than a statutory code.' Taking a similar view, the Greenbury Committee also considered statutory controls unnecessary.[28] The 'comply or

[21] A survey condected by EY revealed fraud and unethical practices in CSR programmes and found financial misrepresentation of CSR funds (33%), fraud in procurement of goods and services (34%), and the diversion of funds (30%), see: 'Weak Governance and Lack of Due Diligence Pose a Grave Risk to CSR Programs: EY Survey' (*EY India*, 6 May 2020) <https://www.ey.com/en_in/news/2020/05/weak-governance-and-lack-of-due-diligence-pose-a-grave-risk-to-csr-programs> accessed 2 May 2023.

[22] The theory recognises the interest of all stakeholders as 'ends' in themselves and argues that their interests should be recognised in due course, even if this will not result in the advancement of shareholder interests, see: R Edward Freeman *et al*, 'Stakeholder Theory and "The Corporate Objective Revisited' (2004) 15 Organization Science 364.

[23] Jean J du Plessis and others (eds), *Globalisation of Corporate Social Responsibility and Its Impact on Corporate Governance* (Springer International Publishing 2018) 212.

[24] Soft law is generally referred to as a non-legally binding instrument such as treaties, codes of conduct, voluntary resolutions, and joint declarations. It is not mandated by law or subject to any formal enforcement mechanisms but may be enforced through voluntary, market-orientated means. See: Dinah Shelton, 'Normative Hierarchy in International Law' (2006) 100 American Journal of International Law 291; Jennifer A Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006) 70.

[25] Shelton (n 23) 322; CM Chinkin, 'The Challenge of Soft Law: Development and Change in International Law' (1989) 38 International and Comparative Law Quarterly 850, 861.

[26] Shelton (n 23) 322.

[27] 'Report of the Committee on the Financial Aspects of Corporate Governance (The Cadbury Report).' (1992) <https://media.frc.org.uk/documents/Cadbury_Code_-_The_Financial_Aspects_of_Corporate_Governance.pdf> para 1.10.

[28] 'Greenbury Report (Study Group on Directors' Remuneration)' (CBI 1995) < https://www.ecgi.global/code/greenbury-report-study-group-directors-remuneration> [1.13].

explain' approach of the code assists companies to be flexible in their strategy without setting a rigid set of rules. It also allows room for judgment calls and common-sense application. [29]

The UKCGC 2018 makes the Board accountable to a broader range of stakeholders and introduces a process of integrating their interests in corporate decisions, allowing stakeholders an opportunity to engage with the Board's decisions. Provision 5 of the UKCGC expressly details methods of integrating workforce (limited number of stakeholders) interests by stating that one or a combination of the following methods should be used to ensure their engagement: (1) a director appointed from the workforce; (2) a formal workforce advisory panel; and/or (3) a designated non-executive director.[30] For the first time, the Code prescribes engagement mechanisms for stakeholders (workforce), which until the UKCGC 2018 was limited to shareholders.[31] However, the limitation in Provision 5 is notable in that it refers to only one specific stakeholder, the workforce. The provision should be used to promote the interests of all stakeholders and reflect the aim of balancing interests of all stakeholders. Nonetheless, Principle D and Provision 5 of the UKCGC, if read together, appear to suggest that the participation mechanism should be developed and kept under regular review for all key stakeholders.[32]

The Indian government released the National Guidelines on Responsible Business Conduct 2018 ('**NGRBC**'), a set of nine principles which require directors to adopt an inclusive approach on a voluntary basis.[33] The guidelines are based on the philosophy of giving back to society, which has been an integral part of Indian culture since time immemorial.[34] On a global level, India has committed to the United Nations Guiding Principles on Business and Human Rights ('**UNGPs**'),[35] SDGs, and the International Labour Organization ('**ILO**') Core

[29] Iain MacNeil and Irene-Marie Esser, 'The Emergence of "Comply or Explain" as a Global Model for Corporate Governance Codes.' 33(1) European Business Law Review (2022) 1.
[30] The UK Corporate Governance Code, Provision 5.
[31] For example, independent directors and board committees representing shareholder interests. See Chalaczkiewicz-Ladna l (n 6) 2.
[32] This is also suggested by the FRC Guidance on Board Effectiveness which 'promotes a more inclusive approach to stakeholder engagement and encourages boards to reflect on the way in which decisions are taken and how that might affect the quality of those decisions.' See: 'Guidance on Board Effectiveness' (*FRC* 2018) 2 <https://www.frc.org.uk/getattachment/61232f60-a338-471b-ba5a-bfed25219147/2018-Guidance-on-Board-Effectiveness-FINAL.PDF> accessed 20 January 2023.
[33] 'National Guidelines on Responsible Business Conduct 2018' (*MCA*, 2018) <https://www.mca.gov.in/Ministry/pdf/NationalGuildeline_15032019.pdf> accessed 7 September 2019.
[34] ibid 5.
[35] The National Action Plan on Business and Human Rights (NAP) reaffirms India's commitments to the realisation of human rights and the promotion of socially responsible businesses. *National Action Plan on Business and Human Rights: Zero Draft* (*MCA* 2018) 5 < https://www.mca.gov.in/Ministry/pdf/ZeroDraft_11032020.pdf> accessed28 January 2023. The UN has also

Conventions 138 (minimum employment age for children) and 182 (worst forms of child labour). These have been aligned nationally with the NGRBC 2018. However, in India, hard law is often preferred over soft law, especially in regulating CSR. The Indian business and the legal cultures are accustomed to relying on government regulation through a mandatory approach because of the presence of controlling shareholders (also termed promoters in India) in India.[36] They are very powerful and control the affairs of the company, directly or indirectly. The lack of sophisticated market players allows decision-makers the discretion to choose between a line of action from a set of viable options as stakeholders are unable to block objectionable acts.[37] This lack of proper enforcement action for breaches – even of hard law – has hampered enforcement, questioning whether the 'softer' comply-or-explain approach will have any greater impact when it comes to stakeholder protection. For this reason, a softer approach to stakeholder protection is regarded as an inadequate mechanism in India.

C. Disclosure

The current disclosure obligations relevant in the context of stakeholder protection in the UK and India are discussed in this section. Both countries have extensive reporting requirements, which give some form of protection to stakeholders. The Strategic Report[38] in the CA 2006 is linked to section 172 that requires directors to provide a 'section 172 statement', describing how the directors have had regard to the matters in subsection (1) of section 172.[39] Its main purpose is to inform shareholders and facilitate participation. The introduction of the section 172 statement has ensured that there exists a stronger emphasis on the consideration of stakeholder interests in the strategic report. This allows companies better to understand the relevance of stakeholders in their decision-making. The FRC's 'Review of Corporate Governance Reporting' 2021 contained a random sample of 100 FTSE 350, and small

welcomed India's development of the NGRBC and NAPs to advance the business and human rights agenda. 'UN Expert Group Welcomes India's Plan to Promote Corporate Respect for Human Rights' (*OHCHR*, 22 March 2019) <https://www.ohchr.org/en/press-releases/2019/03/un-expert-group-welcomes-indias-plan-promote-corporate-respect-human-rights> accessed 25 March 2022.

[36] Umakanth Varottil, 'India's Corporate Governance Voluntary Guidelines 2009: Rhetoric or Reality?' (2010) 22 National Law School of India Review 1, 19. The term 'promoter' has specific significance. They typically manage to secure an effective control over the affairs of the company, directly or indirectly, whether as a shareholder, director, or otherwise. However, fiduciary duties are only imposed on the directors of the company and not on shareholders.

[37] Amir N Licht, 'Culture and Law in Corporate Governance' (2014) European Corporate Governance Institute - Law Working Paper No. 247/ 2014 <http://www.ssrn.com/abstract=2405538> accessed 4 January 2022.

[38] All companies (other than small companies) are required to prepare a strategic report each financial year. CA 2006, ss 414A(1), (2) and 414B.

[39] CA 2006, s 414CZA.

companies showed [40] better quality ESG information compared to their 2020 review.[41] The FRC noted that although more companies are identifying their key stakeholders and their issues, the majority are still not reporting on companies' impact on stakeholders.[42]

Apart from the strategic report, non-financial statements must be issued by certain companies in the UK,[43] which are in line with the EU Directive 2014/95/EU [also termed the Non-Financial Reporting Directive ('**NFRD**')].[44] The European Commission has published a proposal to amend the EU Directive with Corporate Sustainability Reporting Directive ('**CSRD**'), which would amend the existing reporting requirements of the NFRD and extend the scope to all large companies and those listed on regulated markets.[45] Recently, sustainability disclosure based on TCFD has also been mandated with an aim of to ensure that climate-related risks and opportunities are priced into investment decisions.[46] The downside of this from CSR perspective is that there is limited discussion on risks of climate change on the stakeholders.[47] In its recently released three-year plan, the FRC aims to strengthen the reporting framework further by aligning it with ESG norms, with improved investor engagement especially on climate-related matters.[48] The EY's research assessment of TCFD disclosures by the largest public companies in high-risk sectors (2021),[49] revealed that the companies based

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[40] FRC, 'Review of Corporate Governance Reporting, 2021' <https://www.frc.org.uk/getattachment/b0a0959e-d7fe-4bcd-b842-353f705462c3/FRC-Review-of-Corporate-Governance-Reporting_November-2021.pdf> accessed 23 February 2022.

[41] FRC, 'Review of Corporate Governance Reporting 2020' (2020) <https://www.frc.org.uk/getattachment/c22f7296-0839-420e-ae03-bdce3e157702/Governance-Report-2020-2611.pdf> accessed 23 February 2022.

[42] FRC (n 39) 24.

[43] CA 2006, ss 414CA- CB

[44] Directive 2014/95/EU of the European Parliament as regards disclosure of non-financial and diversity information by certain large undertakings and groups (2014) <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0095> accessed 20 April 2021. The directive can be cited

[45] 'Corporate Sustainability Reporting' (*European Commission*) <https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en> accessed 7 March 2021. Although the UK is no longer a member of EU, it cannot be said that EU law will not affect the UK law indirectly such as through investor pressure and competitive advantage. Both parties agree on bilateral exchanges of views without prejudice to the unilateral and autonomous decision-making process of each side. See Citation can be given <https://ec.europa.eu/info/sites/default/files/brexit_files/info_site/com_2020_855_final_annexe3_v1.pdf> accessed on 25 July 2022.

[46] HM Treasury, 'Interim Report of the UK's Joint Government-Regulator TCFD Taskforce' 2 <https://www.webarchive.org.uk/access/resolve/20201110001724/https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/933782/FINAL_TCFD_REPORT.pdf> accessed 5 June 2021.

[47] Impact on the workforce is mentioned briefly under acute physical risk. See TCFD, 'Final Report Recommendations of the Task Force on Climate-Related Financial Disclosures' (2017) 10.

[48] FRC, 'Financial Reporting Council: 3-Year Plan, 2022-2025' (2022) 12 <https://www.frc.org.uk/getattachment/50d6616f-e43d-49ad-9916-a9f03f0e49a9/FRC-3-Year-Plan-2022-25.pdf> accessed 11 April 2022.

[49] The study on Global Climate Risk Disclosure includes more than 1,100 companies across 42 jurisdictions (including the UK, India) in the assessment so broadening the size and geographical scope of the sample (as identified by the TCFD recommendations). See 'Climate Risk Disclosure Barometer' (*Ernst & Young* 2021)

in the UK have the most advance reporting, scoring 94% on coverage and 66% on quality of reports.[50] The EY linked the high performance of the UK in climate change disclosure to the maturity of the UK market and active shareholders and investors.[51] However, even in the UK where the coverage is near universal, there is still scope for improvement in the quality of disclosures.

The current approach to stakeholder protection in India is also largely disclosure-based. Section 134(3)(o) mandates all companies under the threshold in section 135 to disclose their CSR activities in the Board's report. Section 135(4) mandates every company qualifying under section 135 to make a statutory disclosure of its CSR policy approved by the Board, the content of the policy, and the composition of the CSR Committee**.**[52] Although there is an improvement in transparency, there are sill concerns about the nature of the explanations. Companies use standard statements with severely limited content and scope – ie, boilerplate statements. [53]

The Securities and Exchange Board of India[54] ('**SEBI**') – the country's market regulator – raised NGRBC to a mainstream phenomenon in India by mandating a Business Responsibility Report ('**BRR**') on the guidelines for the top 1000 listed companies. The key areas on which reporting is required are ESG issues. Although the Indian companies disclose information on the NGRBC principles, they need to be clearer and more accurate. Companies frequently provide irrelevant details or insufficient information.[55] This creates the impression of greenwashing, that reporting is being used as a marketing tool. There is considerable scope for improvement in the quality and depth of disclosure. The overall standard is limited by the lack of a detailed and granular approach to disclosure, which also poses a challenge for stakeholder

<https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/assurance/ey-if-the-climate-disclosures-are-improving-why-isnt-decarbonization-accerlerating.pdf> accessed 14 December 2021.

[50] ibid 7.

[51] ibid.

[52] CSR Policy means a 'statement containing the approach and direction given by the board of a company, taking into account the recommendations of its CSR Committee, and includes guiding principles for selection, implementation and monitoring of activities as well as formulation of the annual action plan'. See The Companies (Corporate Social Responsibility Policy) Amendment Rules 2021, r 2(f).

[53] Singh (n 12) Pt 4.2. Several empirical studies are discussed to illustrate how companies in India perform their non-financial disclosure. The results of various studies are consulted to test compliance by companies and establish the form and quality of explanations offered for non-compliance.

[54] SEBI was established on 12 April 1992. It applies to listed companies and governs their disclosure requirements. 'Listed company' means a company which has any of its securities listed on any recognised stock exchange. The basic function of SEBI is to protect the interests of investors in securities and to promote the development, and regulate the securities market and matters connected therewith or incidental thereto. See 'About SEBI' (SEBI) < https://www.sebi.gov.in/about-sebi.html> accessed 5 December 2022 . See also Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations 2015, s 3 and Ch 2; The Companies Act 2013 s 2 (52).

[55] Singh (n 12)

engagement. The BRR has recently been replaced by Business Responsibility and Sustainability Reporting (‘**BRSR**’). There is strong momentum for continuing reform in India which can help the country achieve adequate regulation of stakeholder protection by integrating stakeholder interests as part of the decision-making process.

There is a clear disconnect between what directors do and what they say. Although the high compliance with disclosure requirements in the UK informs stakeholders to some extent there is room for improvement, the disclosure in CSR and BRR reports is incomplete.Companies provide only brief statements or short sentences to illustrate the application of the NGRBC principle, rather than offering a detailed and relevant description in their reports. This shortcoming can be ascribed to India’s limited regulation, lack of stakeholder awareness, and the lack of audit or verification of information. There is, therefore, an urgent need to increase transparency in terms of how directors make decisions, which disclosure alone is unable to meet. Stakeholder interests are largely marginalised, and disclosure is unable to allow them an entry point to decision-making.

D. Comparative Analysis

Overall, the framework in India concentrates on socio-economic development to enable the stakeholders to take part and benefit from India’s economic progress. The focus is on protecting its external stakeholders, for example, the society and the community, through a philanthropic approach to CSR. Considerable focus on section 135 implies a traditional (philanthropic) understanding and failure to offer a holistic view of CSR. Thus, India’s approach is prescriptive and outcome orientated in the sense that it should assist and contribute to the country’s national agenda of inclusive development and help address India’s various developmental challenges.

In the UK, the emphasis is on protection of employees, especially if one considers the UKCGC, where employee (workforce) engagement mechanisms are recommended. The regulatory regime adopted by the UK is hybrid, incorporating elements of both hard law and soft law, with a focus on disclosure and decision-making by company directors. The directors have been provided with a flexible framework, giving them flexibility in making policies and strategy for the company. It sets a direction for directors to establish a long-term sustainability culture in order to better understand stakeholders’ needs and expectations. The UK’s approach is more closely aligned with ESG investing, mainly due to the influence of the EU regulations on the UK. The ESV approach adopted by the CA 2006 also considers shareholder interests to be a priority in the process of decision-making.

In conclusion, the comparative discussion shows that: Assuming directors are acting in good faith in the best interests of the company, the discretionary powers they have in both jurisdictions under review are sufficiently broad to enable them to promote CSR goals. Overall, the regulatory frameworks, despite their differences, do not prevent directors from considering stakeholder interests and integrating the externalities. However, directors' duties have not had a significant practical impact on their behaviour.Changes are required to support a corporate governance framework of stakeholder inclusivity, where a balance in the distribution of wealth and power is established. Disclosure increases transparency by informing stakeholders on various social and environmental issues. However, it has its limitations. It is unable to give stakeholders an entry point to the decision-making process. Several reforms are required in both countries to establish an accountable framework for better stakeholder protection. The article argues that there is no single method of achieving the CSR goals.It is suggested that substantive duties must be supplemented by mechanisms that aid in achieving the desired outcome.

The next section analyses the various potential techniques to protect stakeholder interests under the theme 'process v substance'. It argues that the wide discretion afforded to directors under the substantive duty has marginalised stakeholder interests. For a more transparent and accountable framework, there is a need to implement the substantive duty through complementary mechanisms that focus on the process of decision-making. The article aims to contribute positively to the debate on 'substance v process' from a company-law perspective. The discussion on the different approaches to regulation is new to the CSR field, despite its long-standing prevelance in legal thinking.[56] Therefore, it has the potential to offer valuable insights by distinguishing between the two aspects of regulation and what they mean in the context of stakeholder protection.

III. SUBSTANCE v PROCESS

Firstly, the meaning of 'substance' and 'process' as understood in this article is discussed and the importance of each aspect in the context of stakeholder protection is evaluated. The

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[56] For example, see discussion of 'Goals-Based and Rules-Based Approaches to Regulation' BEIS 67; Colleen George and Maureen G Reed, 'Revealing Inadvertent Elitism in Stakeholder Models of Environmental Governance: Assessing Procedural Justice in Sustainability Organizations' (2017) 60 Journal of Environmental Planning and Management 158; Iris HY Chiu and Roger Barker, 'Submission to The Business Skills and Innovation Commons Select Committee: Corporate Governance Inquiry' [2016] Centre for Ethics and law; Lori Snyder Bennear, 'Are Management-Based Regulations Effective? Evidence from State Pollution Prevention Programs' (2007) 26 Journal of Policy Analysis and Management 327.

potential role of process-based regulation as a way of achieving the desired outcomes in the two jurisdictions is highlighted. The possible reform proposals for improving the current regulation in the UK and India are then discussed. The importance of articulating corporate purpose and embedding it in the regulation of CSR is also discussed, followed by an evaluation of due diligence and stakeholder engagement mechanisms that can be adopted by companies to better protect stakeholders.

There are various ways by which stakeholder interests can be protected – ie, the focus can be on the substantive aspect or the procedural aspect (process). These two terms may represent two distinct but related categories.[57] It is important to understand the meaning and advantages and disadvantages of both aspects. The table below summaries the differences.

Table 1: Differences between substance and process

Substance (directors' duties)	**Process (Decision-making)**
'What' goals are to be achieved	'How' to achieve those goals
Outcome oriented – sets goals	Focus on the internal system and process
Flexibility – Directors have room to use their discretion	Prescriptive[58] – constrains or controls on discretion
Application – where directors are generally more responsible	Can be applied where change in behaviour is required
Black-box method of decision-making	Increases transparency in board's decision-making
Certainty of outcome is unknown	Certainty of outcome is unknown
Enforceable	Cannot be enforced

[57] Albert Kocourek, 'Substance and Procedure' (1941) 10 Fordham Law Review 157, 160.
[58] Cristie L Ford, 'New Governance, Compliance, and Principles-Based Securities Regulation' (2008) 45 American Business Law Journal 1, 5.

The substance-focused provisions are concerned with 'what' goals are to be achieved, whereas the process is concerned with 'how' to achieve those goals.[59] The substantive aspect aims at achieving the right outcomes andgives directors space to apply their judgement.[60] For example, sections 172(1) of the CA 2006 and 166(2) of the CA 2013 allow directors a wider discretion in integrating stakeholder interests by stating 'what' directors are required to do – i.e., consider the interests of stakeholders in their decision-making processes.[61] In addition to the pluralist approach adopted under section 166(2), the Indian Act introduced a code for independent directors which stresses the need for them to safeguard and balance the diverse and often competing interests of all stakeholders – but without guiding them on how to do so.

The substantive aspect relies on broadly stated rules when setting the standards by which directors must conduct their business.[62] It defines what directors must do and gives them flexibility to act in what they believe to be the best interests of the company as a separate entity. It places greater reliance on directors by giving them the responsibility and discretion to ensure that the outcome is achieved. A director as a fiduciary must have some scope to exercise discretion[63] in making tactical decisions, one of the key elements of decision-making power.[64] Decision-making power does not mean coercion or that directors have direct control over others.[65] It means that directors have a choice in making decisions, the consequences of which affect others significantly. This type of power gives rise to a need for justification and forms the basis for companies acting in the public interest.[66]

Disclosure aims to increase transparency by requiring directors to disclose information about the stakeholders' non-financial issues.[67] Directors get a chance to explain their decisions which

[59] As pointed out by Panagopoulos, 'the matters of procedure are concerned with manner, whereas matters of substance are concerned with matter'. See George Panagopoulos, 'Substance and Procedure in Private International Law' (2005) 1(1) Journal of Private International Law 69 71.
[60] The desired outcome in the CSR context is a balanced consideration of the interests of all stakeholders in the decision-making process by directors.
[61] Chalaczkiewicz-Ladna (n 6) 2.
[62] Julia Black and others, 'Making a Success of Principles-Based Regulation' (2007) 1 Law and Financial Markets Review 191, 191.
[63] Discretion implies the possibility of choice, which in turn calls for the exercise of judgement. See: HLA Hart, 'Discretion' (2013) 127 Harvard Law Review 652, 656.
[64] JE Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (OUP 1995) 10.
[65] ibid.
[66] However, these powers are constrained in various ways- eg, government, consumer, and community pressure that limits and shapes the decision making. Several non-legal constraints such as market forces, reputational concerns, and social or moral norms can influence the exercise of a discretion. Social norms are often a product of values system shaped by many influences across time. See: ibid
[67] The main aim of disclosure is to increase transparency by providing information once decisions have been made It, therefore, does not necessarily form a part of the decision-making process.

provides a more level playing field for stakeholders to make an informed decision while facilitating stakeholder engagement. However, information is currently provided after the decisions have been taken,allowing stakeholders no point of access to the Board's decision-making process. It therefore, does not necessarily form a part of the decision-making process. While disclosure is a procedural mechanism, it is distinguished from the 'process' as it does not allow stakeholders an entry point in the decision-making process. There is often limited transparency as it is common practice for directors to greenwash their reports.[68]

There is no way of knowing how directors arrive at a particular decision. Directors have been given flexibility under their substantive duties to make decisions for the success of the company. However, there is no way of knowing how directors act and more importantly from the stakeholders' perspective, what they do not do. Stakeholder interests have been marginalised by the flexibility afforded to directors to make decisions. Giving too wide a discretion can create an opportunity for directors to be biased towards shareholders or advance their own interests at the expense of stakeholders. This means that for greater transparency and board accountability, the 'black-box' of decision-making must be opened[69] to allow control over the factors that contribute to effective decision-making. There is a need to extend recognition[70] and its importance to different types of stakeholders on which companies depend for their wealth creation. The narrow legal and ideological construct of the modern corporation has resulted in undue emphasis on the importance of managerial talent and shareholder investment,impacting stakeholders and companies' performance negatively.[71] While it is important that directors have a measure of discretion in making corporate decisions, there is a need for greater transparency as regards <u>how directors make decisions</u>. The process-focused provisions consider the descision-making process of the board, i.e., the steps and the way board make its corporate decisions as opposed to the substantive aspect, which is linked to the duties of directors. It deals with the internal decision-making process, i.e., how directors integrate stakeholder interests and how they are allowed to participate meaningfully in board decision-

[68] Singh (n 12) Ch 4.
[69] The board's decision making can be compared to a black box where the process of how a decision is actually made is opaque and whether directors integrate the relevant interests is unknown, See: (n 6) 2.
[70] Recognition means right to participate in the director's decision making. See discussion in Singh (n 12) Ch 4 Pt 2.2.
[71]Ideological construct here refers to contractarian ideology (law and economics theory) of the corporation which underlies shareholder primacy. See Stephen Bottomley, 'From contractualism to constitutionalism: A framework for corporate governance' (1997) 19(3) The Sydney Law Review 277; Iris HY Chiu and Roger Barker, 'Submission to the Business Skills and Innovation Commons Select Committee: Corporate Governance Inquiry' (2016) Centre for Ethics and Law 6.

making. Thus, it brings greater clarity to the process of decision-making and the asymmetries in power dynamics company governance.

A. Corporate Purpose and Remuneration

Corporate purpose in the two countries already allows integration of stakeholder interest.[72] Nevertheless, the fact that directors are permitted to consider various social and environmental factors in their decision-making process is not an adequate way of promoting CSR. For CSR to be effectively embedded in the corporate policy, the board ought to ensure that the consequences of the company's operations have been considered in determining its policies and practices. The board should take responsibility for defining the company's purpose and demonstrate commitment to shaping, monitoring, and overseeing the culture that supports long-term sustainability and limits unethical business practices.[73] To safeguard the purpose, it should be clarified and embedded in the governance or constituting documents of a company.[74] MacNeil and Esser propose a broadly drafted purpose provision which states that directors should act in a sustainable manner.[75] This provision should also be linked to section 172, which requires more than a purely subjective consideration of stakeholder interests. A 'say on purpose'[76] provision by shareholders can be achieved through majority voting.

Compared to the UK, India has adopted a broader corporate purpose under section 166(2). Similar to company law in the UK, Indiaincludes no express statement of corporate purpose. A potential change to the 'objects clause' of the company could be linked to a 'say on purpose' for shareholder voting.[77] Purpose can be made explicit in an objects clause so that directors are under a duty to comply.[78]

[72] Mayer describes corporate purpose as the aspirational vision of 'solving problems profitably' and it is associated with creating shared value for all and profits are legitimate only when earned without harming anyone. See: Colin Mayer, 'The Future of the Corporation and the Economics of Purpose' [2020] Journal of Management Studies 16 <https://onlinelibrary.wiley.com/doi/10.1111/joms.12660> accessed 24 March 2021. Davies argues that section 172 of the CA 2006 does not prevent companies from adopting broader purposes and that it gives a wide discretion to the board over the setting of policies. See: Paul L Davies, 'Shareholder Voice and Corporate Purpose: The Purposeless of Mandatory Corporate Purpose Statements' [2022] SSRN Electronic Journal 36 <https://www.ssrn.com/abstract=4285770> accessed 11 January 2023.
[73] Jeroen Veldman and others, 'Corporate Governance for a Changing World Report of a Global Roundtable Series' (2016) Frank Bold and Cass Business School 11.
[74] ibid 24.
[75] MacNeil and Esser (n 4) 36.
[76] ibid.
[77] In UK company law s 31(1) of the Companies Act 2006 allows companies to have an objects clause.
[78] MacNeil and Esser (n 6) 29 recommend the objects clause to be entrenched so that shareholders cannot create a hurdle for future changes. See too Companies Act 2006, s 22(1).

These changes will promote the implementation of a broader purpose in the business and be shielded from any inconsistent shareholder proposal.[79] The broader purpose should also be reflected in the director's remuneration and incentive plan, which currently does not encourage the promotion of long-term sustainability. In the UK, it has been highlighted that the structure of executive pay (which is dominated by incentive-based elements) and the weakness of remuneration committees work against a company's long-term sustainability.[80]

Linking ESG issues and the incentive structure can be relevant. It is also important to focus on stakeholder outcomes and the company's impact on society and the environment.[81] To promote long-term shareholdings by executive directors, the UKCGC has extended the holding periods for share options from a minimum of three years to five years.[82] Further, the UK director's remuneration report quoted or registered companies with more than 250 UK employees must contain pay ratio (CEO pay to the average pay of their UK workforce) information annually.[83] Giving directors long-term incentives – eg, allowing them to own a long-term share in the business to ensure their horizons extend beyond their tenure – can be appealing in this context. The long-term goals should be supplemented by annual incentive objectives as intermediate milestones to acknowledge progress toward the long-term outcomes.[84] Targets and incentive pay-outs should be related to the purpose of the company.[85] Aligning managerial interests with companies' purposes can establish accountability to a range of stakeholders.[86] This will send a signal about the company's priorities both within the business system and to all the stakeholders and ensure that the CSR culture drives the company.[87] To have a strategic approach towards this process, the International Corporate Governance Network ('**ICGN**') recommends linking environmental or social responsibility pay metrics to the ESG goals

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[79] Veldman(n 72) 24.
[80] BEIS, *Executive Rewards: Paying for Success: Eighteen Report of Session 2017–19* (2019) 3 <https://publications.parliament.uk/pa/cm201719/cmselect/cmbeis/2018/2018.pdf> Accessed on.
[81] The focus of ESG is more on the way social and environmental risks affect company's performance, but CSR focuses on the impact of company's operations on the stakeholders. For stakeholder protection it is crucial to keep this difference between CSR and ESG in mind.
[82] The UK Corporate Governance Code, Provision 36.
[83] The Companies (Miscellaneous Reporting) Regulations 2018, Reg 17.
[84] Seymour Burchman, 'A New Framework for Executive Compensation' (*The Harvard Law School Forum on Corporate Governance*, 13 March 2020) <https://corpgov.law.harvard.edu/2020/03/13/a-new-framework-for-executive-compensation/> accessed 30 May 2021.
[85] ibid.
[86] 'Principles for Purposeful Business' (Year) 23 <https://www.thebritishacademy.ac.uk/documents/224/future-of-the-corporation-principles-purposeful-business.pdf> accessed 20 May 2021.
[87] 'Bringing ESG into Executive Pay' (*PWC* 2020) 5 <https://www.pwc.co.uk/human-resource-services/pdf/bringing-esg-into-executive-pay-v3.pdf> accessed 17 May 2021.

already prioritised by the company. The reporting frameworks that provide ESG metrics can be used as targets for this purpose

This notwithstanding, governing directors' incentives through remuneration remain a challenge in India with a study by Refinitiv showing that only 8% of Indian firms have a policy on ESG-related executive remuneration.[88] Lack of regulation in this area limits ESG integration metrics to minority companies, slowing down business transition to long-term sustainability.[89] In many instances directors' remuneration does not include variable or performance-based payments.[90] As a starting point in India, regulators should make linking LTIP and ESG issues mandatory and provide guidance in understanding the provisions, in the interests of stakeholder protection. Further, the overarching purpose should be supported by a mandatory due diligence duty to permit stakeholders to participate in the decision-making process. The next section analyses due diligence as a mechanism to protect stakeholder interests in the context of '*process v substance*'.

B. Due Diligence

Due diligence is a 'bundle of interrelated processes to identify actual and potential adverse impacts with respect to the companies' operations on workers, the environment, human rights, their supply chains, and other business relationships'.[91] The globally recognised instruments encouraging companies to put due diligence mechanisms in place, are the OECD Due Diligence Guidance for Responsible Business Conduct, OECD Guidelines for Multinational Enterprises,[92]I the UNGP on Business and Human Rights,[93] and the Tripartite Declaration of

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[88] Ashley Coutinho, 'Only 8% Indian Firms Have ESG-Related Compensation Policy: Refinitiv' *Business Standard India* (14 October 2020) <https://www.business-standard.com/article/markets/only-8-indian-firms-have-esg-related-compensation-policy-refinitiv-120101400060_1.html> accessed 17 May 2021.

[89] Directorate-General for Justice and Consumers (European Commission) and EY, *Study on Directors' Duties and Sustainable Corporate Governance: Final Report* (Publications Office of the European Union 2020) 109. <https://data.europa.eu/ doi/10.2838/472901> accessed 18 June 2022.

[90] For example, in the NSE and SES studies of 50 companies for FY 2018-19, only 37% of the total EDs' remuneration consisted of variable performance-based remuneration. See 'ESG Analysis on 50 Listed Companies in India 2020' (*SES, NSE* 2020) 57 <https://www.sesgovernance.com/pdf/home-reports/1594458276_ESG-Analysis-on-50-Listed-Companies-in-India_2020.pdf> accessed 29 September 2021.

[91] 'OECD Due Diligence Guidance for Responsible Business Conduct' (*OECD* 2018) 15 <http://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf?_ga=2.37488864.1343405047.1620926589-1678981573.1620926589> accessed 2 February 2021; OECD, *Guidelines for Multinational Enterprises* (2011) 20.

[92] OECD (2011), =(n 90).

[93] 'UN Human Rights Council, 'Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework' (*HR/PUB/11/04*, 2011) <https://www.ohchr.org/ documents/publications/guidingprinciplesbusinesshr_en.pdf> accessed 16 July 2019.

Principles Concerning Multinational Enterprises and Social Policy introduced by the ILO.[94] These initiatives are an important part of the regulatory framework but remain ineffective in holding multinational companies responsible for violations of environmental and human rights.[95] The continuing reports about violations of social and environmental standards set by these frameworks, signal voluntary due diligence progress in preventing and mitigating the adverse impact on stakeholders, as inadequate.[96]

Recognising the limitations of voluntary due diligence, the EU has recently proposed a corporate due diligence and corporate accountability initiative (ESG Due Diligence Law), which will require companies to have an ongoing dynamic due diligence process covering the adverse impacts on the ESG areas.[97] It stresses transparencythe need to establish procedures for stakeholder engagement the imposition of sanctions depending on the severity of the case, and the establishment of a grievance mechanism that can provide effective early-stage recourse.[98] The proposal on the Directive on Corporate Sustainability Due Diligence ('**CSDD**'), released in February 2022, aims to make due diligence mandatory. It introduces duties for directors to set up and oversee the implementation of the due diligence processes and integrate it in their corporate strategy.[99] The enforcement is through administrative supervision and civil liability.[100] It also mandates disclosure in line with the Paris Agreement's 1.5°C limit on global warming.[101] The proposal introduces control over remuneration, which requires linking the variable remuneration and the contribution of a director to the company's business

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[94] 'Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy' (Year) <https://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---multi/documents/publication/wcms_094386.pdf> accessed 16 July 2019.

[95] 'European Parliament Resolution of 10 March 2021 with Recommendations to the Commission on Corporate Due Diligence and Corporate Accountability' (2020/2129(INL))' 10 <https://www.europarl.europa.eu/doceo/document/TA-9-2021-0073_EN.pdf> accessed 3 August 2021.

[96] The Global Estimates of Modern Slavery and Child Labour 2017 found that over the five-year period from 2012 to 2016, 89 million people were victims of modern slavery, largely in private companies. See ILO, *Global Estimates of Modern Slavery: Forced Labour and Forced Marriage* (2017) 25 <https://www.alliance87.org/global_estimates_of_modern_slavery-forced_labour_and_forced_marriage.pdf> accessed 3 August 2021.

[97] Richard *Sterneberg* and others 'The European Commission's New Approach to ESG Due Diligence and Corporate Accountability | Insights | DLA Piper Global Law Firm' (*DLA Piper*, 25 March 2021) <https://www.dlapiper. com/en/belgium/insights/publications/2021/03/the-european-commissions-new-approach-to-esg/> accessed 3 August 2021.

[98] 'European Parliament Resolution of 10 March (n 237) 14–15. Stakeholder engagement is arguably the key to effective due diligence. See OECD, 'Due Diligence Guidance for Responsible Business Conduct' (2018) 16–19 <https://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf>.

[99] 'Directive of The European Parliament and of the Council on Corporate Sustainability Due Diligence and Amending Directive (EU) 2019/1937' 4 <https://eur-lex.europa.eu/resource.html?uri=cellar:bc4dcea4-9584-11ec-b4e4-01aa75ed71a1.0001.02/DOC_1&format=PDF> accessed 15 May 2022.

[100] ibid art 41.

[101] ibid art 15.

strategy,long-term interests, and sustainability.[102] This effort may shelter directors from shareholders' influence and bring a change in the balance of power between the shareholders, other stakeholders and directors. The proposal aims to translate soft recommendations of the international organisations such as the UN and the OECD into hard law requirements.However,it is vague in terms of setting the target where climate change is identified as a 'principal risk' for the company's operations.[103] This notwithstanding, when implemented at national level, the proposals may indeed be more specific and include relevant rules.[104] The mandatory disclosure requirement may enable standardisation and comparability. It is expected that with the implementation of mandatory due diligence, the cost of compliance will increase depending on several factors such as sector, type of activity, and the risk that the company generates.[105] However, it would also increase a company's performance, potentially leading to increased profitability across Europe and positive outcomes for stakeholders.[106]

In its response to the EU, the ICGN recommends the regulation of due diligence through a principle-based approach over a mandatory due diligence duty.[107] Implementation through hard law regulations may become prescriptive and lead to tick-box compliance.[108] However, as is clear from the discussion above, the voluntary approach to due diligence has been ineffective in guaranteeing a level playing field. Further, the efficacy of disclosure as a regulatory approach is questioned.[109] It is often considered to be a weaker option in regulating the issue, especially when targeting social issues.[110] For example, , section 54 of UK's Modern Slavery Act 2015 ('**MSA**'), which is based on mandatory disclosure, is considered to be unsuccessful. This highlights tick-box compliance and the weakness of voluntary due diligence. It is

[102] ibid art 41.
[103] Wolf-Georg Ringe, 'Net-Zero Plans under the Proposed CSDD' (*Oxford Business Law Blog*, 28 April 2022) <https://www.law.ox.ac.uk/business-law-blog/blog/2022/04/net-zero-plans-under-proposed-csdd> accessed 10 May 2022.
[104] Guido Ferrarini, 'Corporate Sustainability Due Diligence and the Shifting Balance between Soft Law and Hard Law in the EU' (*Oxford Business Law Blog*, 22 April 2022) <https://www.law.ox.ac.uk/business-law-blog/blog/2022/04/corporate-sustainability-due-diligence-and-shifting-balance-between> accessed 11 May 2022.
[105] European Parliament, Directorate General for Parliamentary Research Services, 'Corporate Due Diligence and Corporate Accountability: European Added Value Assessment.' (*Publications Office* 2020) 62 <https://data.europa.eu/doi/10.2861/594198> accessed 30 April 2021.
[106] 'European Parliament Resolution of 10 March 2021 with Recommendations to the Commission on Corporate Due Diligence and Corporate Accountability (2020/2129(INL))' (n 94) 64.
[107] ICGN, 'ICGN Comment Letter-European Union (EU) Sustainable Corporate Governance Consultation' (8 February 2021) 10 <https://www.icgn.org/sites/default/files/3.%20ICGN%20 response%20to%20 Sustainable%20Governance%20EU%20Consultation%202021.pdf> accessed 30 April 2021
[108] ibid 4–5.
[109] ***See*** discussion in 0 for evaluation of disclosure as a technique to protect stakeholders.
[110] Barnali Choudhury and Martin Petrin, *Corporate Duties to the Public* (CUP 2018) 85.

criticised as non-stringent, vague, and generic,[111] with no strong enforcement mechanism. The companies are merely required to provide statements in relating to slavery and human trafficking, with not much detail about the steps taken to tackle modern slavery.[112] The UK also has the Bribery Act 2010,[113] (‘**UKBA**’) which establishes extra-territorial, corporate criminal liability for bribery in global supply chains. Section 7 creates a corporate offence of ‘failure to prevent’ bribery,establishing strict liability[114] for companies and partnerships that fail to prevent bribery.[115] Under the UKBA, criminal liability, including fines, can be imposed on a director even where he or she was unaware of the bribery. Further, a director may even be disqualified for up to 15 years under section 2 of the Company Directors Disqualification Act 1986. The UKBA requires companies to have adequate procedures designed to prevent associated persons from undertaking such conduct. Companies however, have a statutory defence if they have adequate procedures.[116]

The ‘failure to prevent’ model is currently under consideration with the ‘failure to prevent’ liability model for due diligence. This was first proposed in 2017 by the Parliamentary Joint Committee on Human Rights (‘**JCHR**’).[117] It is expected to bring legal certainty, clarity in human rights obligations, and a level playing field to align the current legal landscape with standards set by the UNGP.[118] Introduction of a failure-to-prevent mechanism for human rights harm as a form of strict liability may be considered as progress in the scope and sanctioning of

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[111] Genevieve LeBaron and Andreas Rühmkorf, ‘The Domestic Politics of Corporate Accountability Legislation: Struggles over the 2015 UK Modern Slavery Act’ (2019) 17 Socio-Economic Review 709, 728.
[112] UK Joint Committee on Human Rights, ‘Human Rights and Business 2017: Promoting Responsibility and Ensuring Accountability, Sixth Report of Session 2016–17’ (2017) 38 <https://publications. parliament.uk/pa/jt201617/jtselect/jtrights/443/443.pdf> accessed 9 May 2022.
[113] The Bribery Act 2010 came into force on 1 July 2011. See ‘Bribery Act Guidance’ (*Serious Fraud Office*) <https://www.sfo.gov.uk/publications/guidance-policy-and-protocols/bribery-act-guidance/> accessed 12 May 2022.
[114] Companies can be found guilty of the offence if the bribery is carried out by an associated person such as an employee or an agent. Strict liability exists when ‘defendant is liable for committing an action, regardless of what his/her intent or mental state was when committing the action’. See ‘Strict Liability’ <https://www.law.cornell.edu/wex/strict_liability> accessed 30 April 2022
[115] Associated person in terms of section 8 of the UKBA includes employees (who are presumed to be performing services for their employer), agents, and subsidiaries. Section 8(4) is wide enough to include the whole range of persons connected to an organisation who might be capable of committing bribery on the organisation’s behalf. Bribery Act 2010 section 8(4); ‘The Bribery Act 2010 - Guidance’ 45, para 37.
[116] The burden of proof falls on the companies to show that they have adequate procedures in place to prevent bribery. Adequate procedures, according to the UKBA Guidance. Adequate procedures, according to the UKBA Guidance, is based on six flexible and outcome-focussed principles . Bribery Act 2010, s 7(2). The guidance is issued by the Ministry of Justice. See ibid [9]; ‘The Bribery Act 2010 - Guidance’ (n 114). As the ‘failure to prevent’ is paired with the statutory defence of adequate procedure, it creates an incentive for directors to monitor it carefully.
[117] UK Joint Committee on Human Rights (n 111) 6.
[118] Irene Pietropaoli *et al,* A UK Failure to Prevent Mechanism for Corporate Human Rights Harms’ (BIICL 2020) 68 <https://www.biicl.org/documents/84_failure_to_prevent_final_10_feb.pdf> accessed 29 December 2022.

the MSA, potentially increasing the accountability of directors and senior managers. Together with the due diligence requirement, the 'failure to prevent' mechanism is likely to affect the decision-making of directors as well as the reporting requirements of the company.[119] The understanding of the material risk is likely to include risks to rights-holders and companies.[120]

The need for due diligence is emphasised in section 135 of CA 2013. It is recommended to apply a due diligence mechanism to the company's CSR activities and the Implementation Agencies ('**IAs**').[121] Companies can implement their CSR policies by engaging IAs, but such IAs should have established track records of at least three financial years in undertaking similar activities.[122] IAs effectively execute the CSR programs as they have the necessary skills and in-depth knowledge of the social conditions in the local area. However, there are a number of fraud and money-making organisations indulging in unethical practices.[123] Hence, it is important to identify the correct IAs. It was noted by the High-level Committee on CSR ('**HLC**') that it is the responsibility of the board to conduct a due diligence of IAs.[124] However, the EY conducted a survey of 100 CSR executives in India and found that only 45% of companies had taken any steps to check their past records.[125] The survey also revealed fraud and unethical practices in CSR programmes and found financial misrepresentation of CSR funds (33%), fraud in procurement of goods and services (34%), and the diversion of funds (30%).[126] To help companies identify the appropriate TA's and put a suitable check on the CSR activities in place, the High-Level Committee said that the MCA can maintain a register of Implementation Agencies.[127] Currently, the MCA does not maintain the data of IAs

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[119] ibid 34.

[120] According to Principle 17 of the UNGP, 'Human rights due diligence can be included within broader enterprise risk- management systems, provided that it goes beyond simply identifying and managing material risks to the company itself, to include risks to rights-holders'.

[121] According to the CSR Policy Rules, 2014,Rule 4(1), companies can undertake CSR activities through an eligible entity called the Implementing Agencies. The Companies (CSR Policy) Amendment Rules, 2022 (CSR Policy Amendment Rules) has widened the class of entities that can be engaged as IAs.

[122] CSR Rules 2014, Rule 4

[123] EY, 'Weak Governance and Lack of Due Diligence Pose a Grave Risk to CSR Programs: EY Survey' (2020), <https://www.ey.com/en_in/news/2020/05/weak-governance-and-lack-of-due-diligence-pose-a-grave-risk-to-csr-programs> accessed 18 February 2023.

[124] MCA, *The Report of the High-Level Committee on Corporate Social Responsibility* (2019) 77; MCA, 'The Report of the High-Level Committee' (2015) 25 <https://www.mca.gov.in/Ministry/pdf/HLC_report_05102015.pdf> accessed 30 April 2021.

[125] EY, 'Corporate Social Responsibility in India: Re-Engineering Compliance and Fraud Mitigation Strategies- Forensic & Integrity Services' (2020) 5 <https://www.ey.com/en_in/forensic-integrity-services/how-can-companies-integrate-ethics-in-corporate-social-responsibility-programs-to-mitigate-fraud-risks> accessed 30 April 2021.

[126] 'Weak Governance and Lack of Due Diligence Pose a Grave Risk to CSR Programs: EY Survey'(Publisher, Year) <https://www.ey.com/en_in/news/2020/05/weak-governance-and-lack-of-due-diligence-pose-a-grave-risk-to-csr-programs> accessed 24 April 2022.

[127] MCA (n 123) 77.

involved in CSR activities. However, the recent amendment of CSR Rules makes the registration of IAs mandatory.[128] This is a welcome step as it may help companies to stop fraud or unsuitable IAs. Making a wrong choice of IAs can significantly affect the stakeholders as they may not be able to access the benefits of the CSR programs. But for the success of section 135, conducting a due diligence process is crucial to assessing the IA's ability to execute CSR programmes. The CSR Committee should move beyond tick-box compliance and actively monitor, so as to identify, mitigate,and assess the impact of riskson stakeholders.

From the above discussion, it can be said that in both India and the UK, there is a need to establish a higher standard for companies to prevent corporate abuse and irresponsible behaviour. The impact of shareholder primacy is exacerbated by a loophole in the regulation of transnational corporate groups and the limited capacity of traditional corporate control mechanisms.[129] Therefore, there is a need to put in place comprehensive ESG due diligence process.[130] The existing regime in the two jurisdiction is limited in scope and unable to achieve the desired outcomes for stakeholders. There is a need to reform the regulatory framework and rely more heavily on a mandatory approach in this context. This will overcome the tendency of directors to priorities shareholder valuein absence of a legal requirement to do so. The duty to conduct due diligence can be implemented either through the substantive aspect or the procedural aspect. If a substantive duty is created in relation to the due diligence mechanism, potential difficulties may arise in relation to enforcement by stakeholders. Due diligence, however, may be regulated similarly to section 172 of CA 2006 so that it can only be enforced by shareholders to the exclusion of other stakeholders.[131] Due diligence, coupled with a failure-to-prevent mechanism's requirements, will potentially broaden the scope of consideration of stakeholder interests and engagement. Implementing the due diligence duty will provide legal certainty as regards directors' duties and assist in addressing the shareholder primacy norms.[132]

[128] '60% of Total CSR Expenditure Done through Implementing Agencies, Data of NGOs Not Maintained by MCA' (*India CSR Network*, 6 April 2021) <https://indiacsr.in/60-of-total-csr-expenditure-done-through-implementing-agencies-data-of-ngos-not-maintained-by-mca/> accessed 18 June 2021.

[129] Justine Nolan, 'Refining the Rules of the Game: The Corporate Responsibility to Respect Human Rights' (2014) 30 Utrecht Journal of International and European Law 7, 7; Kamil Omoteso and Hakeem Yusuf, 'Accountability of Transnational Corporations in the Developing World: The Case for an Enforceable International Mechanism' (2017) 13 Critical Perspectives on International Business 54.

[130] John Gerard Ruggie and Emily K Middleton, 'Money, Millennials and Human Rights: Sustaining "Sustainable Investing"' (2019) 10 Global Policy 144, 144.

[131] Methods of enforcement can be through public monitoring, a non-judicial body with a right of review over corporate acts, an ombudsman, or OECD's NCP. See Choudhury and Petrin (n 109) 238.

[132] Beate Sjafjell, 'Company Law: The Corporate Board and Mandatory Sustainability Due Diligence' (*Human Rights and the Environment Blog*, 24 May 2021) <https://novabhre.novalaw.unl.pt/company-law-corporate-board-mandatory-due-diligence/> accessed 8 March 2022.

As an initial step, companies should be asked to undertake a risk assessment and implement a due diligence strategy.[133] Having a due diligence process will also open the door for directors to engage with stakeholders,making a genuine effort to monitor the stakeholders' concernsand finding ways of mitigating them.

C. Stakeholder Engagement

A stakeholder engagement mechanism is an *ex-ante* form of accountability as it has a preventive or precautionary effect on decision-making.[134] It shapes the content of decisions, important for stakeholder protection, especially when it is difficult to evaluate the outcome which may only emerge in the long term or where the decisions are not easy to assess. Recognition, participation, and strengthening the capabilities of stakeholders are important elements in addressing sustainability issues.[135] 'Recognition' refers to the 'formal acknowledgement of the right to participate in decision-making processes'[136] through various mechanisms such as board committees or appointment of a director from a key stakeholder group. 'Participation' refers to active involvement of stakeholders in decision-making by providing them with opportunities to influence outcomes through their ideas, feedback, perspectives, and values.[137] Participation opportunities must be provided in the different stages of decision-making.[138] This builds trust between a company and its key stakeholders by improving communication and transparency.[139] Participation mechanisms should be put in place to ensure that stakeholders take part in the decision-making process and then provide them with feedback on the outcome of the decisions made.[140] 'Capability' refers to the knowledge, skill, and ability of an individual or community to contribute to the realisation of

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[133] External verification of the process is also recommended along with the audit of annual report on the strategy so that stakeholders are able to trust the information provided by the companies.
[134] Keay and Loughrey (n 3) 269.
[135] George and Reed (n 55).
[136] ibid 160.
[137] Mark S Reed, 'Stakeholder Participation for Environmental Management: A Literature Review' (2008) 141 Biological Conservation 2417, 2419; Gregg B Walker and others, 'From the Forest to the River: Citizens' Views of Stakeholder Engagement' (2006) 13 Human Ecology Review 193, 194.
[138] Magnus Boström, 'A Missing Pillar? Challenges in Theorizing and Practicing Social Sustainability: Introduction to the Special Issue' (2012) 8 Sustainability: Science, Practice and Policy 3, 6.
[139] Reed (n 136) 2420.
[140] It is important for stakeholders to know how their concerns affected the decision of the board. Irene-Marié Esser and Iain MacNeil, 'Disclosure and Engagement: Stakeholder Participation Mechanisms' (2019) 30 European Business Law Review 201, 202.

a goal or the accomplishment of what is required.[141] Stakeholders must be empowered to take part in the process.[142]

The complex and dynamic nature of CSR issues demands transparent decision-making which acknowledges and engages the various stakeholders in the process. Non-financial disclosure informs the stakeholders by providing them adequate information, forming the basis for stakeholder engagement. However, this is contingent upon: *first*, regulators facilitating disclosure of non-financial issues on a mandatory basis to reduce the information asymmetry; *second*, companies disclosing sufficient relevant information on which stakeholders are able to perceive and act; and *third*, auditing reports to ensure reliability and transparency. Making non-financial disclosure mandatory in both countries appears to be a step in the right direction as it creates a level playing field for stakeholders to make an informed decision. In the UK, disclosure indeed informs stakeholders to some extent and constitutes a basis for stakeholder engagement. Disclosure in India does not inform stakeholders or constitute the basis of stakeholder engagement. However, for disclosure to be an effective tool in protecting stakeholder interests, companies must avoid vague and boilerplate statements.

Changes are needed to the Indian position as there is a lack of focus on stakeholder engagement in corporate decision-making. Stakeholder engagement must be identified as a core policy and mechanism for some form of structured stakeholder participation and must be legislated. A provision mandating reporting as part of directors' duty to strengthen stakeholder interests is required. This can be compared with the 'section 172 statement' under the UK CA and UKCGC. This should be accompanied by guidance for directors to raise awareness regarding how they should balance the various interests and integrate them in their strategy. Further, it is suggested that the BRSR framework be improved by focusing on comprehensiveness, granularity, and completeness of information from a stakeholders' perspective. The auditing and external verification of reports is necessary to provide an insight to companies ESG approach and make them avoid a tick box approach.

For a more advanced approach to section 135, stakeholder engagement is suggested through different channels such as site visits to hear the stakeholders' opinions, or through surveys or

[141] George and Reed (n 55) 161–162.
[142] This step is especially crucial in developing countries where stakeholders are not active enough as regards issues of CSR due to their lack of awareness or education. Reference here could be made to s 135 of CA 2013 where companies are required to contribute to the social and environmental issues for the stakeholders to be able to benefit from the overall community development.

feedback to provide local solutions to the stakeholders' problems. Engaging with stakeholders in the process is vital for an understanding of their needs and views, which will influence the CSR programme decisions. Although the responsibility of the CSR Committee under section 135 of the CA 2013 is restricted to formulating and recommending a CSR policy to the board, it might be appropriate to broaden their responsibility to represent the companies' wider stakeholder community on the board. The functions or responsibilities of the Committee, as recommended in this paper, is much broader than under section 135. A dedicated CSR committee can influence directors' decision-making by regularly identifying social and environmental issues relevant from a stakeholder perspective. Moreover, it can enhance CSR performance by working on innovation, different strategies, and policies to further the interests of all stakeholders. Since such committees can closely and regularly monitor stakeholder issues, it can advise the board in solving controversies between different stakeholders, or in case of trade-offs between shareholders and stakeholders. Together with the stakeholder participation mechanism, it can provide a level playing field for stakeholder engagement and thus, empower them in the governance of the company. However, it may be difficult to achieve a collective view of the directors without creating a conflict of interest in the context of directors' duties. [143] Therefore, clear guidance should also be provided on what is expected of these committees. A CSR Committee can appropriately address the problems identified above which can lead to integration of CSR in its company strategy.

Since disclosure results fall below the desired level in India, this will directly affect the level of stakeholder participation at board level. Stakeholders will not have sufficient information to enable them to participate meaningfully in decision-making.[144] Companies need to scale up their performance and, to achieve this, it is important to introduce reforms focused on process. Further, it is important that stakeholders can contribute to the process and in influencing the directors.

The UK position is considerably more positive as regards both disclosure and engagement. However,not all reports are of an equal standard. Most companies are fulling the requirement of Provision 5 but fewer companies are disclosing the outcomes or in the changes in their decision-making.[145] As highlighted above, the importance of Provision 5, from a stakeholder's

[143] Esser and MacNeil (n 139) 218.
[144] ibid 203.
[145] The evaluation of the early stages of the implementation of Provision 5 workforce showed the workforce engagement processes do not seem to be well-embedded as yet, despite the engagement tools being in place, see: Chalaczkiewicz-Ladna*l* (n 9).

perspective, is that it brings control and certainty to how decisions are made, which is lacking otherwise. However, the provision cannot yet be said to be successful as compliance requirements have not changed how directors make decisions. In this light, an '*apply and explain*' approach to disclosure may be more successful in increasing regulatory intensity than the current '*comply or explain*' approach.[146] This will still give directors flexibility in choosing the most suitable arrangements.

It is also suggested that in the UKCGC, an advisory panel, or a CSR Committee should be established, to represent the wider stakeholder cohort. Provision 5 of the UKCGC may lead to friction between the interests of the various stakeholders and raise questions as to why only the workforce deserves a seat on the board. A CSR Committee, representing all stakeholders, will be better able to manage the complex and multi-layered disclosure requirements,allocating sufficient time to discharging its duties effectively.[147] Having a separate committee for CSR may lead to an increase in regulatory intensity, which could prove more beneficial than the current framework for CSR,falling within the realm of soft law.

IV. CONCLUSION

In conclusion, the importance of this article lies in its capacity to fill a gap in comparative company law literature regarding the *content and scope of CSR*. In particular, it suggests a more meaningful and robust framework for stakeholder protection, hard law intervention, in particular as regards the duty of due diligence, stakeholder engagement, and participation mechanisms. The recommendations and proposals framed in the context of the two jurisdictions do not advocate for changes to the substantive aspects of company law. Rather, they see value in streamlining board actions and decisions through process-based regulation, that effectively integrates stakeholder interests to achieve the desired outcome. They include some key legal reforms linked to purpose, such as control on management's remuneration, the duty of due diligence, stakeholder engagement, and board committees. These mechanisms can only work if they are implemented in a way which will compel directors to pay adequate attention to and integrate stakeholder interests. At the same time, stakeholders must be vigilant

[146] ibid 27.
[147] The presence of a CSR Committee improves the quality and quantity of CSR reporting in a country. See Shayuti Mohamed Adnan, David Hay and Chris J van Staden 'The Influence of Culture and Corporate Governance on Corporate Social Responsibility Disclosure: A Cross Country Analysis' (2018) 198 Journal of Cleaner Production 820, 821.

and able to monitor conformity. Whether such process-based mechanisms will bring about the desired change in corporate behaviour is a question that only the future can answer.