

# Experiences with the Catholic Relief Services' clustering process for agroenterprise development and some suggestions for improvement<sup>a</sup>

R.B. Murray-Prior<sup>1</sup>, S.B. Concepcion<sup>2</sup>, P.J. Batt<sup>1</sup>, F. Israel<sup>3</sup>,  
D.I. Aparar<sup>3</sup>, R.H. Bacus<sup>3</sup>, M.F. Rola-Rubzen<sup>1</sup>, M.O. Montiflor<sup>2</sup>,  
R.J.G. Lamban<sup>2</sup>, J.T. Axalan<sup>2</sup> and R.R. Real<sup>2</sup>

## Abstract

An evaluation of the Catholic Relief Services' (CRS) eight-step clustering approach to agroenterprise development was a key focus of the Australian Centre for International Agricultural Research (ACIAR) – Philippine Council for Agriculture, Aquatic and Natural Resources Research and Development (PCAARRD) horticulture project on 'Enhancing the profitability of selected vegetable value chains in the southern Philippines'. The CRS approach encourages farmers to form small, collaborative marketing groups (clusters) and to facilitate the sustainable development of these clusters. The research, which used participative action learning and action research processes, identified that an enhanced clustering approach should incorporate processes that overcome issues such as: input financing arrangements to replace loans from informal moneylenders and traders; risks associated with production failures and pest and disease problems; maintaining relationships with buyers; and building group resilience and independence so that donor agencies have an exit strategy. The research findings suggest that to enhance the sustainability of the clusters the CRS eight-step process should be applied to three phases: (i) establishment, (ii) building resilience and (iii) implementing an exit strategy.

## Introduction

An integral part of the Australian Centre for International Agricultural Research (ACIAR) Project HORT/2007/066 Component 4, 'Analysis of selected value chains in the southern Philippines', was to analyse the performance of the Catholic Relief Services' (CRS) eight-step clustering approach to agroenterprise development, to ascertain its potential for

<sup>1</sup> School of Management, Curtin University, Bentley, Western Australia 6102, Australia. Corresponding author: r.murray-prior@curtin.edu.au

<sup>2</sup> School of Management, University of the Philippines Mindanao, Davao, The Philippines

<sup>3</sup> University of the Philippines Strategic Research and Management Foundation, Davao, The Philippines

<sup>a</sup> The paper draws heavily on the following papers: Murray-Prior R.B., Batt P.J., Concepcion S.B., Montiflor M.O., Axalan J., Lamban R.J.G., Real R.R., Israel F.T., Bacus R.G. and Aparar D.I. 2011. Towards a sustainable approach to clustering small-scale farmers to market their agricultural produce. Pp. 136–145 in 'Building capabilities for sustainable global business: balancing corporate success and social good', Proceedings of the 12th International Conference of the Society for Global Business and Economic Development, Singapore, 21–23 July 2011. Accessible at <<http://sbus.montclair.edu/sgbed>>. Murray-Prior R.B., Batt P.J., Rola-Rubzen M.F., Concepcion S.B., Montiflor M.O., Axalan, J., Real R.R., Lamban R.J.G., Israel F.T., Aparar D.I. and Bacus R.G. Theory and practice of participatory action research and learning with cluster marketing groups in Mindanao, Philippines. *Acta Horticulturae* [submitted for publication].

facilitating the development of collaborative marketing groups (clusters) and to suggest improvements to the process. Initially, CRS was to facilitate the cluster marketing groups, and the role of the University of the Philippines Mindanao (UPMin) and Curtin University (Western Australia) was to evaluate their effectiveness. In the wake of the global financial crisis, a lack of external funds forced CRS to re-evaluate its development activities in the Philippines, particularly agriculture and, more specifically, this project. Unable to find a suitable agency to undertake the role of CRS, the University of the Philippines Strategic Research and Management Foundation (UPSTREAM) assumed the role of facilitating the development of the cluster marketing groups using the CRS process.

### The CRS clustering approach to agroenterprise development

The CRS clustering approach to agroenterprise development is referred to as the 'eight-step clustering approach' (CRS-Philippines 2007) (Figure 1). It begins by identifying the project site, building partnerships with farmers and other stakeholders, such as local businesses, local government and non-government organisations (NGOs), forming a working group and providing a project and cluster orientation to smallholder farmers. Step 2 is a participatory process in which the farmers identify the community's

resources, products, and production and marketing practices during basic marketing training. The group then decides what product or products will be the focus of their activities. Step 3 involves training farmers to undertake a market chain study and to conduct market visits in which they develop an understanding of the chains for their selected products and negotiate trading terms with potential buyers.

Step 4 is the cluster formation phase, in which interested farmers form the cluster, select leaders and settle on a basic cluster agreement and objectives. Step 5, or cluster plan formulation, involves the development of a planting and harvest calendar for the products of the cluster and deciding on the test-marketing plan. The test-marketing activities in Step 6 involve at least four trial product deliveries. After each delivery, cluster members hold meetings to assess performance and adjust the plan to enable improvements. Once the group and facilitators judge the test markets successful, Step 7 follows, which involves planning and conducting a scaling up process. Scaling up involves producing more products or additional products to supply existing markets or more diversified markets. Cluster members and facilitators appraise readiness for scaling up against criteria that assess cluster willingness, level of product supply, market performance, management performance and their financial needs. The final step of cluster strengthening involves undertaking activities

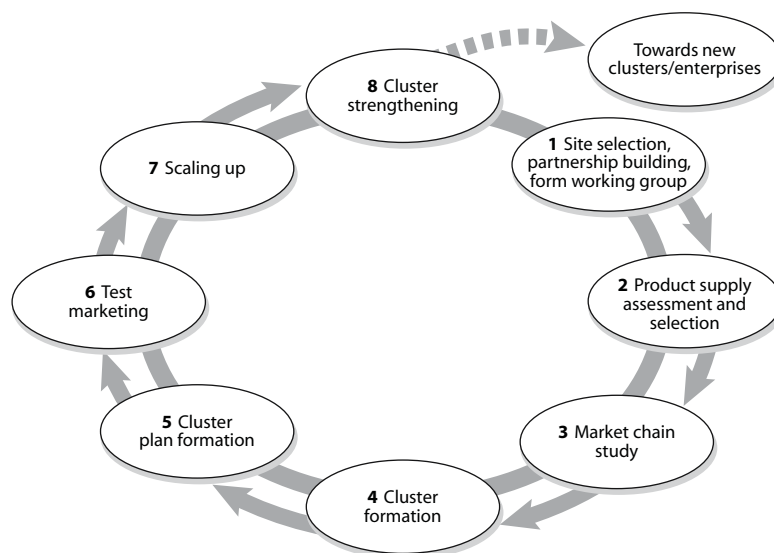


Figure 1. Eight-step process of the clustering approach to agroenterprise development: an action learning process (Source: CRS-Philippines 2007)

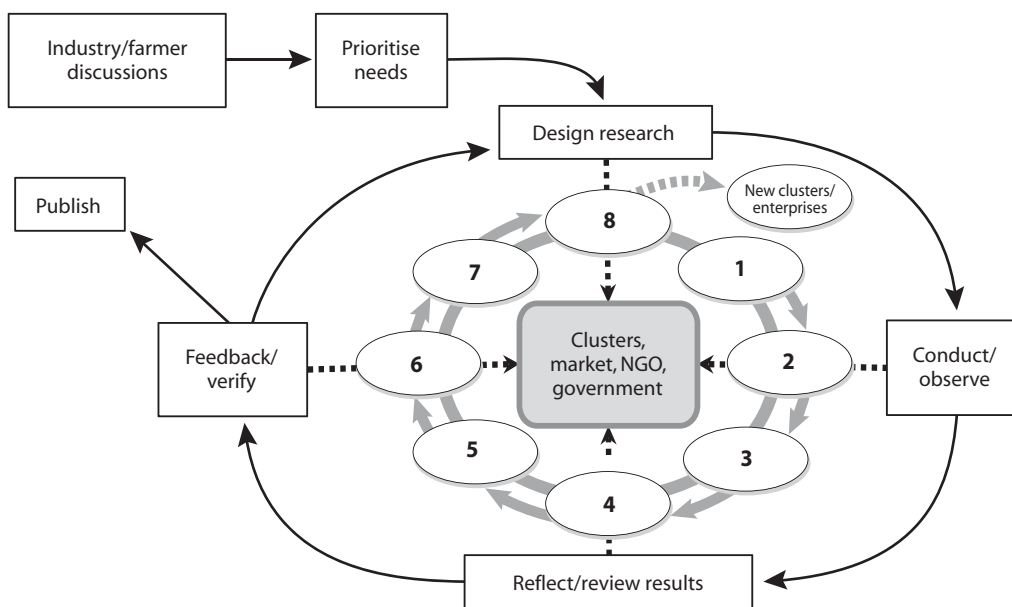
that expand cluster capacity and networks with other clusters and businesses. The objective is to improve cluster maturity.

While this process has been extensively employed in facilitating the development of clusters, the evidence to date suggests that very few of these cluster marketing groups have survived once funding has been withdrawn. Murray-Prior (2007) suggests that collaborative marketing groups will survive only where they offer some comparative advantage. In other instances, it is apparent that many NGOs are reluctant to let their more successful groups go, for future funding is contingent upon their ability to demonstrate success. Inadvertently, this may often result in the cluster becoming dependent upon the NGO. With limited budgets, if the clustering process is to be replicable, there must be a process by which formal linkages with the more mature groups can be severed, to enable them, with minimum intervention, to make their own decisions and to become self-sustaining. In turn, that enables resources to be redirected towards the formation of new cluster groups, greatly increasing the reach and the impact of the project.

This paper explores some suggested improvements to the CRS eight-step plan for agroenterprise development that will lead to more sustainable and successful cluster marketing groups.

## Methodology

The methodology used to investigate the application of the CRS clustering approach involves an integrated participatory action learning and action research process with over 29 cluster marketing groups (CMGs) in Mindanao, the southern Philippines. The UPMin, through the UPSTREAM Foundation, facilitated the establishment of several CMGs in Davao, Bukidnon and South Cotabato using the CRS eight-step process. At the same time, research officers from UPMin were involved in an action research process that documented each cluster group's activities and investigated issues as they arose (Figure 2). Surveys were conducted of farm household resources, production activities and the relationships among farmers, wholesalers and traders, farmers and the cluster, clusters and traders, and wholesalers and institutional markets. Case study reports were prepared for each cluster and on selected farmers within the clusters. Findings from these investigations, discussions between the researchers and field officers, and evidence from the literature and experiences of the researchers, field officers and farmers, were used to identify and evaluate changes to the clustering process and activities.



**Figure 2.** Participatory action research process integrated with action learning process for marketing clusters

Because of the quantity of data involved in this action research/action learning study, which occurred over 4 years with 29 cluster groups, it is not possible to present the results supporting the discussions. Therefore, the paper summarises data, discussions and conclusions presented in previous papers published by the research team. It also follows the qualitative research approach in presenting the results and discussion together, which is the norm for action research.

### **Issues to be addressed by an enhanced clustering process**

This combined participative action learning and action research process identified the need for an enhanced clustering process to incorporate processes that would overcome some of the major issues such as: input financing arrangements to replace loans from informal moneylenders and traders; the risks associated with production failures; maintaining relationships with buyers; and building group resilience and independence so that donor agencies have an exit strategy.

#### **What to do about the input financing problem**

Smallholder farmers in the Philippines and elsewhere have limited or no access to the formal lending sector. Thus, they have to rely on informal moneylenders, including local traders, landlords, commodity wholesalers and other village moneylenders (Robinson 2001; Llanto 2007). These loans are often at rates well above those charged by commercial microfinance institutions because such markets sometimes have characteristics of monopolistic competition (Robinson 2001). When smallholder farmers market their produce through a CMG, such as those created using the CRS clustering process, these arrangements often bypass the traditional marketing system. Consequently, the farmers may be unable to access loans from local traders and commodity wholesalers. These lenders often lend money for inputs in the expectation that they will be able to buy the product at prices that are advantageous to them. They may also threaten smallholders with not lending money or refusing to buy their product if they sell through a cluster. This appears to be a common occurrence (Llanto 2007).

Llanto (2007) and Campaigne and Rausch (2010) suggest that lending to farmers who are connected

to an integrated supply chain is more feasible. Some of the cluster groups from Bukidnon and South Cotabato have accessed finance through microfinance institutions, partly because they were organised groups. However, their outcomes have been mixed (Axalan et al. 2010; Real et al. 2010). When production fails due to weather or disease problems, farmers who have formal loans from microfinance institutions face additional burdens, which can affect both the viability of the cluster and its marketing arrangements. In Bukidnon, squash, sweet pepper and bitter melon clusters were unable to meet their contractual obligations due to disease- and weather-related problems (Real et al. 2010). Since the microfinance institution provided the loans because the farmers were members of a CMG, some clusters had farmers who withdrew because they expected that they would be liable to repay the loans of other cluster members. On the other hand, members of a sweet pepper cluster in South Cotabato who received loans from a microfinance institution had fewer problems, partly because they did not have the same level of production failures, but also because of the way in which their loans were structured (Axalan et al. 2010). Other clusters in the Davao City area do not have access to microfinance and must therefore self-finance or obtain some funding from informal moneylenders.

In light of the literature on microfinance, some lessons can be drawn from these examples. Microfinance loans can increase the risk to farmers because they lead to greater investment in inputs, which the microfinance institution may not recover if production problems occur or if market prices are inordinately low. Often farmers involved in new cluster marketing groups are involved in learning about and implementing many new and interrelated behaviours. Adopting new behaviours and crops is inherently risky. In this case, farmers are adopting new marketing arrangements, often growing new or expanded areas of crops, and are learning to cooperate to produce, market and deliver their crop to a focal buyer at some particular time.

If farmers in the early stages of clustering are provided with loans, the combination of these risks can leave farmers and clusters in a perilous financial position, as happened to the clusters in Bukidnon. In one case, the loan was linked to a particular crop and marketing arrangement (Real et al. 2010). The microfinance institution lent the money on the expectation that the crop would be sold through a particular

agent who would deduct loan repayments and pay the farmers the remaining money. When the group could not meet the quantity and quality requirement due to a viral infection, the agent rejected the clusters' product and hence repayments were not made. Since the repayments were linked to a particular crop and repayment arrangement, some farmers did not feel obligated to repay the loan.

Some of the loans made to clusters in Bukidnon were based on overoptimistic assumptions about yields and prices (Real et al. 2010). Since farmers are learning and adopting many new skills and behaviours in the early stages of clustering, the likelihood of crop failure is high. Vegetable prices in the Philippines are extremely volatile because of seasonal variations in production, with the frequency and potency of typhoons (Batt et al. 2011) adding an additional complication. Budgeting for loans must be conservative to allow for the high level of production and price risk, and to decrease the risk of over indebtedness.

Furthermore, such loans should be made only for the purchase of physical inputs such as seed, fertiliser and pesticides. In Bukidnon particularly, it was evident that the value of the loan extended was much greater than the crop needs, which resulted in funds being redirected towards the purchase of household goods. Ideally, farmers should finance part of the crop from their own resources. Hermes and Lensink (2007) suggest that credit rationing can increase the likelihood of loan repayment, which is consistent with this view. Additionally, there is some evidence that loans are necessary only for crops that are more expensive to grow and not for all crops, at least in the initial trial stages. As farmers gain experience with crops and cluster marketing, and as the clusters seek to expand production and scale up, loans may become more necessary.

A comparison of the lending strategies followed by microfinance institutions in Bukidnon and South Cotabato and their successes and failures supports some of the principles underlying the Grameen Bank and the Association for Social Advancement (Llanto 2007). These include compulsory savings or capital build-up, progressively larger loans based on demonstrated competence, and financial education for loan recipients in budgeting, saving and managing debt (Llanto 2007; Cohen 2010).

Finally, donor agencies need to be careful when promoting and supporting loans to cluster marketing groups, because the action can lead to the impression that the loans are a gift. Farmers are used to

charitable institutions providing gifts, and even where the loan is provided by a microfinance institution, if it is linked to the support that a donor agency provides for the cluster marketing group, it can be perceived as a handout. Experience with the loans made to some of the farmers in Bukidnon suggests this was a contributing factor to problems associated with repayment by some farmers.

### **Risks associated with production failures**

Vegetable farming in the Philippines can be a risky business, with production quantity and quality varying widely due to climatic conditions and pest and disease outbreaks (Batt et al. 2011). Dry periods can lead to poor crop emergence and growth, while wet periods can dramatically affect seedling survival, flowering, product quality and yield. Wet weather also intensifies fungal diseases, which can increase costs of control and severely reduce yields. Similarly, poor seed selection results in disease outbreaks (as occurred for the bitter melon cluster), while pest and disease outbreaks can occur as a result of climatic conditions, poor rotations or poor crop hygiene. These variations in yield and quality not only reduce farmers' returns, but also make it more difficult for clusters to be consistent suppliers to institutional markets.

One strategy adopted by farmers to manage the risk is to adopt lower-input production systems that require lower financial outlays and reduce yield variability. Many clusters are in relatively remote areas, so imported fertilisers and pesticides are expensive and difficult to obtain. Accordingly, farmers have been investigating the use of organic and 'natural farming' (Jensen et al. 2006) systems. These systems use local inputs, such as organic fertilisers, composts and homemade pesticides. Further investigation is needed to see what effects these systems have on levels and variability of yield and quality.

Another strategy is for the cluster to commit only a portion of its expected yield to the focal buyer, particularly if this is an institutional buyer who wants consistent supply. A common figure is 60% of a conservative estimate of yield, although this varies depending on the crop and the number of buyers. This strategy has additional advantages, in that farmers are then free to sell their surplus product to other buyers, particularly if there is a spike in prices. They can also maintain their relationships with traditional buyers who provide other services such as credit. It also spreads their risk if one of their buyers defaults or refuses to accept product for whatever reason.

### **Maintaining relationships with buyers**

Modern value chains, because they require consistent quantity and quality of supply and processes for ensuring food safety, have generally developed in advanced economies and are therefore more suited to medium- to large-scale farmers. Smallholder farmers in the Philippines have little understanding of these markets because they have traditionally dealt only with local traders, and rarely visit the wet markets where most of their product is sold. The clustering process tries to overcome this deficiency by training farmers to conduct their own market chain studies, including talking to buyers at different stages of the chain and in different markets. Farmers are also taught negotiating skills, which improves their confidence and ability to negotiate prices, volume and quality with institutional and other buyers. Nevertheless, smallholder farmers generally take some time to develop their knowledge of market operations and requirements, and this can create misunderstandings and conflict between the cluster and buyers—especially institutional buyers. Conversely, institutional buyers often come from cities and have little understanding of the constraints faced by smallholder farmers, which exacerbates misunderstandings and conflicts between the two groups. This combination has led to numerous breakdowns in the relationship between buyers and clusters.

One strategy to reduce the effect of this issue is the conduct of series of test-marketing activities (CRS Step 6). After each trial, the cluster evaluates the performance of the trial product deliveries in terms of the quantity and quality of the product that was delivered versus what was planned. However, there can still be misunderstandings between the cluster and its buyer, and sometimes the donor agency has to facilitate a discussion about the causes of the misunderstanding. Sometimes the problem is with the farmers, but equally the problem can be with the buyer who can try to take advantage of the farmers, possibly because that is what they have been used to doing.

This is a learning process for both sides and it appears that in some cases it requires a couple of years, including periods where the cluster sells to other buyers, before a sustainable relationship is achieved. In other situations, a sustainable relationship may not be possible due to a whole range of reasons. The donor agency that is facilitating this process needs to have patience and to act as an honest broker

by not taking sides, and by attempting to identify the root causes of the problem. It is important for farmers to be involved in discussions and negotiations with the institutional buyers, as this is the only way in which understanding and mutual respect can be gained and sustained. Supermarket buyers of vegetables from Davao and Bukidnon clusters have been taken to the smallholder farms where the vegetables they are buying are grown, to give them an appreciation of some of the difficulties faced by the farmers in getting a quality product to market.

### **Enhancements to the CRS clustering process**

Cooperatives and cooperative marketing arrangements have a poor record in the Philippines. Many of these cooperatives were set up for political reasons such as agricultural development, pacification of revolutionary activities and distribution of subsidised inputs. Most cooperatives failed when government removed institutional supports. Outside support can enhance the chances of success of smallholder cooperatives (Murray-Prior 2007), but it can encourage dependency, which means the cooperatives are not sustainable once external support is withdrawn (Shigetomi 2006). If cluster marketing is to be a successful alternative, processes are required that develop resilience in the groups so that they can survive with minimal external support. This also implies building in an exit strategy as a component of the clustering approach.

There are two key factors that are important to the success of cluster marketing arrangements: 1. a comparative advantage over alternative marketing structures; and 2. trust in cluster management and between cluster members (Murray-Prior 2007). The clustering approach addresses the first of these issues through its focus on developing a marketing plan and its test-marketing activities. The group is unlikely to form unless the cluster farmers see a comparative advantage for cluster marketing over their existing marketing arrangements. The second issue is addressed in a number of ways (CRS-Philippines 2007). First, the process is participatory and transparent, and considerable effort is devoted to activities that involve cluster members, market chain investigations, development of the production plans, and keeping records on deliveries and payments that are accessible to all members. Members develop a cluster agreement, develop cluster enterprise plans and business

policies and systems, and review test-marketing activities. Second, clusters conduct regular meetings, and members elect the leadership team. Third, clusters are normally restricted to 15 or fewer members so that trust can be maintained through group pressure. As well, the clusters and their leaders receive training in group processes and leadership. Evidence from the trust measures collected by the research officers (e.g. Montiflor et al. 2010) indicate that cluster members currently have high levels of trust in their cluster.

While comparative advantage and trust are essential to the successful operations of CMGs they are not sufficient; nor do they guarantee success in the long run. A three-phase clustering framework is proposed that builds on and enhances the processes outlined in the CRS eight-step process. It incorporates three phases: Phase 1—Establishment; Phase 2—Building resilience; and Phase 3—Implement an exit strategy (Figure 3). Each of these phases is a type of participatory action learning cycle and contains a series of steps that may be repeated depending on the maturity of the group.

### Phase 1—Establishment

The establishment phase follows the first six steps of the CRS process (CRS–Philippines 2007) with minor modifications and takes 1–2 years. In step 1 (site selection, partnership building and formation of working group), greater emphasis needs to be put on investigating input-financing arrangements, both the existing informal lending arrangements and potential microfinance lenders if farmers are not involved with

them already. More orientation is required on saving, loans and financing alternatives in addition to the orientation on marketing that is currently provided.

In step 2 (product supply assessment and product selection), potential crops and products should be ranked but not selected. Product selection would then be re-evaluated following the market research (CRS step 3). This step should be expanded to include an investigation of input requirements for particular crops selected following the market research, potential sources and costs of those inputs, and the ability of farmers to finance these inputs. Financial institutions may help with the latter.

In step 4 (cluster formation), the eight-step process of orientation on marketing basics and clustering needs to be broadened to include production issues, sources of inputs and the financial implications of particular crops. Step 5 (cluster plan formulation) would then proceed according to the eight-step process. The test-marketing activities (CRS step 6) would go through a number of stages including: (i) assessment of cluster commitment and capability of members; (ii) identification of information and training needs and conduct of trainings to overcome deficiencies; (iii) evaluation of buyers and establishment of a good working relationship; and (iv) refinement of agroenterprise plans.

### Phase 2—Building resilience

The focus of Phase 2 is essentially cluster strengthening and capacity building—an expansion of the CRS step 8, known as cluster strengthening. Groups

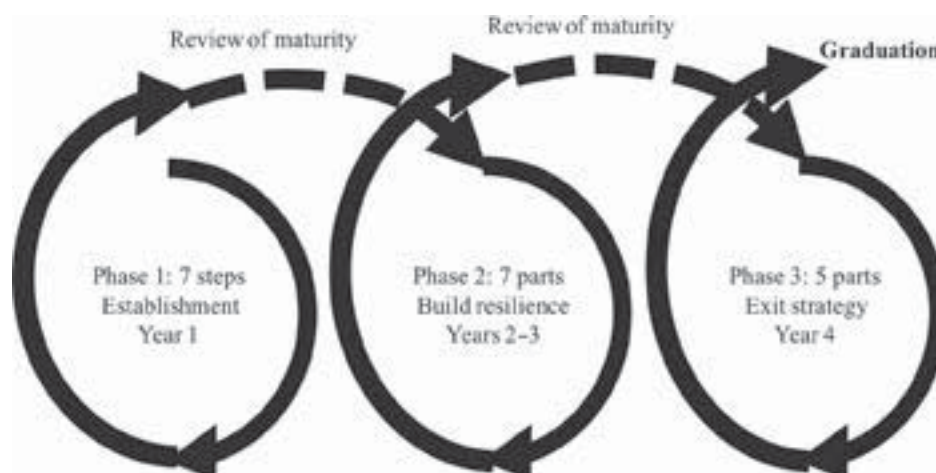


Figure 3. Three phases in enhanced clustering process

will often go through periods of decline in activity, often caused by production or marketing problems. A lack of capacity and immaturity in the cluster can sometimes cause marketing problems, but buyers not paying or not complying with their agreements can also be a cause. Problems like these can cause the cluster to collapse, but if the donor agency is able to support the cluster in developing strategies to deal with these problems, the clusters develop confidence in their own abilities and are in a better position to deal with future issues without assistance. One example of this from our research occurred with the Ned cluster, which delivered product to a buyer who did not pay them. The group negotiated with their microfinance agency to obtain a loan and then investigated and found new markets for their products (Axalan et al. 2010). Their ability to overcome this problem led to greater commitment.

Kaganzai et al. (2009) argue that this ‘repair and maintenance’ support from donor agencies may be necessary in the scaling-up phase of collaborative marketing groups. In fact, one or two of these difficult periods can be part of the process of developing resilience. Clusters have overcome production problems by establishing links with seed companies to provide better quality seed and changed production practices with the assistance of local government advisers. Clusters have overcome marketing problems by identifying new buyers and markets and subsequently diversified their markets. In this phase, the role of the donor agency is to provide assistance when the cluster is struggling, to help enhance cluster networks and to build cluster capacity. They provide less direct assistance, and the group is encouraged to draw on its own resources. The steps in this phase include: (i) revisiting the product supply assessment step and reassessing training support needs; (ii) undertaking a further market chain study with a view to reassessing the cluster’s performance in meeting market needs, identifying additional markets and selecting focal market chains; (iii) review cluster membership and structure; (iv) identifying information, training and support needs which are addressed through training and capacity-building activities; (v) formulating cluster and operational plans; and (vi) conducting and reviewing marketing activities.

### **Phase 3—Implementing an exit strategy**

Sustainability of cluster marketing arrangements is problematic, as many such groups have failed after the donor agency withdraws. Some reasons for this

problem include: donor agencies taking control of marketing and hence replacing the market intermediary; donor agencies providing too many gifts and creating a ‘handout mentality’; competition between donor agencies; donor agencies focusing on ‘favourite’ groups that have a ‘reputation’ for success; and the failure of donor agencies to develop exit strategies. Markelova and Mwangi (2010) call for donor agencies to develop viable exit strategies from the onset of their project, so as to lessen dependency issues. The CRS clustering process already includes criteria for assessing cluster maturity (see CRS—Philippines 2007, p. 140), so the focus here is on how to incorporate these into a process for implementing an exit strategy for the donor agency. The specific steps in this phase could include: (i) a workshop to assess maturity for graduation or exit of the donor agency; (ii) training in business planning and the development of business plans; (iii) strengthening links with support institutions; (iv) formulating a business plan for the cluster’s afterlife; (v) participatory evaluation of the clustering process, the donor agency involvement in the process and the donor agency performance; and (iv) organising a graduation activity. It must be made clear to the farmers from the beginning of the establishment phase that the donor agency will provide support for only a finite period and that the CMG will need to build its resilience and become self-sustaining. Identifying this phase in the process helps to emphasise this reality to the cluster members and to the donor agency staff.

## **Conclusions**

Development activities of many donor agencies fail because they do not focus on an exit strategy from the initial planning stages. This paper outlines an expansion of the CRS eight-step plan for agroenterprise development to cover each of three phases: (i) establishment; (ii) building resilience; and (iii) implementing an exit strategy, so that the focus will be on the cluster marketing group becoming self-sustaining. It also addresses access to finance from the formal lending sector, but this can increase risks for farmers, so the donor agency must ensure that farmers do not get the perception that the loans are a gift. Building long-term relationships between cluster marketing groups and institutional buyers in the Philippines is a difficult process. A donor agency will have to invest considerable time and effort in facilitating this process and organising activities



that build capacity and relationships between the smallholder farmers, institutional buyers and other government and non-government institutions, so that clusters can undertake these activities after the donor agency exits.

This is the first time the CRS eight-step plan has been investigated scientifically. The three-phase process also has the potential to become a process used widely in the Philippines and elsewhere, as a mechanism to facilitate rural development and improve smallholder farmer incomes. However, the sustainability of clusters under this process and under the existing CRS eight-step plan, and the factors that will increase long-term sustainability still need to be investigated.

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