Realising the Potential of International Development Challenge Funds: Lessons from Practitioners

February 2015

Learning about challenge funds: participants at the workshop

Introduction

Triple Line Consulting and the University of Bath welcomed a gathering of more than fifty development practitioners to a workshop at the National Council for Voluntary Organisations, London, on 5 December 2014. The aim was to examine the use of challenge funds as a means to promote social and economic development and to discuss scope for enhancing the potential of this funding modality. Challenge funds are intended to promote learning and innovation through action, in pursuit of often difficult goals. One goal of the workshop was to compare how, and how far, challenge funds are managing to realise this intent.

Experiences from four well-established challenge funds were considered:

(1) **Food Retail Industry Challenge Fund (FRICH):**[1] With funding of GB£2.4m, this UK Department for International Development (DFID) enterprise challenge fund aims to bring more African food products to the UK through more innovative and sustainable supply chains. Nathan Associates is the fund manager of FRICH.

We extend sincere thanks to our presenters, panellists and workshop participants, all of whom contributed to an insightful and thought-provoking day. Participants included representatives from Bond, Brentec Investments, Care Bangladesh, Care UK, Coffey International Development, Crown Agents, The Development Innovation Fund, DFID, The DFID Impact Programme, The Donor Committee for Enterprise Development, Ecorys, Global Giving, ITAD, KPMG, McKinsey, Mott MacDonald, Nathan Associates, Oxford Policy Management, The Partnership for Transparency Fund, PwC, SIDA, SNV World, The Somali Stability Fund, Triple Line Consulting, Twin Trading, The University of Bath, The University of Oxford, Womankind Worldwide and independent consultants.

[1] www.gov.uk/food-retail-industry-challenge-fund-frich

(2) **Africa Enterprise Challenge Fund (AECF):**[2] This US$244m enterprise challenge fund supports nearly 200 business projects across 23 Sub-Saharan African countries. It aims to increase small holder farmer incomes and improve the lives of the rural poor. The fund supports local private sector businesses in pioneering profitable ways of improving access to markets and the way they function. It is co-funded by a consortium of development partners and is managed by KPMG.

(3) **Civil Society Challenge Fund (CSCF):**[3] Beginning in 2000, this is DFID's longest running global challenge fund for civil society. It aims to give poor and marginalised men and women a voice in decisions taken by local and national governments that affect their lives. Over GB£164m has supported 526 projects run by UK-registered civil society organisations working with local implementing partners. Triple Line and Crown Agents have managed the CSCF in a joint venture since 2010.

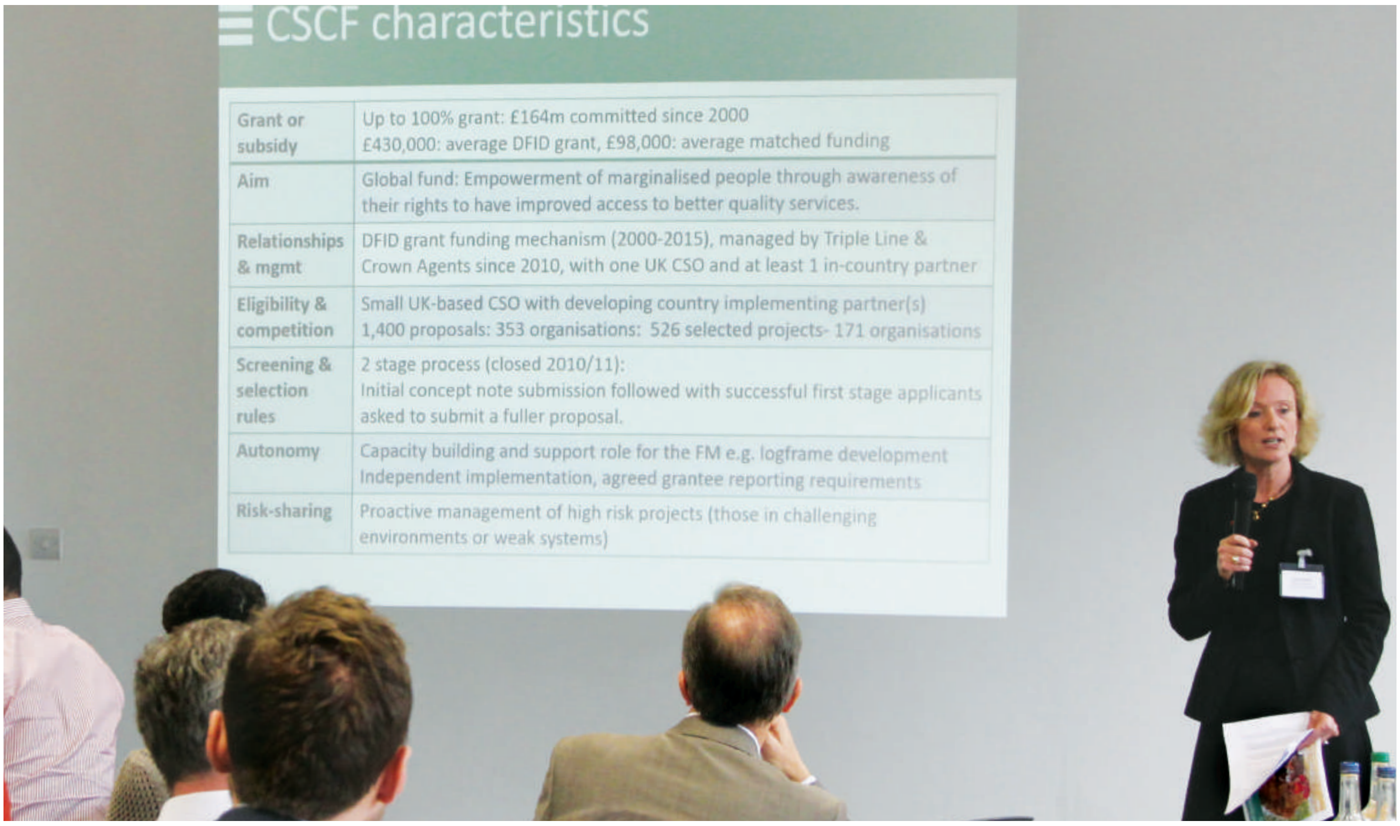
(4) **SHIREE (Stimulating Household Improvements Resulting in Economic Empowerment):**[4] The objective of this challenge fund, funded by DFID, is to enable one million people in Bangladesh to lift themselves out of extreme poverty and to develop sustainable livelihoods. The fund has provided over GB£83.3m since 2008 to establish non-governmental organisations working on economic empowerment, research and advocacy projects. SHIREE is managed by Ecorys UK and PMTC Bangladesh.

For each challenge fund, a presenter from the fund management or monitoring team detailed the fund's characteristics and provided insight into learning processes. A grantholder then described their specific project, what it had achieved, the challenges faced and how the funding modality or fund management processes had either helped or hindered their progress.[5]

This briefing note presents fifteen important lessons that emerged from the workshop discussions. These lessons are relevant to development partners, fund managers and other development practitioners.[6] They concern risk appetite, supporting innovation, flexibility in implementation, monitoring and evaluation, learning, funding time horizons, accepting the cost of failures, and the importance of building and cultivating good relationships.

Definitions and the appropriate use of a challenge fund modality

Triple Line and the University of Bath define a challenge fund as *'providing grants or subsidies with an explicit public purpose shared between independent agencies, with grantholders who are selected competitively on the basis of advertised rules and processes, who retain significant discretion over formulation and execution of their proposals, and who share risks with the grant provider'* (O'Riordan et al., 2013:3).



Juliette Seibold (Triple Line) discusses learning from the DFID-funded Civil Society Challenge Fund

[2] www.aecfafrica.org
[3] www.gov.uk/civil-society-challenge-fund
[4] Also known as the Economic Empowerment of the Poorest (EEP) programme, www.shiree.org
[5] 'Grantholder' refers to either an enterprise or a non-governmental organisation holding a challenge fund grant or subsidy.
[6] 'Development partner' refers to the donors and investors using challenge funds.

Challenge funds aim to reduce poverty and inequality, promote sustainable development and enhance development capacity. Two broad classifications of challenge funds in international development exist: enterprise and civil society challenge funds. Enterprise challenge funds can improve the way businesses and markets operate to reduce poverty and inequality. Civil society challenge funds are used to promote wider social, economic and civic goals, including promoting poor people's livelihoods, human rights and government accountability.

Lesson 1

Understanding what a challenge fund is and when it is best used are important steps in realising its potential for poverty reduction. The niche of a challenge fund approach is to confront applicants to respond to particular development issue. Their response should ensure a demand-led approach to solutions or effecting anticipated 'changes'. If these solutions are being proposed by the funder, then a different modality may be more appropriate (e.g., a managed fund or technical assistance).

The real cost of a challenge fund

More obvious costs are incurred in the running of a challenge fund, e.g., fund management staff costs, reporting costs, conducting field visits, running grantholder learning seminars. However, the level of understanding of the real cost effectiveness of challenge funds was questioned by some fund managers. Rarely do the costs incurred by *unsuccessful applicants* get factored into fund cost calculation. This would include costs associated with application screening, due diligence checks and feedback to unsuccessful organisations. Unsuccessful organisations can incur significant financial and time costs in putting an application together.

Lesson 2

In calculating the real cost of a challenge fund, inclusion of costs incurred by the fund manager and the applicants in the submission of unsuccessful proposals would give a more accurate costing.

Supporting innovation

The use of challenge funds to seek and support innovative solutions to complex development issues is usually considered in relation to projects. But what about regarding challenge funds as a way to innovate and improve the systems that support action on the ground, including the relationships and fund management processes? SHIREE's fund management introduced a system for monitoring and capturing change: mobile phones allowed beneficiaries to express their needs directly to programme staff. In another example, CSCF fund management acted on feedback from grantholders who said final project reports were a poor medium for conveying complexity and nuance. In response to this feedback, the technical team and grantholders now have a final meeting and feedback is discussed and recorded for further analysis that informs best practice and the development approach's evidence base.

Lesson 3

Driving the use of challenge funds forward involves innovative fund management processes and procedures that support implementation.

Embracing flexibility

A challenge fund's unique selling point is its flexible approach to solving a complex development issue. Within a fund's broad overarching framework, grantholders retain control over their own project design and implementation. Flexibility can be achieved with robust due diligence checks carried out during project selection, to ensure that projects share the objectives of the development partner and that they have sound organisational structures in place. After that, fund managers step back and let projects get on with their work. Even when projects are not on track, the model allows project staff flexibility to find their own solutions. For example, grant-funded businesses may not initially achieve what was expected, but rather than being problematic, this provides businesses with the space to examine their operations to learn from mistakes, tailor their business model accordingly and develop a more robust and sustainable approach. Brentec Investments, an AECF grantholder, discovered that the distribution model for their chicken vaccine, as described in their project business plan, was not effective. With support from the AECF fund manager, they were provided with the space to test another distribution model that was ultimately successful. Additionally, retaining flexibility of design enables projects to address short-term volatility in the enabling environment.

Lesson 4

Providing grantholders with the space and support to alter project plans to ensure that they remain relevant and effective is an approach that enhances fund performance and potential.

Risk appetite and risk management

Development partners as well as fund managers accept and manage certain levels of risk, including those associated with project failure. While a range of different appetites for risk was evident amongst development partners participating in the workshop, best practice appears to be an approach to risk that is based on well-researched contextual knowledge and that is transparent, i.e., development partners clearly understand the nature of the risks they face and how much risk is acceptable.

Lesson 5

A robust risk strategy is based on real contextual understanding of the specific project implementing environments as well as the risk around the capacity of grantholders and implementing partners. This approach advocates for fund managers to have a close relationship with each grantholder and an understanding of the political economy in which they are working.

Supporting projects in high risk environments with a measured approach can deliver higher impact: consider enterprise challenge funds in fragile states where there are few opportunities for enterprises to gain access to credit or international markets. This is the reasoning behind the Swedish International Development Cooperation Agency's decision to support businesses in countries such as the Democratic Republic of Congo and Somalia through the Post-Conflict Window of the AECF. In such contexts, high levels of failure should be expected, and development partners can explicitly plan for this by budgeting for project reviews aimed at identifying and understanding the reasons behind it. Success in such contexts should also be learned from: Twin Trading was positively supported through FRICH in the post-conflict and volatile context of the Democratic Republic of Congo and shared learning from their experience at the workshop.

Lesson 6

Development partners can use challenge funds strategically in high-risk environments, but high-risk endeavours need to be accompanied by a calculated approach to learning in cases of both failure and success. Disseminating such learning is key to informing development partner policy choices to ensure that they are relevant and successful in tackling development issues.

Monitoring and evaluation

Programming for effective monitoring and evaluation: Grantholders are not always best placed to monitor and evaluate the outcome and impact of their efforts on poverty reduction and inequality. Those running businesses are unlikely to have skills in poverty reduction research, while civil society organisations may be too small to collect the necessary data and analyse such research. This does not mean that businesses and civil society organisations should not be involved in, for example, data collection, but rather that they require certain levels of support for this.

Lesson 7

Understanding the strengths and limitations of grantholders in monitoring and evaluation can help development partners and fund managers identify the most appropriate service provider or collaboration arrangements with, for example, specialised research institutions to yield more meaningful results.

Results – telling the story: Reporting progress and results across complex portfolios of projects with different start and end dates, working in different countries and in different thematic areas, remains fraught with complication. There is a perception that development partners crave both a simple performance narrative (i.e., percentage of projects meeting or failing to meet expectations), and a more in-depth account of what is being achieved in a compelling format. Aggregating project performances with grade scores loses the contextual richness of project progress. Trying to report on all the nuances of every project makes for a disorganised narrative that is difficult to comprehend. Where is the middle ground? What is good enough in terms of reporting?

Lesson 8

The use of marker projects (e.g., in key thematic areas) and case studies to supplement portfolio-wide quantitative and qualitative analysis may be the most practical approach to demonstrating how a challenge fund is performing. A combination of standard monitoring, case studies and flexible qualitative impact assessment methodologies could be used to provide a more comprehensive analysis of portfolio performance and results. What is equally important is the quality of discussions and the application of learning that comes from discussing results.

Impact dilemmas: Impact may only be felt several years after challenge fund support has ended. For example, if a funded civil society project is successful in persuading a government to start collecting data on a specific disability in the national census, the time lapse between closure of the project and the challenge fund, analysis of the data, increased resource allocation to improve access to targeted services for disabled people, and subsequent improvements to their lives, is likely to be years. Are development partners

Two project members from the **DFID-funded Civil Society Challenge Fund Womankind Worldwide project** working to increase women's participation and representation in decision-making at the local and national level in Ghana

sufficiently primed to capture the long term impact of a challenge fund? If so, can it be done, and how? Is there scope for longer investment time frames to allow for more nuanced ex-post evaluations? What do impact evaluations require in terms of leadership, partnership, relationships, resources and commitment? A related problem is the focus by some development partners on change that brings improvements for poor people *now* or within the lifetime of the project.

Lesson 9

Consider building impact evaluation into challenge fund designs, in addition to further commitment from development partners and practitioners to allocate funding and research resources to investigating suitable impact evaluation methodologies.

Identifying and applying learning

The potential to share learning on innovation, successes and failures in challenge funds is huge and not fully exploited. Strong communication processes can help to identify, capture and use learning within challenge fund communities and more widely. In the case of the CSCF, a learning strategy has been developed to help the fund manager, grantholders and DFID identify approaches that work to empower marginalised groups in holding national and local governments to account for rights and services. This approach is valued by all stakeholders because (i) it helps improve fund management processes that support implementation, and (ii) it showcases approaches that work in one setting which can then be taken up by other organisations in other settings. This can lead to intra-grantholder capacity building and helps the fund manager target their capacity-strengthening offer.

Lesson 10

Investment in collecting and using learning is best practice for all challenge fund stakeholders.

Learning from where projects go wrong and fail was a recurring workshop theme. Projects can fail for many reasons: for example, shifting operating environments, mismanagement and fraud, or a weak project theory of change from the outset. A recent analysis of three enterprise fund portfolios suggests a pattern of project success and failure: 10 per cent of projects were flourishing, 57 per cent were on track, 24 per cent were progressing slowly and 9 per cent were stalled and not performing well (Ashley, 2014).

Lesson 11

Learning is best achieved when project staff, relationships, processes and procedures are still in place.

CARE Bangladesh's DFID-funded SHIREE project provides better access to resources and services for poor men and women
Photo: Ian Taylor CARE

Is this an acceptable pattern to expect? Certainly, there is consensus that development partners could usefully accept that a proportion of projects will not go according to plan: immediate withdrawal of support from a failing project was noted as a 'disastrous' lost opportunity for learning.

Lesson 12

Learning is facilitated when grantholders feel confident in disclosing potential failures. Relationship building is critical in creating an environment of trust and a willingness to learn. There needs to be a commitment from development partners to learn from projects which fail.

Implementation timeframes

For challenge funds, short implementation timeframes (one to three years) remain a real barrier to the achievement of project objectives, particularly if projects are engaged in bringing about pro-poor policies, systemic change or attitudinal and behavioural change. For example, empowering girls and women to participate more actively in local and national political forums or lobbying the government to improve its policies and legislation in relation to political representation in Ghana (the objectives of workshop presenter Womankind Worldwide's CSCF project) cannot be expected to achieve results in the lifetime of a three-year project. Similarly, meaningful changes to market systems, the focus of enterprise challenge funds, do not generally happen within short timeframes.

Lesson 13

As projects can need longer implementation periods to achieve desired outcomes, supporting longer timeframes for projects to demonstrate results could be a practical step forward.

Sustainability and follow-on funding

Project sustainability and longer term impact can be threatened by a lack of continued funding. In enterprise challenge funds, there is often an expectation that supported businesses will be commercially viable at the end

Lesson 14

Longer-term support for challenge fund projects may be necessary in some cases: strong intra-development partner collaboration, and coordination with potential investors and alternative funding sources, may assist grantholders at the end of challenge fund support (e.g., a facility for follow-on funding within the challenge fund framework).

of the funding period: this is not always the case. In fact, a key problem businesses face is how to expand production post-project end and access further funding. How can development partners engage with the commercial finance sector to ensure continuity of funding and the longevity of successful challenge fund projects? Solutions have been developed: for example, the AECF has developed links between its projects and feeder funding once successful projects are ready for further investment. Civil society projects, particularly those run by smaller organisations, face similar problems where the sustainability of longer term results is curtailed by lack of further funding.

The importance of relationships

The most persistent theme in the workshop was the crucial importance of relationships in facilitating risk management, results and learning. The due diligence process associated with choosing grantholders may, at times, be arduous but it contributes to selecting partners who share common principles and approaches. Honest and regular communication between all stakeholders, particularly between the fund manager and grantholders, is vital to the success of a challenge fund. An important role for a fund manager is to support and facilitate partnerships and trust between all stakeholders, including beneficiaries.

Lesson 15

All stakeholders share a collective responsibility to invest in building and sustaining strong relationships to ensure that impact and results are achieved. Events such as learning and training workshops, seminars, and pre- and post-project meetings, facilitate relationship building and lead to learning.

Conclusions and going forward

Lessons from this workshop were informed by shared experiences from practitioners working in the world of challenge funds. What is clear is that challenge funds have contributed to improving the lives of millions of people across the world. Some lessons may have more or less resonance for those working through civil society or enterprise challenge funds, but there is significant overlap. However, it is clear that the success of all challenge funds hinges on embracing flexibility and innovation, managing risk, effective monitoring and evaluation, capturing learning, supporting sustainability, and fostering strong relationships. We hope that the lessons presented here will translate into new management practices that help ensure the life-changing potential of challenge funds is capitalised upon.

Women coffee producers from the Democratic Republic of Congo where **TWIN, a FRICH grantholder**, works to bring high quality speciality coffees to the UK market

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For more information

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