An investigation of the role of trust in the relationship between pension fund trustees and investment managers: an Indonesian case study

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1. Introduction

In the previous chapter the research findings and the conclusions reached in this study were given. The major research findings include the reasons for a trustee to hire an investment manager, the key factors of trustworthiness of an investment manager, and the key activities for building a trust relationship. The major conclusions of this study that: (i) trust is important in the relationship between the trustee and the investment manager; (ii) the level of trust the trustee has in the investment manager is determined by the investment manager's degree of trustworthiness, and (iii) a model of a trust relationship that explains how they build and develop their relationship was proposed. The purpose of this chapter is therefore to look at the research contributions, limitations and implications. In this chapter, brief explanations of the theoretical model used in this thesis followed by the research contributions related to these models will be discussed. This thesis has also limitations and still need for further research.

2. Theoretical Model

Two theoretical models were used as a guide for exploring the relationship between an Indonesian trustee and an investment manager: (i) the model of trust
developed by Mayer, Davis, and Schoorman (1995) and (ii) the stages of a trust relationship model proposed by Lewicki and Bunker (1996).

2.1. Theoretical Model of Trust.

The theoretical model of trust developed by Mayer, Davis, and Schoorman (1995) explain that: (i) the propensity to trust influences the level of trust in another; (ii) whether a person is trustworthy it can be determined by three key factors of trustworthiness, these are: ability, benevolence, and integrity; (iii) trust is the willingness to be vulnerable to the actions of another; (iv) the perception of risks is a person's believe about the possibility of gain or loss from a relationship; and (v) if the level of trust is higher than the perceived risk, a risk will be taken in the relationship. Their theoretical models were used as a guide for exploring the key factors of trustworthiness of Indonesian investment managers from the perspective of the Indonesian trustees of pension funds.

There are two reasons for using the theoretical model of trust developed by Mayer, Davis, and Schoorman (1995): (i) the theoretical model focuses on the role of trust in a risk taking relationship and can be applied to the relationship between the Indonesian trustee and the investment manager. This is because the trustee bears the risk in the relationship such as the risk of cheating by the investment manager, (ii) the theoretical model of trust also incorporates explicitly the key factors of trustworthiness deemed as necessary to be considered a trustworthy. These factors of trustworthiness can be used as a guide for exploring the key factors of the trustworthiness of Indonesian investment managers.
2.2. The Stages of Trust Development Model

A trust relationship between an Indonesian trustee and his/her investment manager may developed gradually and may move forward from an early to a long-term relationship. To explore this development, the stages of trust proposed by Lewicki and Bunker (1996) was used as a guide for exploring the activities performed by the Indonesian trustees and investment managers for building their relationship which can be divided into two stages: an early and a long-term relationship. Lewicki and Bunker (1996) proposed three stages of trust development, these are: calculus-based, knowledge-based and identification-based trust. Trust development during a relationship may also move to the next stage or move back to the previous stage.

In the first stage, trust is built by the economic value of the relationship and the regular monitoring of the benefits from a relationship is the associated key activity. In the second stage, trust is built by the both economic and non-economic values and regular communication between the parties is the associated key activity. In the third stage, trust is built by mutual understanding and the sharing of information and goals is the associated key activity.

There are two reasons for using the stages of trust development proposed by Lewicki and Bunker (1996): (i) the stages of trust development can be applied to the stages of a trust relationship between the trustee and an investment manager because their relationship begins with a rational economic calculation about the
benefits from an investment manager; and (ii) the stages of trust development also incorporates the key activity performed by both parties for building their relationship at each stage of the relationship. These activities can be used as a guide for exploring the activities performed by an Indonesian trustee and the investment manager for building and developing their relationship.

3. Theoretical Contributions

Whetten (1989) provide the criteria of theoretical contributions from a research, these are: (i) adding or subtracting variables from the existing model of theory, (ii) demonstrating the impact of adding or subtracting variables on the existing relationship, (iii) finding and explaining the anomaly of a theory that may change the relationship, or (iv) proving unrealistic assumptions of the model.

This thesis provides theoretical contributions in the form of adding new variables and demonstrating their impact on the relationship. These are (i) proposing trust as an important component in a financial intermediation relationship between trustee and investment manager, (ii) providing additional factors to the theoretical model of trust of Mayer, Davis, and Schoorman (1995), (iii) providing additional key activity to the calculus-based trust of Lewicki and Bunker (1996), and (iv) proposing a model of a trust relationship between the trustee and the investment manager.
3.1. Adding Trust as an Important Component in Financial Intermediation Relationship.

The thesis concludes that trust is a component in the relationship between the Indonesian trustee and the investment manager because the trustee is concerned with the degree of his/her trustworthiness. Trust is important for trustee as a basis for building a relationship with an investment manager because of the general characteristics of the financial intermediation relationship between them. These characteristics are: (i) a one-sided reliance in which the trustee relies on an investment manager to obtain returns on investments; (ii) the trustee is unable to control the return on investments; (iii) the investment manager has the duty of managing active investments on behalf of the trustee; (iv) the returns on investment obtained by the trustee from the relationship with an investment manager is uncertain because the returns could be below or above the benchmark, (v) the trustee must pay the agreed upon fees to the investment manager although the returns are below the benchmark or even if the principal capital is decreased, and (vi) the trustee is willing to enter into a long-term relationship with the investment manager because he/she expects long-term returns will be higher than the short-term returns.

The characteristics of a financial intermediation relationship requires the trustee to consider the trustworthiness of the investment manager in their relationship because the trustee is vulnerable from the possible opportunistic behavior of the investment manager such as a cheating (Sheppard and Sherman, 1998). This is also situation in which there is no outcome guarantee (Chiles and McMackin,
1996). Therefore, a high degree of trustworthiness is required to ensure that the investment manager demonstrates his/her ability, is concerned with the trustee's interests, acts honestly, acts with integrity and has open communication.

In conclusion, the trustee considers the benefits and risks from the relationship. In order to obtain maximum benefits and to reduce the risk, the trustee will build a relationship with an investment manager who has demonstrated a high degree of trustworthiness because the relationship between trustee and an investment manager is not only determined by the investment manager's ability but also his/her benevolence, integrity, and openness in communication. These are an important elements of trust.

3.2. Adding a Key Factor of Perceived Trustworthiness

This thesis found that there are four key factors of trustworthiness request of the Indonesian investment managers from the perspective of the trustees of pension funds: ability, benevolence, integrity, and openness in communication. These factors provide two important contributions: (i) to provide empirical evidence to the key factors of trustworthiness of a trusted person as part of theoretical model of trust developed by Mayer, Davis, and Mayer (1995) who argued that trustworthy person determined by ability, benevolence, and integrity; and (ii) to provide one additional factor of trustworthiness of a trusted person, that is 'openness in communication'.
From the perspective of the trustee, openness in communication is a key factor of the trustworthiness of an investment manager who is expected: (i) to have the willingness to provide relevant information related to stock transactions and adequate explanations for these transactions, and (ii) to have willingness to share ideas and exchange thoughts in relation to his/her management of the active investments. There are some reasons for this.

(i) The extent to which the investment manager provides adequate information will influence the trustee’s level of trust in him/her (Sapienza and Korsgaard, 1996) because a well-informed trustee will be able to monitor and control the level of concern (benevolence) of the investment manager in the trustee’s interest.

(ii) The extent to which the investment manager is open with relevant information used in managing active investment, will influence the trustee’s level of trust in him/her because a well-informed trustee will be able to monitor and evaluate the performance (ability) of an investment manager (Zand, 1997).

(iii) The extent to which the investment manager provides accurate information used in making stock transactions will influence the trustee’s level of trust in him/her because a well-informed trustee will be able to evaluate the honesty (integrity) of an investment manager (O’Reilly, 1997).

In conclusion, the four factors of trustworthiness in an Indonesian investment manager are not separate, but they combine together in determining the overall
level of trustworthiness of the Indonesian investment manager as also argued by Mayer, Davis, and Schoorman (1995) and Shaw (1997).

3.3. Adding a Key Activity for Building an Early Trust Relationship

This thesis found the key activities performed both by Indonesian trustees and investment managers for building their early relationship, to be providing benefits and building communication links. This finding of key activities for building an early relationship provides two contributions: (i) evidence that support the calculus-based trust development proposed by Lewicki and Bunker (1996) who argued that calculus-based trust is built based on rational economic calculations, and (ii) one additional key activity for developing calculus-based trust, that is building communication link between the parties in the relationship.

Building a communication link in an early relationship is important. For the investment manager, communication is a means of demonstrating his/her ability, benevolence toward the trustee, and his/her integrity. For the trustee, communication is a useful way to monitor and evaluate the implementation of the investment management agreement, and the benefits from the relationship. Therefore, the key activities in building an early relationship are not separate but together determine the stage of development of the relationship. However, this exploratory case study research did not measure the interaction among the key activities in building an early or a long-term relationship.
3.4. Proposing A Model of Trust Relationship

By synthesising the research findings, this thesis proposes a model of trust relationship between the trustee and the investment manager. The foundation of this model is the model of trust (Mayer, Davis, and Schoorman, 1995) and the stages of trust development (Lewicki and Bunker, 1996) for a number of reasons. First, the model of trust (Mayer, Davis, and Schoorman, 1995) explains the trustworthiness of a person (e.g., investment manager) as a determinant in a risk taking relationship.

The model of trust, however, does not explain a trust relationship development. Second, the stages of trust development (Lewicki and Bunker, 1996) explains the stages of trust development that move gradually from one stage to another. However, the stages of it does not explain the components of the relationship, that is, the degree of trustworthiness. Third, this thesis combines these two models into a model of a trust relationship.

The model of trust relationship will be useful as an explanation of how a trustee builds on his/her perceived trust in an investment manager, and how a trustee and investment manager build and develop their relationship. The model may be at least three contributions to our understanding of the role of trust and the development of trust relationship between trustee and investment manager in Indonesia.
A model of trust relationship explains the process of building and developing a relationship between a trustee and an investment manager. These processes are: (a) the trustee has reasons to believe that the benefits obtained from hiring an investment manager will be higher than the costs; (b) the trustee assesses the key factors of the trustworthiness of an investment manager in order to obtain maximum benefits and reduce his/her risk in the relationship; (c) both the trustee and an investment manager perform key activities towards building their relationship; and (d) the trustee evaluates periodically the benefits and costs of the relationship and the degree of trustworthiness of the investment manager. On the basis of this evaluation, the trustee will decide to continue or discontinue the relationship.

The model of trust relationship demonstrates that the degree of trust is the results of evaluating the trustworthiness of the investment manager. The degree of trustworthiness of an investment manager is also determined by his/her ability, benevolence, integrity, and communication (openness and willingness to communicate). If the degree of trust of the trustee is higher than the degree of risks in a relationship, the trustee will engage in a trusting relationship.

The model of trust relationship also demonstrates that both the trustee and the investment manager must performed key activities for building a trust relationship. In an early relationship, for example, the investment manager must perform activities to demonstrate his/her ability to provide the most benefits for the trustee and to build communication with the trustee. The trustee must evaluate
periodically the performance of the relationship with an investment manager such as the return on investment and investment services. In a long-term relationship both the trustee and the investment manager must communicate regularly in order to enhance their mutual understanding.

In summary, a trust relationship between the trustee and investment manager is determined by: (i) the degree of the level of trust by the trustee in an investment manager and (ii) the development of a trust relationship between them. First, the degree of trust is determined by the degree of trustworthiness of the investment manager and the reasons for the trustee to hire him/her. Second, the development of a trust relationship between the trustee and the investment manager is determined by their commitment in performing activities for building and developing a relationship

3.5. Providing an Empirical Evidence of The Stages of Trust Development.

This thesis concluded that the trust development in the relationship between the Indonesian trustee and investment manager is gradual during the period of the relationship. This is in line with the reduction of the trustee's fear about the safety of funds which is a result of the investment manager demonstrating his/her honesty and concern in the interest of the trustee; and the satisfaction of the trustee with the benefits obtained from the relationship because the investment manager has demonstrated his ability and integrity in adhering to the investment management agreement. This finding of trust development provides empirical evidence to the stages of trust development proposed by Lewicki and Bunker
(1996) who argued that trust developed gradually during the relationship and trust is dynamic within the stages of the relationship.

The first stage of trust in the investment manager begins for the trustees with the rational decision that the costs of the relationship - fees to the investment manager and transactions costs - are less than the benefits, returns and investment services, obtained from the relationship with the investment manager. The second stage of development by the trustee to trust in the investment manager is based on both a rational decision and emotional reasons. The rational decision is that a continuous relationship with the investment manager is based on the satisfaction of the trustee in past interactions with the investment manager. The emotional reasons shows that the trustee hopes the investment manager will maintain his/her degree of trustworthiness for the benefit of the trustee.

In conclusion, the trust relationship between the trustee and the investment manager is a process that both must have a commitment to build and develop their relationship because trust is dynamic and develops gradually within the period of relationship. This was argued by Lewicki and Bunker (1996). As a consequence, trust relationship develops through several stages so that the relationship may: (i) move forward to the next stage if they are satisfied with the previous, or (ii) move back to previous stage if they are not satisfied with the current stage.
4. Providing Information for Managerial Usefulness.

This thesis found that a trustee assesses the degree of trustworthiness of an investment manager based on his ability, benevolence, integrity, and communication (openness and the willingness to communicate). These findings are useful for: (i) the stock market's regulator who issues a regulation for provide protection to the trustee in a relationship with an investment manager, (ii) investment managers who build and develop a long-term relationship with a trustee, and (iii) the trustees of pension funds who hire, build, and develop a long-term relationship with an investment manager.

4.1. The Stock Market's Regulator: BAPEPAM

The thesis found several findings that are useful as an input for BAPEPAM (Capital Market Supervisory Board) to issue a regulation of the relationship between a trustee and an investment manager because some Indonesian trustees have hired one or more than one investment manager to manage an active investment on behalf of the trustee; and the amount of funds under the management of the trustee will increase in the future. A regulation of a relationship between the trustee and the investment manager can include (i) the duty of an investment manager to demonstrate his/her trustworthiness to the trustees and to communicate regularly with the trustee, and (ii) it is the duty of the trustee to evaluate regularly the degree of trustworthiness of an investment manager these are ability, benevolence, integrity, and openness in communication.
4.2. The Indonesian Investment Manager.

This thesis found the relationship between the Indonesian trustee and the investment manager was developed gradually over time. This development can be divided into two stages: (i) an early relationship and (ii) a long-term relationship. The characteristics of these two stages are useful for an investment manager in managing a relationship with a trustee for a number of reasons:

(i) In an early relationship, the investment manager must be concerned with the benefits he/she provides to the trustee from the relationship. These concerns are because the trustee in making the decision to build a relationship with the investment manager begins with the rational decision that benefits are expected above the costs of hiring an investment manager. The benefits for a trustee could be in the form of return on investments, transfer of knowledge, and the provision of up-to-date market information. The cost of the relationship consists of fees for the investment manager, custodian, and transaction costs made by the investment manager. The investment manager also builds communication links with the trustee in the form of meetings, personal visits, reporting, and phone conversations. The reason for building communication links with the trustee are to reduce the fears of the trustee about the safety of funds from fraud or unreasonable returns a personal gain.

(ii) In a long-term relationship with a trustee, the investment manager must be concerned with providing benefits by a closer personal relationship with the trustee because it is the trustee who makes decision to continue their relationship and it is the investment manager who is expected to have the
willingness to share ideas and enhance the mutual understanding in their relationship. Therefore in a long-term relationship, the investment manager is expected to conduct regular communication and to maintain the degree of trustworthiness, that is, the sum of the functions of ability, benevolence, integrity, and openness in communication.

4.3. The Indonesian Trustee of Pension Fund

This thesis found the key factors of trustworthiness in an Indonesian investment manager to be: ability, benevolence, integrity, and communication. These factors are useful criteria for the trustee in selecting and hiring an investment manager for a number of reasons:

(i) the ability of the investment manager in managing an active investment is important for the trustee who expects to obtain returns on investment and transfer of knowledge and because a good investment performance may come from the selection ability and the timing of decisions by the investment manager.

(ii) the benevolence of the investment manager is important for the trustee who expects that the investment manager will be concerned with the interests of the trustee such as return expectations and safety of the funds because the trustee is responsible for his/her decision to the members for hiring an investment manager.
(iii) the *integrity* of the investment manager is important for the trustee who expects the investment manager to be honest, provide true information, and keep promises because the trustee lacks investment knowledge and the experience that is needed to evaluate the investment performance of the investment manager.

(iv) the *openness in communication* of the investment manager is important for the trustee who expects the investment manager to provide relevant information and adequate explanations for his/her decision in managing active investments of behalf of the trustee because by receiving adequate explanations, the trustee will be able to monitor and control the concern level of the investment manager for the trustee’s interest; and by receiving relevant information, the trustee is able to monitor and evaluate the performance of the investment manager.

5. The Limitation of the Research

The limitations of this research are related to the Indonesian case study selection these were: (i) only one type of institutional investor was available; and (ii) the data collection was restricted. The first limitation is due to the fact that there are many institutional investors in the stock market but the research could only be focused on one type of institutional investor: the pension funds.
The second reason is that the relationship between the Indonesian trustee and Indonesian investment manager is very specific. The major characteristics of most Indonesian trustees is their lack of investment knowledge and experience in investing in the stock market, and selecting and hiring an investment manager directly without using a management consultant. The major characteristics of most Indonesian investment managers have limited performance records, and an unknown investment style. Added to this is that the duration of the relationship between the trustee and the investment manager is only in the range of 1 to 4 years because the Indonesian pension funds and investment management industries are in the early development stage.

The third reason is that only a small number of trustees and investment managers were able to be interviewed. This is because, in the early stage of Indonesian pension funds and Indonesian investment management development, only a few trustees and investment managers have experienced such a relationship. Finally, the primary data was gathered through the conducting of semi structured interviews with the Indonesian trustees and investment managers. Obviously, the researcher cannot observe at first hand the actual relationship between the trustee and the investment manager, therefore, the researcher must accept the statements made by both the trustee and the investment manager as correct.

6. The Future Research

This thesis has explored the role of trust in the relationship between the trustee and investment manager by focusing on two important aspects of a relationship
between the trustee and the investment manager. One important result of this exploration is a proposed model of trust relationship between trustee and investment manager. In relation to this model, there are two major research questions need further research.

First, research question related to the investment manager that is how an investment manager manages his/her degree trustworthiness. For example, if the performance of an investment manager is poor, how she/he maintains his/her degree trustworthiness.

Second, research questions related to the trustee that to what extent the level trust needed by the trustee to build a relationship with the investment manager. For example, whether unexperienced trustee need trust level is higher than experienced trustee to trust in an investment manager.

7. Summary.

In summary, this case study was exploratory in nature because not much is known about the relationship between the trustee and the investment manager. It has provided a theoretical contribution and has managerial usefulness. The theoretical contributions include: (i) adding trust as an important component in a financial intermediation relationship between trustee and investment manager, (ii) adding one key factor of trustworthiness of an investment manager, (iii) adding one key activity for building an early trust relationship between a trustee and the investment manager, and (iv) proposing a model of trust relationship between
trustee and investment manager. The research findings of this thesis provide useful information for: (i) the regulators of the Jakarta stock market who issue regulations for the relationship between trustees and investment managers, (ii) the investment manager who need to build a relationship with a trustee, and (iii) the trustee of a pension fund who will select and hire an investment manager. However, this study has limitations in data gathering and there is still a need for further research.