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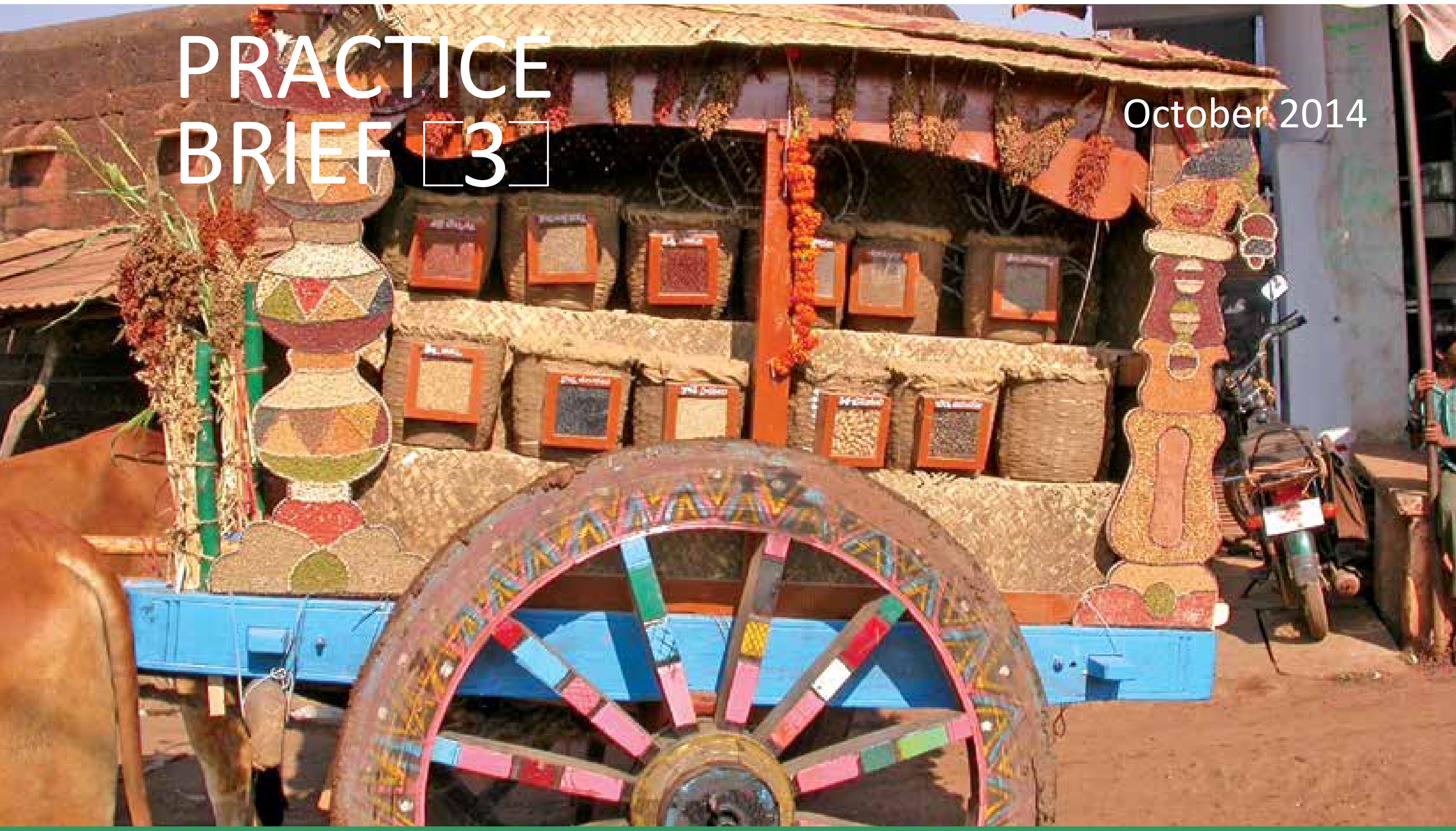


Considerations for Challenge Fund Management

This Practice Brief discusses: a) the tasks, skills and capabilities involved in fund management; b) the options for managing a challenge fund in-house or externally; and c) accountability for results. The Brief draws on current thinking, as well as Triple Line's experience over the last twelve years in designing, managing and learning from challenge funds for private and public bodies.

The Brief shows that, today, more is expected from fund managers than five years ago, particularly in the areas of capacity strengthening of grantholders, results and learning. It argues that more benefits are associated with outsourcing fund management than with retaining it in-house. Important benefits brought by an outsourced manager include: a) the flexibility they bring to managing peaks and troughs of workloads; b) a wider range of outsourced technical capacities; and c) greater ability to respond to changing donor priorities. In considering the extent to which fund managers are accountable for results, the Brief concludes that analysis is required at a fund's inception phase to understand the spheres of influence all parties may have on results, as well as the impact of the enabling environment where projects are implemented.

Introduction

In the field of international social and economic development, challenge funds are increasingly used as a mechanism for providing financial and capacity strengthening support to private sector and civil society organisations. In both cases the broad objectives of the challenge funds are to reduce poverty and inequality. Current debates in challenge fund management include: what the scope of work and influence is of the fund manager; whether to contract out this function or to retain it in-house; and to what extent fund managers can influence fund outcomes and be held accountable for them.

Successful challenge fund management is no longer confined to the selection of eligible grant holders, fund disbursement, risk management, the appraisal of results and the evaluation of outcomes. It is now driven by an aid effectiveness agenda where the goal is to both demonstrate *sustainable* improvements to the lives of beneficiaries, and to do so at a cost which is deemed *value for money*. There is also an expectation that challenge funds will yield not only results but also learning at multiple levels to inform policy and practice. Consequently, donors now seek fund managers with skills and knowledge that add value.

In considering these issues in more detail, this Practice Brief begins by defining core management tasks and identifying the skills and capabilities required to implement the fund.

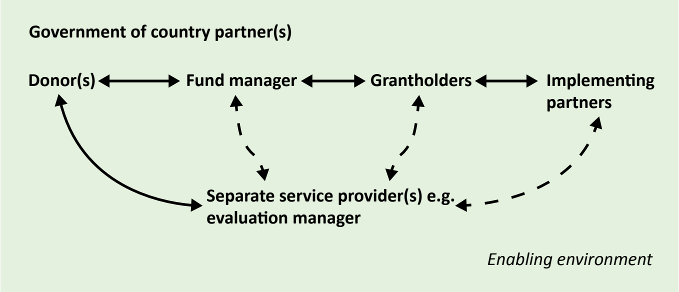
Challenge fund management: core tasks, key skills and capabilities

Triple Line identifies 10 core functions in managing a challenge fund, listed and explained in turn below.

1. Relationship management

This is a core fund management task and its importance cannot be understated. The fund manager either manages relationships directly or has oversight in managing them if they breakdown. Figure 1 demonstrates some of the relationships that need to be purposefully managed.

Figure 1: Potential relationships in challenge fund implementation



Note that an area that may easily be overlooked in relationship management is the government of partner countries: their knowledge, ownership and understanding of a fund. Here, it is worth recalling the Paris Declaration on Aid Effectiveness and the Accra Agenda for Action, where the international community commit to strengthening partner countries' national development strategies and associated operational frameworks.[1]

From the outset of a fund, it helps to agree on a communication strategy and principles underpinning how communications will be managed. The strategy should define roles and responsibilities, and should agree on an approach to communications that encompasses shared values that facilitate good relations (i.e. mutual respect, transparency, clarity and participation).

Key skills and capabilities required: *Leadership; planning; interpersonal communications; problem-solving; responsiveness; coordination; a stable workforce to ensure continuity; values, standards and principles.*

2. Capacity strengthening

Fund managers are playing an increasing role in strengthening the capacity of grantholders. This is done through ongoing grantholder capacity assessments and targeted capacity strengthening support.

Triple Line's capacity strengthening support for grantholders under DFID's Global Poverty Action Fund covers, for example:

(1) Value for money: key concepts and reporting
(2) Financial management and reporting
(3) Governance and due diligence
(4) Working up a concept note to a full proposal
(5) Participatory project planning and design
(6) Basic research methodologies (baseline, mid-term and end-line surveys)
(7) Monitoring and evaluation frameworks: how to develop a logical framework, results chains etc.
(8) Participatory approaches and beneficiary feedback mechanisms
(9) Gender mainstreaming
(10) Reporting results on girls and women
(11) Guidelines for project evaluation
(12) Project level risk management and reporting.

Key skills and capabilities required: *Needs assessments; responsiveness and flexibility; in-depth knowledge of development practice; training and facilitation.*

3. Designing, marketing and launching windows/funding rounds

Fund managers may be required to design, market and manage new funding opportunities or 'windows'. Challenge funds often start with one window (e.g. a general window to a wide selection of applicants), and develop new windows of funding opportunities over time which may be targeted or themed (e.g. jobs and livelihoods; off-track Millennium Development Goals; social inclusion). The fund manager is often well-placed to identify opportunities for new 'windows', as they have technical expertise, knowledge of civil society activities and an understanding, in the case of enterprise challenge funds, of the market system and market failures.

Key skills and capabilities required: *In-country experience; knowledge of key areas in the aid debate; research; communication; marketing; administration.*

[1] http://www.oecd.org/dac/effectiveness/34428351.pdf

4. Screening applications and due diligence checks

Fund managers screen and appraise grantholder applications for funding. Increasingly, donors offer a two-stage application process: a concept note, followed, if successful, by a full proposal.

A core function of fund management is to carry out due diligence checks on grantholders to assess whether their policies adhere to donor requirements. Due diligence checks are likely to assess financial management and accounting practices and systems, child protection, environmental protection, etc.

Key skills and capabilities required: *Specialist sector knowledge; consistency and fairness; transparency; due diligence; communication; learning.*

5. Grant arrangements

The grant arrangement process involves brokering an agreement between the donor and the grant applicant, to commit funds to a selected project. The applicant organisation, in turn, must agree to adhere to the terms and conditions of this funding. The process is designed to ensure that the grantholder is accountable for the funds allocated. Triple Line notes that some donors require grantholders to confirm their adherence to the terms and conditions of their grants each time they request a new tranche of funding.

Key skills and capabilities required: *Financial management; management information systems; communication.*

6. Risk management

Fund managers are expected to manage risk. Risks can be:

(1) External: Stemming from the operating environment in which a grant-supported project is implemented (i.e., natural disasters, conflict, the enabling environment for business/civil society, etc.);

(2) Operational: Arising from the way in which a project is delivered.

The types of risks to manage include:

(1) Delivery risks: Intended benefits will not be achieved and/or there are negative unintended consequences;

(2) Fiduciary risks: Fraud, corruption and/or misuse of funds;

(3) Reputational risks for the donor (and the fund manager) that arise from the above.

At the outset of a fund, a fund manager usually conducts a risk analysis and develops a strategy for mitigating risk which is reviewed and updated at regular intervals.

Key skills and capabilities required: *Technical expertise – political economy and contextual analysis; frequent and reliable communication: research skills: in-country specialism.*

7. Financial disbursements and ongoing management

A fund manager is expected to:

(1) Implement donor policies and standards on financial management, audits and financial investigations;

(2) Ensure fund management staff, grantholders and implementing partners understand and adhere to financial management guidelines;

(3) Appraise expenditure claims and disperse funds (in advance or in arrears);

(4) Maintain comprehensive records;

(5) Manage financial loss.

Key skills and capabilities required: *Auditing; accounting; budgeting; due diligence; data protection; financial forecasting; communications; procedures development; data management; disbursements systems.*

8. Agreeing to the theory of change and results framework

The fund manager and donor(s) usually work together to agree to the theory of change underpinning the challenge fund. A key function of challenge fund monitoring and evaluation is to gather the evidence that tests this theory of change. Therefore, the theory of change informs the overarching results framework for the fund as a whole. The fund manager usually leads a process to agree to a results framework to which all projects contribute, and ensures that grantholder reporting provides evidence against agreed indicators.

Fund managers are also expected to support projects in developing their own results frameworks or results chains. For example, Triple Line provides face-to-face support to civil society grantholders for logical framework development/refinement. Triple Line also supports other fund managers to develop programme and project results frameworks on enterprise challenge funds.

Key skills and capabilities required: *Results measurement systems, including results chains; logical models, framework and indicators; facilitation.*

9. Monitoring, evaluation and learning

Monitoring takes place at three distinct levels:

Project performance: This is usually a mix of self-assessment and reporting against agreed indicators by the grantholder which is, in turn, quality assured by the fund manager through a mix of desk-based report appraisals and field visits. Triple Line notes two important trends in project performance: first, donors are interested in a clear demonstration of beneficiary participation and feedback; second, there is a move towards a payment by results model, i.e., adequate demonstration of results secures continued funding.

Aggregate portfolio performance: This is a question of how the fund portfolio of projects in any given year is performing as a whole. It requires a quantitative and qualitative analysis of results at a macro level. A key challenge is ensuring standardised indicators at a sufficiently high level.
Fund management performance: This is often driven by a self-assessment process, against key performance indicators and milestones agreed with the donor and measured annually. Fund management performance may also be linked in part to payment by results.

Evaluation: A fund manager's role in evaluation is twofold: first, to facilitate any external evaluator's work (i.e., provide access to information); second, to provide guidance to grantholders on commissioning their own independent evaluation when their projects are drawing to a close and on drawing on the findings in their final report to the donor.

Learning: Fund managers increasingly lead processes that contribute to learning in a quest to understand what works and what doesn't. This is about learning from the mechanism of the challenge fund as well as from the results of the project portfolio. Donors also want to gauge how development practices are improving as a result of learning. In taking forward a learning agenda, a key consideration for fund managers is understanding the key audiences interested in learning; how and when learning can take place, be disseminated, and be taken forward into improved practice; and how the resulting changes can be measured.

Key skills and capabilities required: *Communications; technical expertise; development knowledge.*

10. Reporting

In Triple Line's experience, ad hoc reporting arrangements with donors work less well than having an agreed schedule with clear expectations on what will be delivered, to whom, why and when. Triple Line notes that narrative reports are important for laying out an analysis and presenting recommendations, but they are not always read in a timely fashion and they do not (in and of themselves) lead to discussion and decision-making. In some cases a visual presentation in a forum with multiple stakeholders is a far more effective means of communicating.

Key skills and capabilities required: *Writing; presentation; communication; adherence to agreed timeframe.*

To conclude, challenge fund management is facilitated by a clear understanding of what is required and Triple Line has identified 10 major fund management functions. Whether fund management should be carried out in-house or externally is the subject of the next section.

Challenge fund management choices: In-house or outsourced?

The current literature suggests that challenge fund management is increasingly outsourced to external agents (fund managers). Brain et al. (2014:16) comments that there *'is a belief that private sector consultancies and occasionally international NGOs, are better suited to run [private sector] development programmes than public organisations'.* Indeed, donors often use multiple external agents to fulfil different fund management functions, for example, a separate service provider may be engaged for learning and evaluation.[2] There are two reasons for this: first, it avoids any perceived conflict of interest and second, it widens access to a pool of specialist technical assistance. However, it can lead to duplication of effort if communications are weak, if roles and responsibilities are not clearly defined, or if the overall understanding of fund objectives differs between service providers.

In assessing the benefits of either in-house or outsourced management, Triple Line interviewed a range of donors (government and private sector) and concluded that there are three key factors which inform their decision:

(1) The availability of **financial and human resources;**

(2) The **capability and skills** required;

(3) The **distance a donor requires from project implementation** (in some cases donors want close dialogue and in others they prefer a proxy).

To assist donors in making decisions on the fund management model, Table 1 presents the pros and cons of managing a fund internally or externally.

Table 1: In-house and outsourced fund management options

In-house Management	External Management
The donor has maximum fund oversight and control.	Donors gain distance from direct responsibility and accountability. There is less reputational risk for the donor if the fund fails or encounters issues.
Changing (political) priorities are easier to manage diplomatically (Brown et al., 2013).	The fund manager is seen to be a 'neutral' proxy (OECD LEED, 2006). This is useful for riskier, politically-sensitive projects where the donor requires distance.

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[2] In the case of the Global Poverty Action Fund, Triple Line and Crown Agents (Joint Venture) are the fund managers. Coffey International is the evaluation manager and KPMG the due diligence manager.

In-house Management	External Management
There are higher transaction costs associated with hiring external technical staff required to manage a challenge fund.	There are lower transaction costs and increased value for money due to competitive management bidding processes (SIDA, 2013).
It can be challenging for a donor to assemble a flexible team with the right skills and capabilities and to meet peaks and troughs of demand. Donor managers often have staff who are re-posted after three years.	It is less challenging for service providers to assemble flexible teams with skills and capabilities (SIDA, 2013) and to meet peaks and troughs of demand. More stable workforce (lower staff turnover), which means processes, procedures and learning are likely to be retained and refined overtime. (Green, 2013, Santamaria, 2013; ICAI, 2014:4).
Donor staff can retain and build on their learning from the processes and experiences.	A fund manager can dedicate more time to interacting with grantholders and implementing partners than a donor. (Hivos, 2014).

(Adapted from Brown et al., 2013)

Overall, there are benefits to be gained by having a fund externally managed. Triple Line notes that even when funds are outsourced, most donors remain strategically engaged in major management decisions, particularly in relation to portfolio composition and location, risk, and capacity strengthening. Whether a fund is managed externally or internally, there is an important debate emerging concerning the accountability for results, and the link between results and the payment of fund managers.

Who is accountable for results?

In analysing accountability for challenge funds that are outsourced, Triple Line has identified five influencing factors:

(1) The fund's overarching objectives (usually determined by the donor).

(2) The choice of projects to meet those objectives: Were the eligibility criteria followed, and who makes the final decision for grant allocation?

(3) The capacity of those implementing: Were weaknesses identified at the outset, what steps were taken, and by whom, to address them?

(4) The enabling environment where projects are being implemented: Where the enabling environment is particularly challenging, stakeholders need to be realistic about what can be achieved. (Both the World Bank and Civicus measure, rate and compare governance indicators across a wide number of countries.)[3]

(5) Oversight in relation to risk and/or poor performing projects: What decisions were made and by whom?

These five factors suggest multiple roles in shaping results and a need, therefore, to consider the *sphere of influence* of each stakeholder: The donor, the fund manager, other service providers, the grantholders and their implementing partners. In each case, an analysis is required of who has direct or indirect influence over whom and what. Understanding the role of all stakeholders and their sphere of influence is key to determining accountability.

Increasingly, donors are moving towards a payment by results model of fund management. This assumes that the fund manager has influence over inputs, outcomes and impact, even if they do not exercise full control. This model of accountability is likely to compromise the very purpose of a challenge fund: to test a variety of approaches to a development problem. Testing requires the inevitability of failure alongside success. In a world where only positive results are rewarded, the opportunity to embrace failure and learn may be missed, and perverse incentives for good results may be unwittingly introduced.

Concluding remarks

This third Practice Brief in Triple's Line Challenge Fund series has defined core tasks associated with fund management, and the requisite skills and capabilities. Increasingly, donors want to link results to payments for both grantholders and fund managers. However, challenge funds involve multiple players; perverse incentives may arise from holding just one or two players to account, and real opportunities to accept and learn from failure may be missed. Acknowledging the trend of outsourcing fund management, Triple Line has drawn on interviews with donors and concluded that outsourcing brings real benefits in terms of both cost efficiency and the overall effectiveness of the fund, without donors losing their ability to remain strategically engaged.

[3] For more details, see http://data.worldbank.org/data-catalog/worldwide-governance-indicators and http://civicus.org/eei/.

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Credits

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This is the third 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***

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