

PRACTICE BRIEF 2

June 2014



Designing a challenge fund: important considerations

This Practice Brief draws on Triple Line's experience over the last 12 years in designing, managing and reviewing challenge funds for a range of different private and public bodies. Challenge funds aim to reduce poverty and inequality, promote sustainable development and enhance development capacity. *Civil society* challenge funds can build citizen voice and invest in local knowledge to improve governance, transparency, rights and access to services. *Enterprise* challenge funds (enterprise development and business impact) can improve the way businesses and markets operate to reduce poverty and inequality. This Practice Brief (a) reviews when a challenge fund is an appropriate funding modality and (b) outlines some essential steps in the design stage that help enhance impact.

Introduction

Challenge funds are most appropriate for donors seeking solutions, sometimes innovative, to resolve complex development issues through engagement with organisations that have local knowledge, insight, expertise and partnerships. They:

(1) Can be used to support a diverse range of civil society, private sector, research and government orientated

projects or programmes aimed at reducing poverty and inequality

(2) Can be local,¹ provincial, national,² regional³ or global⁴

(3) Can provide funding to independent organisations implementing projects that are competitively selected on the basis of well-defined eligibility criteria and a transparent selection process

¹ Such as the Development Awareness Fund

² Such as the Afghanistan Business Innovation Fund

³ Such as the Africa Enterprise Challenge Fund

⁴ Such as the Global Poverty Action Fund and the Civil Society Challenge Fund

Triple Line's challenge fund experience

- **Civil Society Challenge Fund** (DFID)
- **Global Poverty Action Fund** (DFID)
- **Development Awareness Fund** (DFID)
- **Arab Women's Enterprise Fund** (DFID)
- **Economic Empowerment of the Extreme Poor in Bangladesh, Shiree** (DFID and the Swiss Development Cooperation)
- **Rights and Democracy Inclusion Fund** (DFID, Swiss Development Cooperation, AusAID and Danida HUGOU)
- **Africa Enterprise Challenge Fund** (DFID, SIDA, Australian Department of Foreign Affairs and Trade, Ministry of Foreign Affairs of the Netherlands, Danida and IFAD)
- **Enterprise Challenge Fund** (AusAID)
- **Agricultural Technology Transfer** (DFID, Programme Management Office)
- **Tawanmandi: Strengthening Civil Society in Afghanistan** (DFID and Swiss Development Cooperation)
- **Governance and Transparency Fund** (DFID)

- (4) Can be a mechanism to identify and fund smaller organisations through a one-off approval process and management approach
- (5) Allow donors to share the risk with implementing organisations while maintaining a distance from project implementation
- (6) Provide those who are engaged (grantees, government, donors) opportunities to build their capacity, learn about what approaches work and represent value for money, and consider what could potentially be scaled up with the right partnerships and funding.

1. When is a challenge fund the right instrument?

- (1) When donor objectives are clear but the solutions to the development problem in question are not
- (2) When there is a group of civil society organisations or businesses that are already working in defined thematic areas and the donor, in consultation with other stakeholders, can support and leverage their expertise
- (3) When a donor is prepared to balance the risk of not having direct project control with the advantages of finding solutions which aim to positively impact

upon the lives of significant numbers of hard-to-reach beneficiaries⁵

- (4) When the donor wants to introduce the element of competition into the utilisation of limited or scarce resources.

Challenge funds do not offer an immediate certainty of results. With a demand led fund where the overarching objectives are established by the donors, the quality of the portfolio composition is unknown at the outset. If genuinely innovative projects are selected, they may be untested and they may fail. Also, in the early years of project implementation and fund management, challenges can be expected. It is therefore useful for donors to be clear at the outset about what degree of exposure to risk and failure is acceptable.

2. Core elements of a successful fund

- (1) Objectives are clearly articulated at the outset and remain constant. Flexibility in fund design can come from designing different funding rounds or windows that support sub-objectives or different themes.
- (2) There are effective fund management processes and procedures, as well as supportive institutional arrangements, in place to facilitate the smooth performance of the fund and to present quality evidence on results and learning.
- (3) There is clarity on the amount of funding available (at least for the initial phase), the lifespan of the fund and its geographical focus.
- (4) There is a broad monitoring and evaluation framework in place, supported by beneficiary feedback and a learning strategy that seeks to understand what approaches work and do not work, to capture results and impact to improve donor policies and implementation practices.
- (5) Where desirable, successful approaches can be identified for potential scaling up. While the original donor may not be responsible for taking success to scale, strategic partnerships with other donors, aid practitioners, and national and local governments can be a useful element of fund design.

3. When is a challenge fund not right?

- (1) When a donor requires significant direct control of the design and implementation of individual projects
- (2) When there is confidence that existing approaches and actors can resolve the development problem and the donor can provide grant funds without a competitive call for proposals
- (3) When there is insufficient time to launch a competition and to test the impact of the challenge fund.

⁵ For more on when the challenge fund model is an appropriate funding mechanism, see [KTP Practice Brief One](#)

Challenge fund design processes, procedures and systems considerations

Drawing on Triple Line’s experience, Table 1 outlines some important steps and procedures to consider in the design phase of a challenge fund.

Table 1: Necessary steps and considerations when designing a challenge fund

| Pre-launch considerations | |
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| Preparatory design steps | <ul style="list-style-type: none"> • Develop an evidence base for the challenge fund’s business case. • Define the overarching objectives, target beneficiaries, target grantees and geographic location. Clarity in fund objectives will help ensure congruity between what donors and grantees aspire to achieve. • Agree the level of involvement and influence of the fund manager over each aspect of the fund. Assess in reality what manager can be accountable for. • Consider how individual projects will be selected. A selection process that draws on the views of independent practitioners and academics not employed in the delivery of the fund can ensure a fair and transparent process that protects both the donor and any external fund manager from accusations of bias. However, donors may wish to have the power to vet applications and final selections. As the fund matures, the role of an independent selection committee can be reviewed and revised. • Promote the fund to other potential donors (if desirable) to deepen the pool of funding available. • Establish the risk appetite of the fund. Accept that projects are untested and a certain number may fail. • Develop a robust risk management strategy. |
| Develop eligibility and selection criteria for potential grantees | <ul style="list-style-type: none"> • Clear eligibility criteria define the rules of the competition, while selection criteria determine how the winners are chosen. • Ensure clarity on funding arrangements with grantees. Options include full grants, incorporating loan elements alongside grants, or securing a level of matched funding from grantees. • Funding rounds or ‘windows’ that are themed or applicant-restricted are a useful means of targeting new and different types of applicants and project ideas within the same fund. For example, the most recent funding round in the Global Poverty Action Fund supported projects aimed at creating sustainable jobs and livelihoods (GPAF, 2014). |
| Promote the fund to potential grantees | <ul style="list-style-type: none"> • Promote, inform and demonstrate the merits of the fund to potential grantees. Research the most appropriate means of marketing the fund. This will optimise selection and reduce costs associated with re-marketing if the pool of applicants is too small. A challenge fund which is poorly promoted is more likely to fail. • Decide how potential demand for funding will be managed. Funding can be made available in shorter, time-bound windows or in windows that are open for the duration of the fund. The latter may reduce staff costs, as applications can be vetted as they are received by a small team of experienced staff. At the same time, rejected applicants have an opportunity to improve their applications. The downside of an open application window is that it is not possible to compare the relative merits of applications received throughout the vetting period. In addition, it may be difficult to allocate sufficient lead time for changing application guidelines. • Triple Line has found that targeted workshops with potential grantees help to forecast the scale of interest and improve the eligibility and quality of applications. |
| Implementation considerations | |
| Performance assessment and results measurement | <p>(a) Assessing grantee performance</p> <ul style="list-style-type: none"> • Decide <i>what</i> grantees will report on, and <i>when</i> and <i>how</i> their reporting will be assessed, analysed and presented. • Do not overburden grantees with reporting requirements. For private sector funds, independent monitoring and evaluation of poverty impacts is required as this is outside the scope of what businesses do. • Consider standard performance measurement indicators for projects with shared characteristics. • Consider designing standardised templates for reporting. • Factor into the design an independent mechanism to assess annual and final project reporting. |

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| Implementation considerations | |
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| | <ul style="list-style-type: none"> Establish criteria for judging when project performance is inadequate and what actions are required (including closure). Consider how the quality of evidence from projects in annual and final reports will be assessed and verified through field validation. Develop a management information system to collate and analyse performance data. Decide who will assess reporting and provide tailored feedback to grantees. Will this be done by the donor directly or a Fund Manager? Which options are most cost effective? Provide capacity support to ensure reporting requirements are understood. Create incentives for robust reporting (e.g. funding in arrears if appropriate, or discontinuing funding for poor reporting). Ensure that each project has clarity about its aims and objectives and about mechanisms to assess achievement, (e.g. a logframe or results chain and supporting monitoring and evaluation processes). Consider an annual portfolio analysis which aggregates the performance of on-going and complete projects that delivered results/impact with quality evidence. <p>(b) Assessing fund manager performance</p> <ul style="list-style-type: none"> Set key performance indicators for fund management (management of risk; appraisal of projects; disbursement of funds within timeframe; grantee perception of fund management processes; delivery of capacity building and lesson sharing). |
| Financial management oversight | <ul style="list-style-type: none"> Define a due diligence process prior to the funding of each individual project. Design a stringent financial oversight mechanism to manage disbursements and check grantee expenditure. Design mechanisms to appraise and quality assure financial reporting from grantees. Design workshops to build the capacity of grantees to manage and report on finances. |
| Managing risk | <ul style="list-style-type: none"> Understand the risks associated with the fund at all levels, such as operating environment risks, financial mismanagement and weak grantee implementation capacity. The risk appetite of a donor (including reputational risks) can change throughout the lifetime of a challenge fund and its design should retain flexibility to accommodate such change, e.g. by establishing new funding rounds. Establish a risk management strategy that details potential risks and actions to address them. Maintain a register to track, monitor and support at-risk projects. Communicate the donor's risk appetite to grantees and clarify when implementation challenges need to be reported. Reduce the risk of fraud through random audits and quality assurance visits. |
| Building grantee capacity for aid effectiveness | <p>In addition to funding opportunities, grantees may be attracted to challenge funds by their knowledge sharing and capacity building potential.</p> <ul style="list-style-type: none"> Design mechanisms (round tables, workshops, seminars, newsletters) for sharing knowledge and expertise, particularly as new donor priorities arise in practice areas such as value for money, beneficiary feedback mechanisms, quality of evidence and gender mainstreaming. If new donor priorities (e.g. reporting on quality of evidence and value for money) are introduced, do not expect high uptake until there is shared understanding and expectations for reporting are clear. |
| Learning considerations | |
| Make systemic change part of the design | <p>Challenge funds are criticised for not bringing about systemic change. For enterprise challenge funds, systemic change refers to 'the impact on the systems that the businesses work in, such as markets, government, or civil society' (Kessler, 2013:26). For civil society challenge funds, systemic change stems from the impact of civil society organisations on the uptake and implementation of pro-poor policies and approaches that secure, for example, better access to and quality of social sector services to alleviate poverty and promote equality.</p> |

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| Learning considerations | |
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| | <p>Triple Line has found that systemic change can be factored into challenge fund design by:</p> <ul style="list-style-type: none"> • Identifying or anticipating the development of key partnerships to take any successful approaches to scale • Allowing a sufficient timeframe to capture the impact of policy change or improvements in service delivery or markets, which may only be felt after the lifetime of an individual project. |
| Capturing learning | <p>Learning from a fund is distinct from assessing and scoring project performance. Triple Line has identified three levels of learning that can be considered in the design phase:</p> <ul style="list-style-type: none"> • What works and what doesn't work in relation fund management processes. Key audiences for learning are the donor(s), the fund manager and, to some extent, grantees, who will have perspectives and whose views can be elicited by an annual perception survey. • Which approaches can reduce poverty and inequality at the level of individual projects. Key audiences for learning are grantees, their partners (including local and national governments), the donor(s) and the fund manager. • At an aggregate level, through a portfolio analysis that provides insight into the performance of the fund as a whole in meeting its overarching objectives, and into emerging lessons. Key audiences include the donor(s) and the fund manager. <p>Grantees and their implementing partners can benefit from being part of a wider community of learning. This is best achieved through building networks and organised forums that bring people together (e.g. workshops, business-to-business seminars and thematic or practice working groups) and followed up through easy-to-read and well-presented papers that summarise findings or provide links to tools and approaches.</p> |
| Fund evaluation | <p>Evaluation objectives should be agreed at the outset with a defined budget allocation. Key aspects to evaluate include:</p> <ul style="list-style-type: none"> • The efficiency of the challenge fund instrument, e.g. the success of the competitive selection process in choosing strong projects and developing their capacity and learning potential • The effectiveness of the fund management processes and procedures • The results achieved, what has succeeded and what has not, and the explanations behind these results • The impact of projects in the portfolio on the reduction of poverty and inequality. |
| Outreach and dissemination | <ul style="list-style-type: none"> • At the outset of a fund, consider who in the wider community of development is interested in its performance and results and in learning from it. • Conduct a stakeholder analysis to target key audiences and consult with them on what they want to know, when and how. |

Additional considerations

- (1) **Who should design a challenge fund?** External agents and donors can usefully collaborate to design a challenge fund. If an external agent is engaged in design they may also be well-placed to implement the challenge fund because they are already familiar with its design, have spent time mapping out stakeholders and have already undertaken engagement activities. However, design and evaluation should be kept separate to avoid bias.
- (2) **Who should be consulted and involved?** Elicit the opinions of target beneficiaries, local interest groups, potential grantees and partners, government officials at local and national level, other donors and investors, other units within the sponsor organisation, and those with context-specific knowledge of the development problem the challenge fund hopes to address.
- (3) **Should the fund be managed by the donor or outsourced?** In thinking through this decision, donors could usefully examine whether they have the full range of expertise to manage the fund and whether it is cost effective to do so internally. Outsourcing can provide the flexibility of resources required to manage the peaks in workload associated with processes such as the screening and appraising of projects. The topic of challenge fund management will be explored in more detail in Practice Brief Three.
- (4) **Is a challenge fund a standalone entity?** A fund can either be embedded into a wider programme or it can act as a standalone programme. For example, the Rights, Democracy and Inclusion Fund was part of the Department for International Development (DFID) Nepal's Enabling State Programme (Brown *et al.*, 2013). Alternatively, the challenge fund model could be used

to disperse the entirety of a pool of funding in one singular programme, as is the case with DFID's Global Poverty Action Fund or the Africa Enterprise Challenge Fund (funded by a consortium of donors).

- (5) **Donor priorities change.** How can this process be managed effectively? Economic and social development is an evolving discipline and changes in expectations are to be expected. Expectations about the length of time it takes to introduce new themes and ideas regarding, for example, the quality of evidence and value for money principles, and to prepare for action, need to be managed. The starting point for any new priority should be communications to raise awareness and build the capacity of grantees to take action.

Concluding remarks

Many donors to international development view challenges funds as an effective conduit of finance support to civil society and business activity. This Practice Brief argues that before designing a fund, donors should consider whether it is the right mechanism to support a set of overarching objectives that will ultimately be implemented by third party organisations. If it is the right mechanism, then the steps outlined by Triple Line, drawing on over ten years of experience, can help ensure key aspects of project selection, fund management, monitoring, and evaluation and learning are considered. Attention to design details will increase the likelihood of results in terms of reducing poverty and inequality, and ensuring aid effectiveness.

References

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Credits

This Practice Brief was written by Anne-Marie O'Riordan, Juliette Seibold and David Smith. Readers are encouraged to quote and replicate material from these Practice Briefs in their own publications. In return Triple Line requests due acknowledgement and quotes to be referenced.

This is the second Practice Brief in a series of papers that examines challenge funds as an aid modality.

Practice Brief One: *What is a challenge fund and when should it be used?*

Practice Brief Two: *Designing a challenge fund: important considerations*

Practice Brief Three: *Considerations for challenge fund management (forthcoming)*

The Practice Briefs are part of a two-year collaborative research project under the Knowledge Transfer Partnership (KTP) between Triple Line Consulting and the University of Bath. The KTP is jointly funded by the UK Technology Strategy Board and the Economic and Social Research Council.

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