

# Do Challenge Funds Work?

## Lessons from a Decade Long Journey

### An Evaluation of Sida's Global Challenge Funds

**Challenge funds offer Sida the opportunity and flexibility of enabling civil society and the private sector to engage in innovative solutions on development issues. There is clear evidence that challenge funds as a mechanism have proven ability and flexibility to adapt to situations with a high degree of economic and political risk, but experience has highlighted the importance of good contextual analysis with a clear logic and pathway to impact.**

Sida's main objective with the evaluation was to understand when to use challenge funds and how to manage them. The evaluation assessed 10 global enterprise and civil society challenge funds supported by Sida, and tested Sida's rationale and underlying assumptions for the use of challenge funds in development cooperation. The evaluation pinpoints when challenge funds are an appropriate mechanism for tackling specific challenges and identifies good practice examples of fund design and implementation.

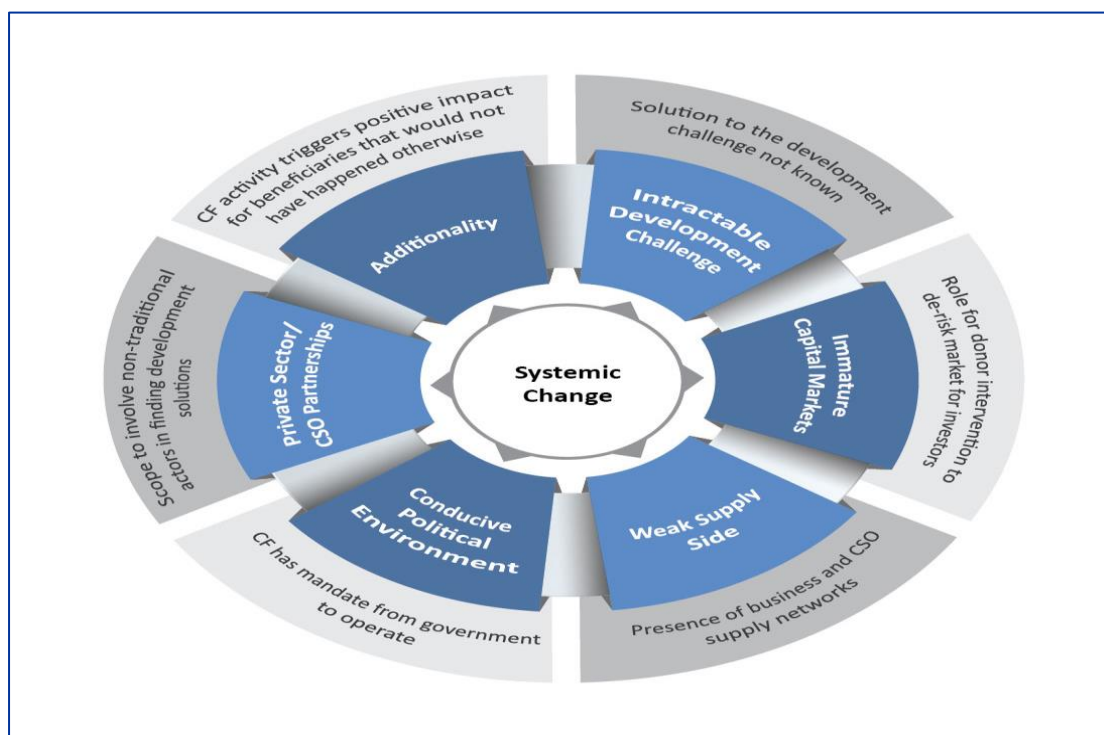
*Sida defines a challenge fund as "a financing mechanism to allocate (donor) funds for specific purposes, using competition among organisations as the lead principle". Challenge funds are different from conventional funding processes as the grantees typically have a large degree of freedom in finding and designing innovative solutions. The funds are therefore focused on a desired outcome and the means are not prescribed.*

#### ***Challenge funds have been an appropriate instrument***

The evaluation concluded that challenge funds have been an appropriate instrument for addressing development objectives and the intended outcomes for the majority of the funds have been broadly achieved. Sida's funding of SEK 1.2bn over the 10 year period has leveraged additional development funds from donors of SEK 5.8bn. The scale of the engagement is even greater when account is taken of the match funding by grantees, more than doubling the figure. Sida has been lucky in the relative success of the portfolio, given that an explicit consideration of alternative support instruments was not undertaken as part of their appraisal process. In future, at the appraisal stage, Sida could give more detailed consideration to other comparative aid instruments, before selecting a challenge fund.

***The rationale for the challenge fund instrument needs to meet pre-conditions for relevance***

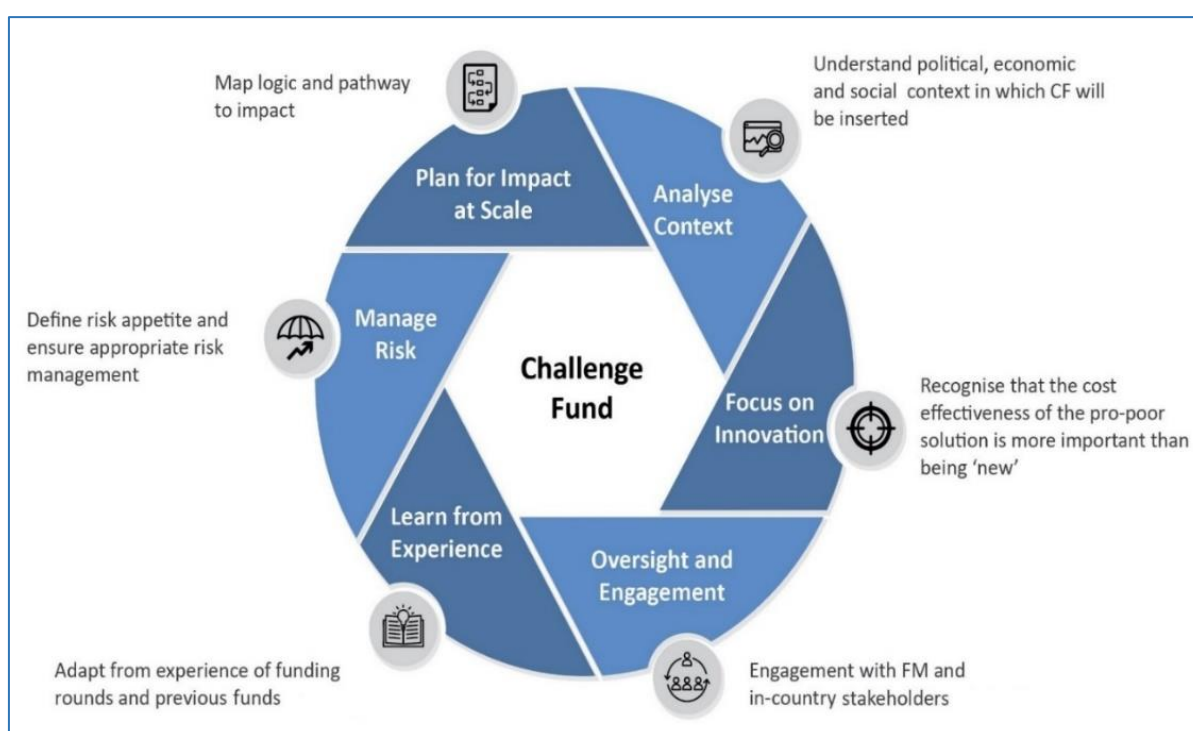
The evaluation identified the following conditions as important: i) a well-defined challenge with no tested solution available, also illustrated in the figure below; ii) the potential for the challenge fund to deliver systemic change by partnering with a range of organisations and addressing constraints to both supply and demand in target markets and sectors; iii) immature, risk averse capital markets which open the space for additionality; iv) open, conducive political environments which provide the challenge fund with space to operate; and v) in situations where the political and economic environment is less conducive donors and fund managers will need to modify their ambitions with a focus on de-risking the market for future commercial investment.



***Challenge funds have proven effective in opening up and de-risking markets***

Enterprise Challenge Funds have proven effective in opening up and de-risking untapped or hard-to-reach markets and in revealing hidden innovation across a wide range of sectors and geographies. Challenge funds can be used to address specific challenges where the outcomes are quite narrowly defined or where the project outcomes are broader. Both types of challenges have their place, but the conclusion of the evaluation is that the outcomes of the challenge need to be directed towards ensuring that projects will produce a scalable poverty reducing solution. To this end, challenge funds with a greater regional and sectoral focus have achieved better outcomes.

### Six key success factors identified



The figure sets out a summary of the success factors identified for Sida’s engagement with challenge funds. There is clear evidence that challenge funds as a mechanism have a proven ability and flexibility to adapt to situations with a high degree of economic and political risk but experience has highlighted the importance of good contextual analysis with a clear logic and pathway to impact. For enterprise challenge funds it is about reviewing the impact of entering a market and whether there will be market making/crowding in benefits. For civil society challenge funds, contextual analysis provides insight into the specific social, political and cultural challenges the fund will encounter, and the stakeholder groups whose support and engagement are crucial to the success of the programme. Innovation is a core principle of challenge funds but learning from the funds indicates the importance of ensuring that the planned outcomes are poverty reducing and consistent with the preconditions for choosing the challenge fund instrument. Other important factors are flexibility in implementation and of learning from experience and adapting the management of subsequent funding rounds as well as defining and agreeing on the risk appetite for the fund and providing for appropriate systems and resources to support performance and risk management.

### More intensively managed funds are more likely to deliver impact

Challenge funds were originally conceived as an instrument that only required a light touch engagement by both the donor and the fund manager with the onus of responding to the development challenge lying with the grantee. In general, it was found that more intensively managed funds, with a more hands-on approach at all stages of the project cycle, had a greater degree of success in ensuring sustainable development outcomes than the lighter touch funds. Challenge funds which enlist wider stakeholder support, are more likely to deliver impact. Also, the

more proactive engagement by the fund manager in all areas, including technical assistance is likely to lead to more sustainable development outcomes. The evaluation found that regional engagement by Sida in an oversight and influencing role improved not only the outcomes of the challenge funds, but also the process of local engagement with individual challenge fund projects which in turn offered the opportunity to learn and inform Swedish country development strategies.

***Strong intentions to address cross-cutting issues tend to weaken during implementation***

The evaluation showed inconsistencies in the understanding of the barriers, challenges and opportunities to address the cross cutting issues of gender equality, environment, climate change and local ownership. The experience has shown that clarity in the definitions of these terms, as well as an understanding of what objectives might be relevant and achievable is essential to ensure that the fund managers takes cross-cutting issues forward. While the responsibility of project implementation remains with the grantee, the task of the fund manager is becoming increasingly complex and demanding. There is an expectation that the fund manager should have a skill set which covers cross-cutting issues and a range of skills beyond grant management and due diligence.

***Sida needs to institutionalise the learning from 10 years of experiences***

Sida has gained considerable experience over the last 10 years, which has been reflected in the improvement in the design and delivery of challenge funds. However, this learning has not yet been accompanied by the formal institutional changes in the procedures and processes of engagement by Sida, or by agreement on the allocation of staff resources. Therefore, the evaluation proposed a set of recommendations on how Sida could institutionalise the knowledge gained. The evaluation also proposed a set of recommendations centred on enhancing Sida’s strengths in improving challenge fund design and the efficiency of implementation.

**2018:1 Sida Evaluation Series: Evaluation of Sida’s Global Challenge Funds**

The evaluation was commissioned by Sida and carried out by an evaluation team from IPE Triple Line between December 2017 and October 2018. The evaluation team included David Smith (team leader), Matthew Kentridge, Martin Wright, Juliette Seibold, Kathrine May and Theo Sands. Field visits were made to Bangladesh and Kenya. The evaluation can be downloaded from [www.sida.se/publications](http://www.sida.se/publications)