

## A Five-point plan on improving funding modalities

### Purpose

This document provides an update to the System Council for its 6<sup>th</sup> meeting on improving CGIAR System funding modalities as part of the adoption of a multi-year business plan for the System from 1 January 2019.

The document provides additional information to the ideas proposed in **Section 3.2** of meeting document *SC6-02: A Business Plan Concept*. It is intended to inform discussions on the proposed 5-point plan agenda and the challenges associated with the current funding environment.

### **Document category: Working document of the System Council**

There is no restriction on the circulation of this document

Prepared by: System Management Office

Introduction: Tackling incentive, predictability and allocation challenges in CGIAR's funding model: a 5-point plan

1. In 2016, key elements of CGIAR's governance system were successfully addressed. Their resolution has opened the opportunity to resolve long-standing challenges in CGIAR's financing system. This is needed to build confidence in CGIAR financing such that the reliability, percentage share, and absolute level of overall and system financing can be maintained and even increase.
2. A key 'big idea' for potential inclusion is fixing the funding model. CGIAR funding is caught between two poles – a traditional 'one pooled fund' approach and an earmarked bilateral arrangement, with often conflicting expectations around which approach applies. Right now, the funding system does not represent the optimal approach of either. Most realistic in the current funding environment would be an effort to improve the hybrid approach to make it work in a more efficient and effective way, and anchor it on an allocation/target-setting approach that has the strong support of Council.
3. This paper sets out some potential concrete ideas to address this set of issues – in particular:
  - a. The unpredictability of CGIAR pooled system funding
  - b. The incentives created by the CGIAR funding model
  - c. The transaction costs associated with a funding model currently dominated by small projects
  - d. The challenge of achieving full cost-recovery in CGIAR's funding model
  - e. A lack of clarity around how to allocate pooled system funding
4. This paper is a further step in a series of reports to the CGIAR System Council:
  - a. May 2017 paper – [Improving System Financing Modalities – A Scoping Note for further development and presentation to the System Council](#)
  - b. October 2017 paper – [An allocation strategy for the CGIAR System](#)

## Section 1: A 5-point plan to improve System funding modalities over the initial business cycle (2019-2021)

5. Key elements of a revised approach to hybrid funding could be the following actions:

**Table 1**

W1 = Window 1, CGIAR Trust Fund, W2 = Window 2, CGIAR Trust Fund

Item	DESCRIPTION
1. <b>Adopt:</b> a multi-year pledging process - with W2 pledges multi-year and at CRP/platform (and flagship where desired) level	A central objective of business plan is to increase the share of multi-annual pledges and to translate these into multi-annual pledges at the CRP/platform level – transforming the level of forward predictability of W2.
2. <b>Revise:</b> Use of W1 to change the internal hydraulics  Further explained in paragraph 6 below	De-link W1 from W2 in terms of its <u>ex post</u> “shock absorbing” within each financial year but continue to link W1 to W2 to support the rebalancing of funding <u>ex ante</u> at the start of the multi-year funding period based on W2 forward pledges/commitments.
3. <b>Clarify:</b> Approach to allocation within and between cycles	Clarification of between and within business-cycle approaches, alongside adoption of a funding target-setting approach to guide funding decisions over the remaining time in the current portfolio.
4. <b>Efficiency:</b> Optimal funding received to manage down transaction costs	Re-concentrate funding in large pooled programs and decrease number of small W3/bilateral projects.  <b>A possible goal</b> of the initial 2019-2021 business plan could be to explore appropriate incentives to reduce the number of projects that are less than \$200K by [X% – for discussion and agreement]
5. <b>Recovery:</b> full overhead cost recovery	Adoption of collective System Council ambition to cover minimum overhead costs requested by Centers. For example: i) CGIAR indirect cost rate to remain on average at around 15% - with a range of maximum +/- 5%; and ii) Funder commitment to meet full costing principles and support ‘CGIAR Cost Principles and Indirect Cost Guidelines’ (which will be replacing Financial Guidelines #5 by end-2018).

6. **Revise the use of W1 (Point 2 of the plan):** The use of W1 could function as follows:
- a. **De-link W1 from W2 in terms of its ex post “shock absorbing” within each financial year** - since because of action 1 there would no longer be a situation of end of year W2 surprises. This would resolve many of the perverse incentives issues created by the hydraulics of W1-2 since upwards additionality of funding would be enabled (see analysis below).
  - b. **Continue to link W1 to W2 to support the rebalancing of funding ex ante at the start of the 3-year funding period based on W2 forward pledges/ commitments.** This would be informed by a more articulated allocation process supported by the funding decision support tool. 3-year target W1 contributions to Programs would be made at the start of the 3-year period (and updated annually) in response to the projected levels of W2. The guiding principle to some or all W1 allocations would be to maximize alignment between actual CRP/platform funding projections (based on multi-year W2 pledges) with the total CRP Funding Target.
  - c. **Set out multi-year W1 allocations at the start of the business cycle.** Review these allocations and W2 targets annually, with changes made by exception in light of any changes in, for example, strategic directions and through new funding initiatives.

## Section 2: The allocations process for System-level funding

7. An immediate concrete task is to clarify the allocation process within the business plan. There are two distinct allocation ‘moments’:
- a. **Between each 3-year business cycle; and**
  - b. **Within a specific business cycle.**

**Table 2**

Between business cycles	During business cycle
<p><b>Potential reset of starting point in funding across system:</b> Fundamental reconsideration of new programs and balance of funding between these programs, based on the list of prioritization criteria set out in the Council Paper on an allocation strategy referenced above.</p> <p><b>Tool:</b> simulation tool that aligns potential programs with broader strategic SLO/higher level outcomes, potentially also collecting and presenting relevant available information on strategic fit and performance.</p> <p><b>Overall output of process:</b> [W1/2] funding targets for programs for business cycle period.</p>	<p><b>Methodology:</b> Annual review of funding targets and W1 forward allocations, to take into account any exceptional changes - particularly changes in strategic considerations such as a changing risk context (e.g. new pest/disease) or a potential new funding opportunity.</p>



12. Should the '2030 Plan' and successive 3-year multi-year business plan concepts be supported, the budget envelope would be shorted by 1 year to match the shortening of the implementation period of the current Portfolio of CRPs/Platforms to 5 years.

### Section 3: An allocation simulation tool

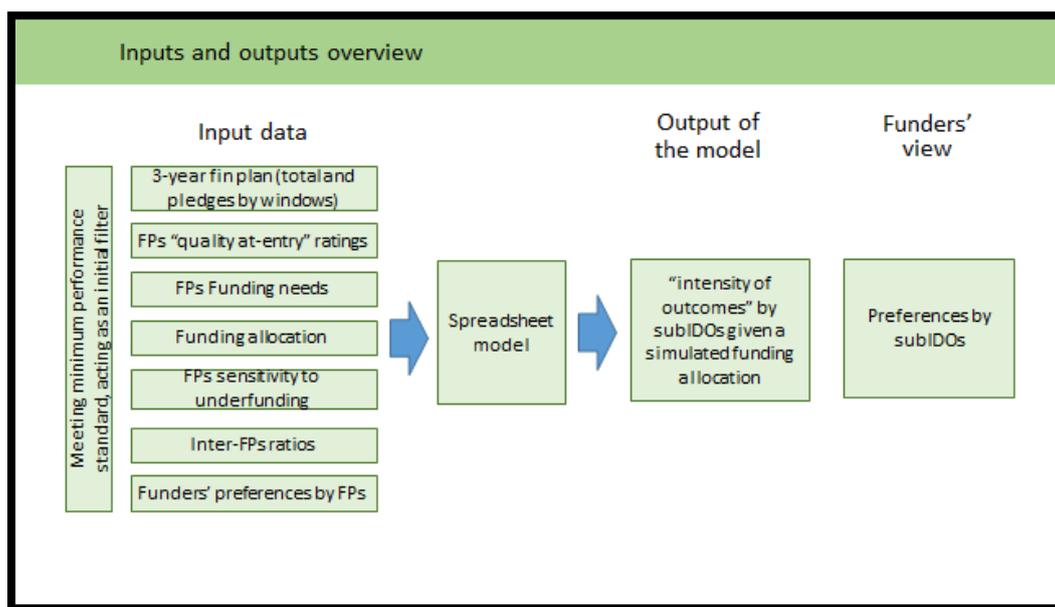
13. During the November 2017 5<sup>th</sup> System Council meeting, it was proposed to develop a tool that would support decision-making for the funding allocation across the Portfolio. The tool would provide different scenarios of funding allocations, each based on a set of input criteria covering three domains: estimates of likely results, estimates of program funding needs, and Funder priorities. Since then, the System Management Office has facilitated a system-wide process involving representatives from the CRPs/Platforms, and ISPC and the IEA.

#### **What the tool will accomplish?**

14. The tool would focus on "what if" simulation modelling rather than attempting to be an allocation formula. This means that the tool would model the implications of different funding allocation scenarios on the Portfolio's overall expected contribution to outcomes. In other words, the funding allocation scenarios become an input to the model, not an output. The output of the model would be a measure of the intensity of outcomes that the Portfolio is believed to contribute to at the sub-IDO level<sup>1</sup>, given the chosen funding allocation, and other input criteria.
15. The tool would use the sub-IDOs framework and a self-rating mechanism to map out the intensity of outcomes of the portfolio by sub-IDOs, given:
- a funding scenario,
  - ratings of flagships' quality-at-entry,
  - belief in flagships' intensity of outcomes by sub-IDOs,
  - dependencies between flagships in terms of contributing to sub-IDOs,
  - sensitivity of flagships' intensity of outcomes to underfunding,
  - and some other input data.
16. **The ambition is that the model will be able to illustrate what happens to the intensity of outcomes of the Portfolio if funding shortfall materializes in different areas of the Portfolio.** In addition, the tool will link and align the sub-IDOs framework into the SDG framework of outcomes and indicators. The tool could potentially also serve as some form of impact aggregation simulation.
17. The above can be summarized in the indicative schematic set out in figure 2 below.

---

<sup>1</sup> This measure of intensity of outcome would be informed by estimates of research outputs and theories of change across the Portfolio.

**Figure 2: Inputs and outputs overview**

18. The tool will include a set of visuals (coherence gauge in the schematic) aimed at facilitating dialogue led by the System Council, and informed by other key stakeholders, on an idealized and a simulated view of a Portfolio outcome for various funding allocation scenarios and decision-making.

#### Section 4: Rationale and justification for these proposed changes

19. These proposed changes directly address two key problem areas in CGIAR's funding system: the incentives framework it creates, and the funding unpredictability of W1 and 2. These factors combine to drive a System that, while still effective, is not optimized to play the major role required of it, as set out below and in various other CGIAR documents.

##### **A. The incentives created by CGIAR's funding model**

20. Funding systems are a key driver of incentives. The current system of funding is such that W2 contributions to CRPs (and also to flagships) typically do not lead to additional funding to that activity, since increases in W2 lead to concomitant decreases in W1.
21. In the same fashion, lower than expected W2 contributions are fully or partially compensated for by W1. This has led to a number of incentive challenges:
- a. A sense of frustration by some Funders that additional contributions to a CRP/platform level do not increase the overall envelope of financing to that area of work.

- b. A lack of incentives on the part of CRP and Centers to advocate for W2 funding for a CRP/platform in the knowledge that, if secured, this would lead to a full or partial reduction in W1 by the same amount.
- c. A lack of incentives for Funders or Centers/CRPs to attract new funding initiatives into pooled funding arrangements (W1/2) in the knowledge that system allocations might not be able to accommodate the required changes, and, without this, the new funding might crowd out W1 funding of other activities in the CRP/platform. [See November 2017 SC5 meeting paper [SC5-06: Allocation Strategy](#)]
- d. A likely resistance to having flagship-level earmarking exceed current levels of funding, which in the current approach would automatically require (sometimes unintentionally) other elements of the CRP/platform to be reduced as W1 is reduced to keep the overall CRP to within the indicative System Council allocation.

## B. The unpredictability of CGIAR pooled system funding

22. This was a key element of the Funding Modalities Scoping paper presented at SC4<sup>2</sup>, which noted (page 9) that:

*“Within-year and multi-year predictability of funds:*

- a. *In the **short term (within year)**, CRP funding from W3 and Bilateral is more predictable than System-level financing since these rely on typically 3- year project commitments. However, the W1&2 predictability of funding is poor – the last Funders to announce their funding decisions are two major Funders who together represent 30% of W1&2 funding, towards the end of the year, requiring Centers to pre-finance the research and absorb the risk between budgeted and actual income.*
- b. *In the **medium and long term**: CRP funding from W1&2 is mostly unpredictable over the medium and long term. In terms of ‘revealed preference’, W2 percentage allocations to some CRPs by Funders appears to be stable over years but the corresponding amount received often varies because of changes in their total size of contributions (including due to exchange rate changes).”*

### **Short-term within-year unpredictability**

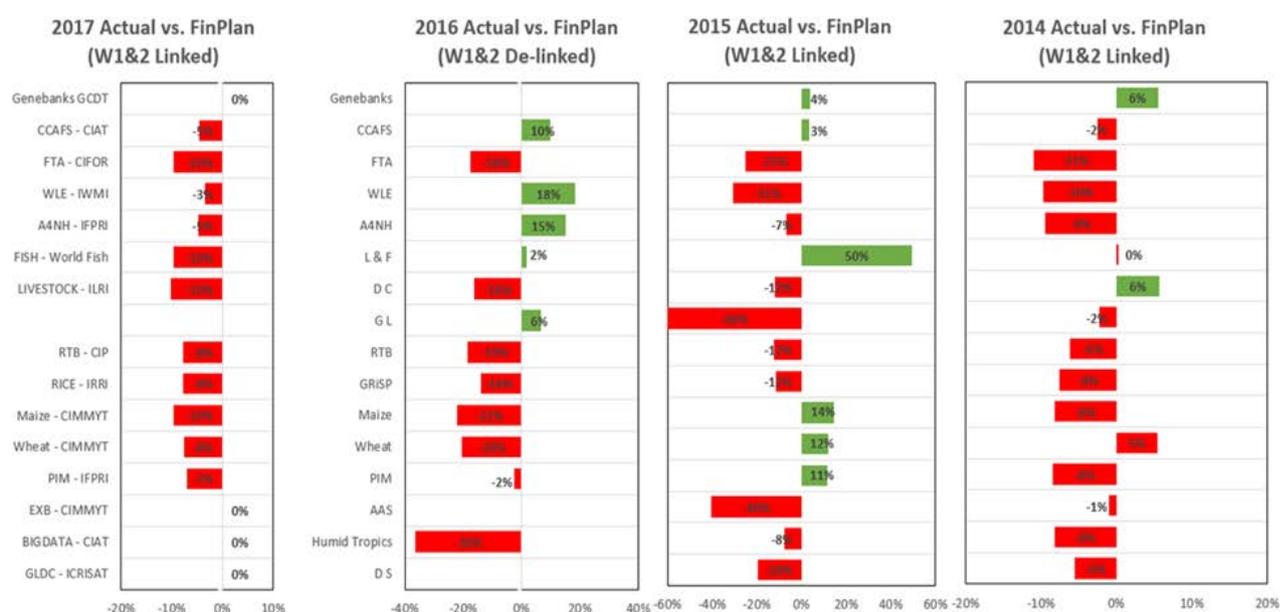
23. Each year, CGIAR develops a financing plan based on prior year funding experience as targets. However, the financing plan typically turns out to be unrealistic each year at the CRP/platform level - end of year differences in actual funding received by CRPs compared to System Council allocations of system funding are significant.

---

<sup>2</sup> [http://www.cgiar.org/wp-content/uploads/2017/05/SC4-03\\_Funding-Modalities-ScopingPaper\\_Revision-1\\_4May2017.pdf](http://www.cgiar.org/wp-content/uploads/2017/05/SC4-03_Funding-Modalities-ScopingPaper_Revision-1_4May2017.pdf)

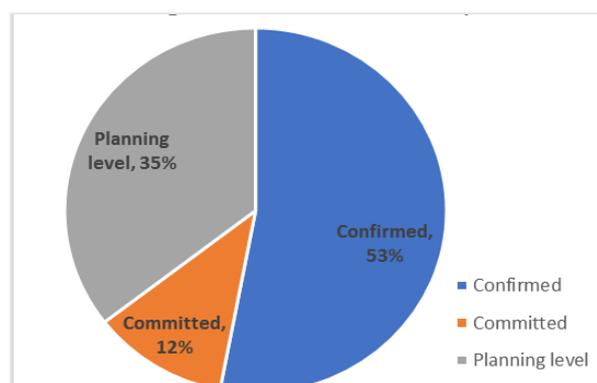
24. 2016 was a particular year in this regard since W1 was fixed in advance and not used to rebalance actual W2 contributions towards System Council allocations. This complete 'de-linking' led to about \$16.7m underfunding of 8 CRPs, which in turn drove a number of Center-level losses and declines in reserves – with some non-payment passed onto external partners.
25. However, end of year financing shocks also existed in past years when W1 and W2 were linked, as illustrated in figure 3 below.

**Figure 3. Financing plan targets vs actual funding**



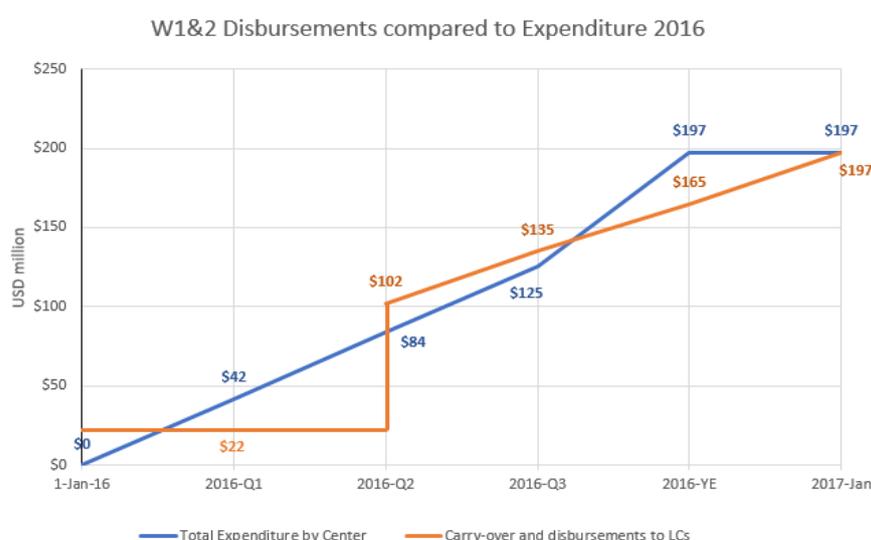
26. In terms of predictability/security of funding:
- As at December 2017** (approval of the 2018 FinPlan), expected funding based on enquiries was: 46% or \$81 million 'confirmed', 16% or \$28 million 'committed' and the remaining 37% or \$65 million was in planning stage.
  - As at April 2018**, and shown in figure 4 below, the level of security around overall 2018 W1/2 funding is: 53% confirmed, 12% committed and 35% still in the planning stage of Funders.

**Figure 4.  
Level of security  
at April 2018**



27. The drivers of this within-year unpredictability are described in detail in the Improving System Financing Modalities paper presented at SC4<sup>3</sup>.
28. In summary, these are:
- Poor forecasting of overall financing levels of W1&2 – in a large part driven by a process whereby CRP/platform allocations are made annually, often towards the end of CGIAR’s financial year (calendar year) – even when funding is based on multi-annual approvals.
  - Significant differences between assumptions of W2 funding, which provides the basis for System Council W1&2 allocation and actual W2 allocations.
  - Changing policies on the use of W1 in terms of whether it should be used to rebalance the gap between actual W2 contributions and System Council W1&2 allocations.
  - Allowing any W2 allocated to CRPs beyond the System Council allocations to be kept for that CRP.
29. Because Centers pre-finance CRPs, the risk of any shortfalls is held at the Center level and typically falls on reserves. Figure 5 below shows how within the year the total pre-financing of W1&2 CRP spend can rise to about \$60 million at its peak mid-year or \$30 million by year-end receiving the balance in January of the following year.

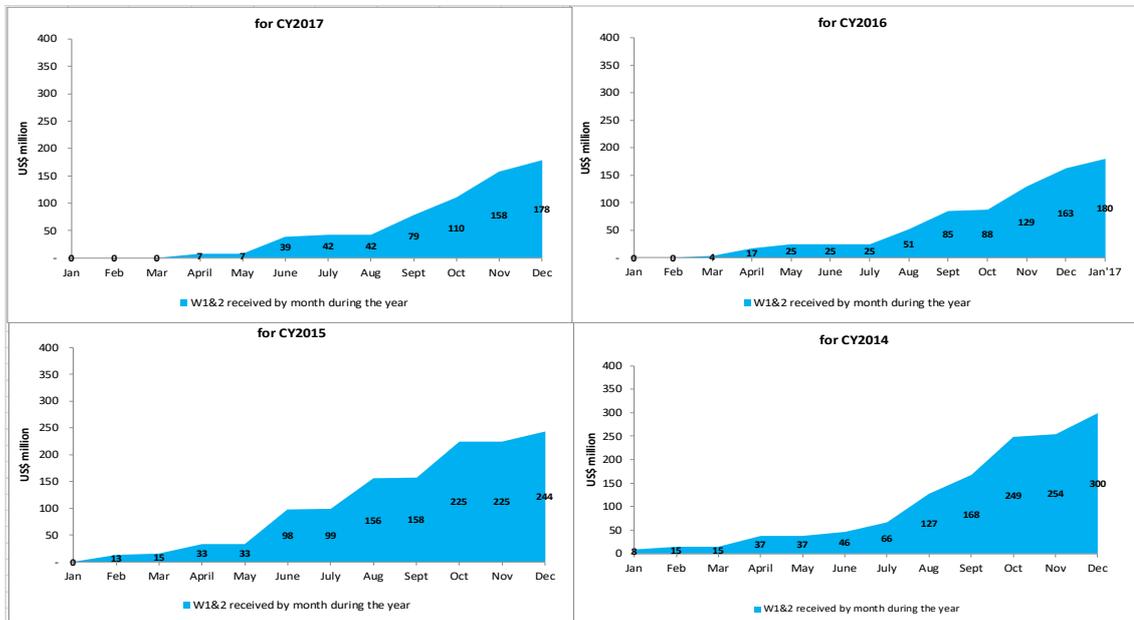
**Figure 5. Level of Pre-financing for W1&2**



<sup>3</sup> Improving System Financing Modalities SC4-03 [http://www.cgiar.org/wp-content/uploads/2017/05/SC4-03\\_Funding-Modalities-ScopingPaper\\_Revision-1\\_4May2017.pdf](http://www.cgiar.org/wp-content/uploads/2017/05/SC4-03_Funding-Modalities-ScopingPaper_Revision-1_4May2017.pdf)

30. Most of the funding becomes available only towards the second half of the year and sometimes, towards the end of the calendar year. Figure 6 shows how W1&2 contributions are concentrated towards the end of the year which is a root cause of the unpredictability of the current funding system.

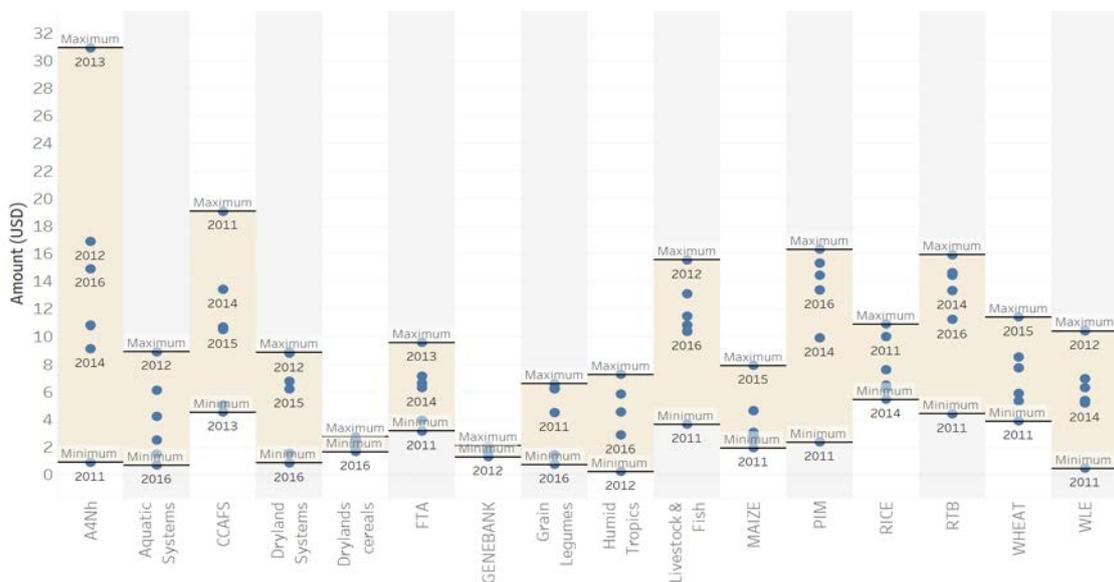
**Figure 6. Pattern of W1&2 inflows to CGIAR Trust Fund (and CGIAR Fund pre-2017)**



**Multi-year unpredictability**

31. A major further element of unpredictability is at the multi-year level. There are large annual variations of W2 amounts allocated to CRPs (figure 7), which have partially been offset by the use of W1.

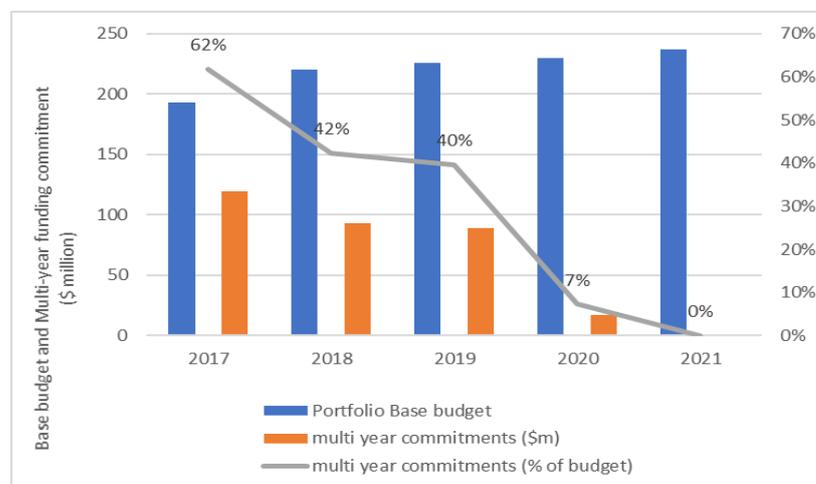
**Figure 7. Variability of W2 allocations**



This chart shows the band (minimum/maximum between 2011 and 2016) of W2 amount received by CRPs.

32. The proportion of multi-year commitments for W1/2 contributions do not align with portfolio base request. In 2017 the multi-year commitment is 62% and is set to decrease in 2018 – to approximately 42% of total W1&2 base request. (See: *multi-year agreements profile chart, figure 8*). It is anticipated that the ratio will be restored to the 2017 level when all Funders have completed the renewal of their multi-year commitments.

**Figure 8. Multi-year W1&W2 Commitments**



33. The operational impacts of this within-year and multi-year unpredictability are negative. In terms of programming, Centers under-program against System Council indicative allocations to factor in a level of risk that they can absorb in case of an actual funding shock.

**C. A lack of clarity around how to allocate pooled system funding**

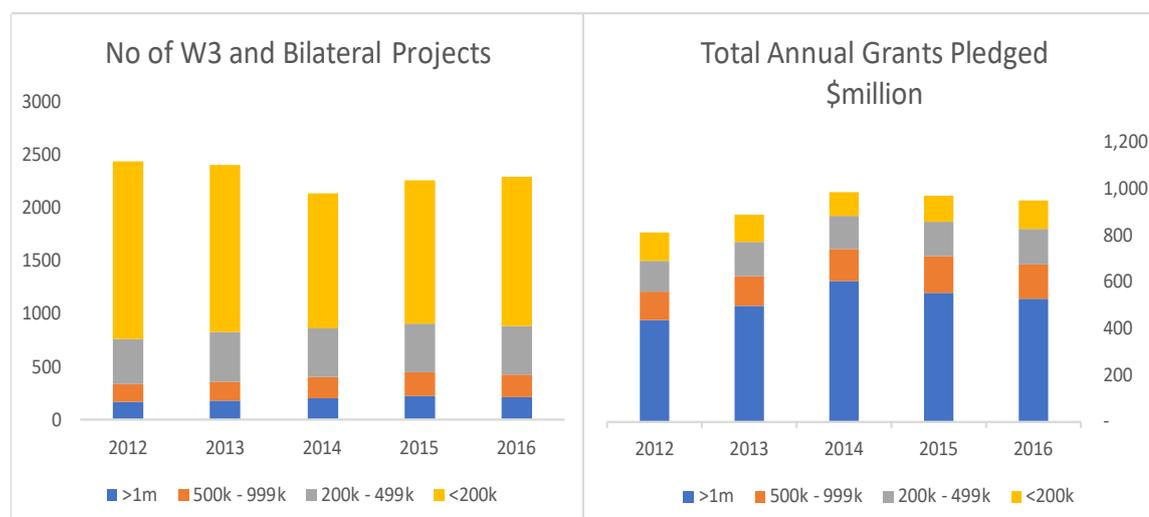
34. There is a major opportunity to use the business cycle approach to more directly link funding with programming and align this with a clearer multi-year target-setting approach for system-level funding. The absence of such an approach has been a major challenge in maintaining confidence in system-level funding, and in allocating reductions in funding across the portfolio. An allocation strategy paper was agreed at the November 2017 System Council that set out various building blocks required to address this challenge.

**D. Transaction costs of project proliferation**

35. The incentives in the overall CGIAR funding model appear to drive finance more towards smaller bilateral projects than typically more efficient pooled program-level

finance. This was set out in the Lions Head 2014 study<sup>4</sup> and as partly illustrated by the volume of transactions set out in figure 9.

**Figure 9. Analysis of Number of Projects vs. Projects size**



**Table 3. Number of Grants by Grant size**

	2012	2013	2014	2015	2016
<200k	1674	1570	1280	1,356	1,398
200k - 499k	424	466	454	457	463
500k - 999k	175	183	202	224	214
>1m	167	182	205	225	212
Total	2,440	2,401	2,141	2,262	2,287

36. Centers continue to manage a large number of restricted W3 and bilateral projects that have high administrative cost. Further **analysis of grants in 2016 below the USD 200,000 category also reveals that projects with average annual grant pledge of less than USD 100,000 represents 935 projects.**

#### E. Cost recovery

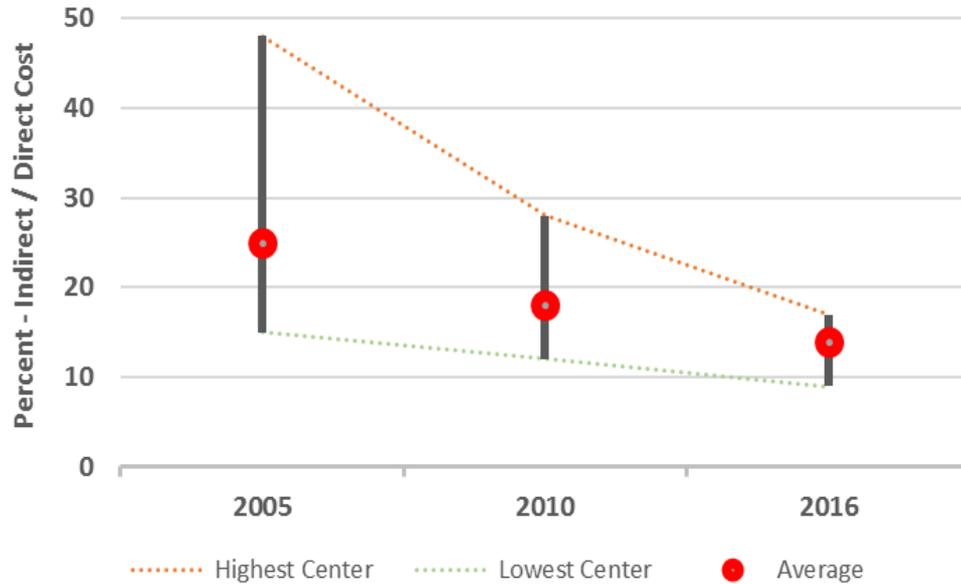
37. Cost recovery methodology across Centers has improved over the recent years but many grants are multi-year which do not allow retroactive adjustment of improved costing calculations (firm contract terms). Some Centers indicate difficulties to recover full costs on certain grants. While some funders allow shifting of indirect cost

4

[https://library.cgiar.org/bitstream/handle/10947/3267/CGIAR%20Resource%20Mobilization%20Strategy\\_21\\_October.pdf?sequence=1](https://library.cgiar.org/bitstream/handle/10947/3267/CGIAR%20Resource%20Mobilization%20Strategy_21_October.pdf?sequence=1)

into direct cost, rejecting grants that does not pay full cost or deliberate use of reserves remains as only alternative (figures 10 and 11).

**Figure 10. Historical Indirect Cost Rate**



**Figure 11. Rate of Indirect Cost Recovery by Funding Source**

