

Dialogue with Narada Foundation: experiences and reflections on exploring impact investment by private foundations in China

Established in May 2007, Narada Foundation is a national private foundation approved by the Ministry of Civil Affairs. Narada Foundation always insists the mission to foster civil society, by actively building the ecosystem of philanthropy sector and promoting cross-sector collaboration as well as innovation in China. Narada Foundation is committed to building philanthropic infrastructure that fosters the growth of non-profit organizations, operating the China Effective Philanthropy Multiplier to scale up effective philanthropic products that target urgent social problems and making the concept of social enterprise more mainstream.



INTERVIEWEE:

Tan Yi

Director of social enterprise and impact investment division of Narada Foundation

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How did you and the Narada Foundation get into the field of impact investing?



In 2009, I started working with Yanni Peng (now CEO of Narada Foundation) at the British Council (BC) on the Skills for Social Entrepreneurs Training Program, helping social enterprises seek granting without expectations of returns from foundations such as Youcheng and Narada. At that time, social enterprises that participated were very small, and they could not generate good financial returns immediately. Therefore, we had been providing support in the form of financial granting. Later, Yanni and I both came to the Narada Foundation and continued this kind of work.

By 2014, BC launched a social investment platform, where investors could invest in social enterprises. As a foundation, Narada Foundation did not directly make equity investment. We launched an interest-free loan program usually with around 500,000 yuan per loan and a three-year loan period to support social enterprises. However, we terminated this interest-free loan program in 2016, when BC ended their investment platform project. Our board of directors did not think Narada had a

professional team to do this loan program. Therefore, this program only lasted for two years, during which we provided loans for only two institutions. In 2018, we invested our own capital in Yuhe Fund of EHONG Impact Capital and became one of its LPs. It was not a coincidence to support EHONG. Mr. Xu Yongguang, the chair of Narada Foundation had known Mr. Tang, the President of EHONG for a long time, and Mr. Xu thought EHONG was making impact investments. He had always been introducing the concept of impact investing to Mr. Tang, and had cited investment cases of EHONG in some speeches. In 2018, EHONG won the first-year impact investment award at the China Social Enterprise and Investment Forum. At that time, Mr. Xu and our funders wanted to drive people to pay attention to impact investing and felt that Narada should be a pioneer. Hence, the investment decision for EHONG was made immediately. We invested 50 million RMB in Yuhe Fund through two separate investments respectively in 2018 and 2019.

How does Narada understand the essential difference between impact investment and other investments?

What is the connection between impact investment of a foundation and assets preservation & appreciation?



Our exposure to impact investing started with the concepts of Global Impact Investing Network (GIIN), including the four core elements. Around 2013, more people in China started to talk about impact investing. They thought people should have goals to pursue positive impact in addition to financial returns. Recently, we have considered that impact measurement and management is a particularly important factor. Without it, impact investing would not be very different from other investments.

The investment in Yuhe Fund and previous investment in Sequoia Capital are part of our assets preservation and appreciation. But the investment in Sequoia is not based on the

consideration of impact investment. We have an investment management committee at the board level, and the investment management committee makes all decisions. Most of our previous assets were given to Sequoia, and the returns were quite good. Then we invested part of the returns in Yuhe Fund.

As far as I know, some large foundations still do some relatively more active asset management, but the majority of foundations may just put their assets in banks. For example, many domestic foundations have done asset management through banks, thinking that putting capital in banks is a particularly safe way. Especially like public foundations, they will have more consideration for liquidity and safety. However, as a private

foundation, we are under less external pressure. Our funders and Mr. Xu agree to impact investing, and then we do it. Another particularly good point is that our funder, Narada Group will donate more funds, if we have a long payback period and encounter short-term liquidity problems due to investment in private equity assets.

Narada Foundation's income comes from not only the investment but also the additional annual donation from Narada Group to cover our expenses. Therefore, I think different foundations have different asset allocation methods to preserve and increase their value, and we cannot lump different matters together.

How does Narada measure and manage the impact of its investments in Yuhe Fund?



We always think that impact measurement and management should be reflected from the beginning to the exit, which is exactly what makes impact investing different. In this regard, we have some communication with EHONG and hope they can pay more attention to impact measurement and management. Although the previous cases of EHONG were quite good, EHONG has not systematically done impact measurement and management before. Now there is some progress. After our investment, many organizations that did not know about EHONG before have gotten to know it and some foreign LPs have started to talk to EHONG. These changes have given EHONG a push to pay more attention to impact measurement and management. Our current docking with EHONG is mainly about the impact and promotion of the projects. The frequency is almost once every six months, which is not particularly intensive.

In addition, although we don't have a very clear requirement on the impact goal of Yuhe Fund, we are actually considering this matter. Narada used to fund various types of projects with large differences, and there was not a unified evaluation system. We may do evaluation on our own based on different conditions of different projects or ask a third party to do evaluation. We also want to have some communication with EHONG and even match some evaluation resources for them, hoping they can

improve the evaluation system. But overall, we don't have a clear goal, or expectation on to what extent EHONG should achieve. Because we are still learning by ourselves. Impact investing is actually a very new thing for us and not quite the same as previous charitable programs. For example, we have recently launched an introductory series of impact measurement and management. In this series, we summarize some cases and tools that are commonly used in the GIIN report, which can also be introduced to Chinese investors as a benchmark.

In terms of specific impact measurement and management tools, we actually have no specific preference now. And we are looking at one tool after another, hoping to have more cases. From the current cases, many organizations have chosen multiple different tools to make a model suiting them most. SDGs are the most used, but they are just a framework. Other tools used more are GIIN's IRIS and IFC's Nine Principles. After checking all cases, we feel that many organizations are integrating several approaches. Therefore, we hope EHONG could refer to more international tools. We don't plan to do our own model because we don't plan to invest in other new projects for the time being, and we don't need to manage impact assets directly. Hence, we don't intend to invest extra time and energy to do it.

For Narada, will you consider other investment categories besides private equity? (e.g., public funds, fixed income, etc.)



For Narada, I don't think we will consider other forms of investment at this time. However, I have recently found that some international institutions have started to explore investing in stocks in the secondary market, such as Wellington and

Blackrock. Still, I think it is quite difficult to do this in China because relevant information is not completely disclosed or is even unavailable in China. Many companies do not have formal reports, or at most only CSR reports or sustainability reports,

which only provide far from enough information for us to do impact investment in the secondary market. In addition, Chinese foundations cannot buy stocks directly in the secondary market but only make such investment via qualified brokerage institutions.

The other reason is investing in the secondary market to practice impact investing emphasizes engagement. I attended Wellington's presentation where the speaker said that investing in impact companies in the secondary market especially emphasized shareholder engagement, meaning that it's only possible to invest smaller companies. Because if the company's market capital is too large, the small investors may not have a voice and cannot effectively engage in the governance of the company. But in China, good companies in common sense are quite large. Therefore, when a public fund buys shares from them, the money certainly cannot play a role. Investment in the

growth enterprise market (GEM) might work. Of course, if you just invest in private equity, you will still encounter the problem of liquidity. Last year a vice president of the Ford Foundation mentioned that they were starting to consider the secondary market because private equity's liquidity was really a problem. I didn't feel anything at that time until recently, when the cash flow of many institutions has been affected by the epidemic. And I realized that liquidity was really a matter. However, we are not currently considering investing in public market impact targets. The Ford Foundation recently issued a social bond with a tremendous amount of value. We have discussed whether we would do that. But we think that in China, it is impossible for foundations to issue social bonds. Because foundations can't even lend money to others or borrow money from others, not to mention issuing bonds. We have different national situations.

What do you think are the obstacles related to laws and regulations when domestic foundations invest? How do the foundations respond?



A few years ago, the Ministry of Civil Affairs issued Interim Measures on Managing Investment of Value Maintenance and Appreciation of Charitable Organizations, which mentioned that charitable organizations could be LPs. But I think charitable organizations are still relatively conservative and afraid of trivial and bothering process. Despite the interim measures, in the process of implementation, some evaluation and audit agencies do not understand the policy properly and often ask various questions to the foundations. Then the foundation board would feel that it is better to avoid bothering. And in the end, they simply don't do it. There are also some foundations that do not want to take additional responsibility related to investment. After all, an investment always carries risks. Even if foundations do not have to make up the loss amount, they are likely to be held accountable, given a loss occurs.

In addition, the foundation's money comes from the donors and therefore is public property, which should be donated to NGOs. But if we invest the money in a business, it is no longer public property. Because investing money means being a shareholder. When the money, as public property is turned into private property, people will feel that there is a loss of public resources. So, there are many people on the side of NGOs who are opposed to foundations making such investments.

In addition, the policy also allows foundations to make direct equity investments in an enterprise related to the foundation's

areas. Narada foundation is fine with this stipulation. Because we do not have any specific areas, we could invest in any field. However, situations are not the same for other foundations. For example, education-based foundations may only invest in the field of education. Furthermore, although foundations are allowed to be shareholders, Narada's own investment rules do not allow us to make direct equity investments. We are also worried about related transactions and the further need to involve more energy in management. Some foundations do not make direct equity investment as a foundation but involve in investments through related investment companies to avoid some trouble.

Finally, the government likes people to help the poor and the needy, and some foundations think that it is good to follow this preference by helping the poor and the needy. They want to avoid situations where things are troublesome, and they may not get any benefit. Therefore, in general I think there is not enough motivation for foundations to make direct equity investments. Because how the value is preserved or appreciates has nothing to do with the decision makers of the foundation. However, in the opposite way, if foundations are held accountable by the public who don't understand or by the evaluation and audit agencies, it will be a big trouble for the foundations. Therefore, they would just do what everyone else accepts and enjoys in common.

Do you think these policies hinderance and perception obstruction that domestic foundations encounter during the investment process, will change in the future?



People have been talking about how successful green finance is in China. And they think that if impact investing could gain the same attention from the government like green finance, it would probably grow especially fast. But I personally think it might be a little difficult because everyone has a different understanding of impact investing. We've approached some government departments before, hoping they could do something to promote impact investing, but they are very conservative about it.

A few months ago, when UNDP issued Technical Report on SDG Finance Taxonomy (China), I attended some speeches from a

few policy banks. And I think that what they are doing is very relevant to impact investing. They have followed the national policy to do things like poverty alleviation and agricultural support. At the same time, they also recognized that the technical report was quite good, and it could provide some useful indicators. Therefore, I think if people from policy banks can think from the perspective of creating social impact and then make decisions, impact investing will be actually quite promising. Because they are doing good things for national development with a considerable amount of money.

What is the vision of Narada Foundation for its future development?



Actually, last year Narada proposed to do some strategic transformation, hoping to promote cross-sector collaboration among social enterprises, impact investors, or projects done by the young people which we had worked with. We hope to attract both the business community and the youth community to pay attention to public good and social innovation. Because we think the current philanthropy sector is small, and there are only a few famous organizations people are familiar with.

Our support for impact investing and social enterprises is also based on our belief that these two ideas can achieve our goal of promoting cross-sector collaboration and solving social

problems. If there are other better ways to help us achieve our goal, we are willing to make more attempts.

Impact investing and social enterprises require building infrastructures through research and advocacy, creating an ecosystem. But I feel that Narada does not need to do the promotion anymore. Because after so many years of cultivation, there are already some specialized organizations doing this kind of thing. For example, China Social Enterprise and Impact Investing Forum (CSEIF), China Alliance of Social Value Investment (CASVI), China Social Enterprise Certification Center (She Chuang Xing), Impact Hub, etc. are all doing this kind of promotion work. Just let them do it.

What role do you think foundations should play in China's impact investing and social enterprise sector in the future?



Most of the social enterprises we funded ten years ago were probably not very successful. Only a few of them have grown up to a relatively large scale. There is no difference between these social enterprises and other start-ups, or we can say it is even more difficult to cultivate social enterprises. I think foundations

can provide funding in the early stage because these social enterprises must grow large enough to attract investors' attention. Therefore, at the beginning, they need funding that does not require returns and gives them chance to grow up first. The foundation can actually play this role due to its original

intention. In addition, according to Mr. Xu's opinion, it is not enough to rely only on small and beautiful NGOs, but we need to use market-oriented means to solve social problems to the maximum extension. We hope the foundations can play such role: they provide funding for social enterprises at early stage without seeking returns, to cultivate these seedlings to the extent that impact investors can see them. If no one provides any help for them at the beginning, they may not grow up.

In addition, there is no difference between our previous investment in social enterprises and the funding for ordinary NGOs. Social enterprises are also basically registered as Private Non-enterprise Units. We give them grant, which is regarded as funding to an institution. The money does not need to be used for a certain project and can be just used to cover

the institution's operation expenses. We have always been funding philanthropy projects, so we certainly do not have much ability to empower enterprises from the business perspective. Therefore, we may rely on the third parties to provide some services or ask these enterprises to develop independently.

If the seedlings we support grow up, our impact fund can consider incorporating them to form a closed loop. We have such cases, but this is not what we must achieve. We feel that as long as a social enterprise can genuinely solve a social problem, it doesn't matter who it belongs to, in other words, who is the shareholder. Because the foundation exists to fund these projects to solve social problems. We are not saying that the enterprise in which we invest at its first stage must be sponsored by us when it grows up. Making the two things tied together is not the original intention of our foundation.

