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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Chapter 6

The Development of Indonesian Investment Management

1. Introduction

The previous four chapters have shown that a relationship between a trustee and an investment manager exists as a result of the ability of the investment manager to develop and provide investment products and services that are needed by the trustee (chapter 2); and that a trustee has the power to hire investment manager(s) to manage active investments on his/her behalf (chapter 3). It is further argued here that trust by the trustee is an important component in the relationship with the investment manager because the degree of trustworthiness of an investment manager is the key to a trustee obtaining benefits and reducing risks from the relationship (chapter 4). It also was discussed in chapter four that both the trustee and the investment manager need to perform some activities for building and developing their relationship.

The case study research method was used in gathering and analysing the data for investigation into two important aspects of the relationship between an Indonesian trustee of a pension fund and the investment manager: (i) the key factors of trustworthiness of the investment manager, and (ii) the key activities performed by both the trustee and the investment manager for building their relationship which can be divided into two stages: an early and a long-term relationship.
In the next four chapters (chapter 6 to 9), the results of the case study research into the relationship between the Indonesian trustees of pension funds and Indonesian investment managers are analysed. This includes the development of Indonesian investment management (chapter 6), the development of Indonesian pension funds (chapter 7), the trustworthiness of Indonesian investment managers (chapter 8), and the key activities performed by the Indonesian trustees of pension funds and investment managers for building and developing their relationship (chapter 9).

In this chapter, the development of Indonesian investment management is analysed. The aim of this analysis is to understand the major responsibilities and functions of Indonesian investment managers, and to find the key factors of the developing Indonesian investment management services. These factors and the ability of Investment managers to meet their responsibilities might be the impetus for trustee to use the services of investment managers.

The case data of the development of Indonesian investment management consists of both primary and secondary data. The secondary data are derived from the annual reports of BAPEPAM and statistics from the Jakarta stock market. The primary data were collected by conducting interviews with the investment managers whose answers are transcribed and given in the Summary of Interview Data (Appendix 6), and analysed by using the pattern coding technique (Miles and Huberman, 1994). The aim of analysis is to find the key factors of the development of Indonesian investment management. These factors are also be the
The driving force behind the emerging relationship between the investment manager and the investor (e.g., trustee of pension funds).

The structure of this chapter is organised around five topics: (i) the profile of the selected Indonesian investment manager interviewees, (ii) their responsibilities and functions, (iii) the development of mutual funds, (iv) the development of discretionary funds management, and (v) the development of investment advisory services. Indonesian investment managers who participated in this study as interviewees were selected based on their experience in managing active investments on behalf of trustees measured by the amount of funds under management and their duration of the relationship with a trustee. This relationship is a result of the ability of Indonesian investment managers to meet their responsibilities and perform their functions in managing active investment in the form of mutual funds and discretionary fund management, and providing investment services.

2. A Profile of Investment Manager Interviewees

The criteria in selecting investment managers as interviewees were that they had previous experience in managing active investments on behalf of their clients in the form of mutual funds and/or individually managed funds. The duration of experience had to be of more than one year and the investment manager must be in possession of a current investment license granted by BAPEPAM (Capital
Market Supervisory Agency). These criteria led to selecting those who manage funds in the range of medium to very large.

The researcher selected at random the investment managers who were to be the target interviewees. A letter was sent to 16 target interviewees seeking their cooperation in agreeing to be interviewed. This small number is due to the fact that in the early stages of the industry only a few investment managers will have experienced any relationship with trustees; and some investment managers declined to be interviewed or to share their information in an interview. The most common reason giving by the investment managers who rejected being interviewed was 'I am very busy'. This reply can only raise speculations as to the real reason for refusal. Finally, 11 investment managers from 11 different investment management firms agreed to be interviewed; and their information is used as a basis for analysis in this study. The specific profiles of the 11 interviewees are presented in chapter 9, but their general profile is given below.

Firstly, the 11 investment managers participating in this study as interviewees are from 5 national and 6 joint ventures firms (Appendix 6.6: Lists of Interviewees). The interviewees were disguised by using, for example, Mr. 'A', investment manager of 'NBA' an investment management firm. Most investment managers, who work for joint venture investment management firms have more experience in managing funds for clients than the domestic investment managers. The joint venture firm receives a transfer of knowledge and backup research facilities from their head office but their activities are tightly controlled.
Secondly, the amount of funds under the management of the 11 investment management firms was Rp 3,936.08 billion at the end of December 1997 (Table 6.1). This is equal to 45% of the total funds under the management of 46 investment management firms. The highest amount of funds under the management of a firm in the case study was Rp 1,967.20 billion, and the lowest was Rp 26.32 billion. Thus, the 11 investment management firms used here represent small to very large funds.

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<th>Table 6.1 : The Indonesian Managed Funds, December 1997</th>
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Thirdly, the interviewees consisted of 11 investment managers from 11 different investment management firms. Within their firm, these investment managers held named positions ranging from Manager to President Director, these are summarised as: 3 President Directors, 3 Directors, 2 Associate Directors and 3 Managers.
In summary, the number of interviewees is 11, that is, 25% of investment managers who manage funds on behalf of clients. The total amount of funds under management of the 11 investment management firms is 45% of the total of managed funds. The funds under management are in the range of small (Rp 26.32 billion) to large (Rp 1,967.20 billion). The 11 investment management firms consist of 5 national and 6 joint ventures.

3. The Regulators and The Investment Manager.

Investment management in the Indonesian stock markets was controlled by the Decree of the Finance Minister No: 1548/KMK.013/1990, which was later amended by the Decree of the Finance Minister No: 1199/KMK.010/1991. Investment management is defined in this decree as a business that includes: managing a portfolio for the needs of clients to be known as Discretionary Fund Management; managing a collective investment portfolio for a group of clients to be known as Mutual Funds Management; providing investment advice analysis and reporting regarding securities, to be known as Investment Advisory Services. It can be inferred from these definitions that there are two important actors in the Indonesian investment management business: the investment manager and the investors. However, this thesis focuses only on those trustees of pension funds who give mandates to investment managers to manage active investments on behalf of the trustees, and BAPEPAM (Indonesian Capital Markets Supervisory Agency) as one of regulators of Jakarta stock market.
3.1. The Number of Investment Management Firms.

BAPEPAM had granted licenses to 61 firms as at the end of December 1997. Licenses giving them the authority to conduct an investment management business in Indonesia. These consisted of 37 domestic and 24 joint venture firms (Table 6.2 and Appendix 6.7: List of Investment Management Firms). For example, in 1997, the domestic investment management firms which managed large funds including BNI securities, Danareksa Fund Management, Bhakti Investama, BDNI securities, and Bira Asset Management. In 1997, the joint venture investment management firms managed large funds including Bll Lend Lease Investment services, Bahana TCW Management, and Schroder Investment Management Indonesia. The increasing number of investment management firms has impacted on the increasing competition among them, and the development of investment products on offer to investors (see Table 6.1 & 6.4).

Table 6.2
The Indonesian Investment Management Firms

| Source: BAPEPAM - monthly report, January 1998 |

3.2. The Regulators.

On the basis of the Indonesian Capital Market Law Number 8 1995 and the Presidential Decree Number 53 1990, a series of regulations covering investment
management firms was issued by BAPEPAM whose mission, authority, and responsibility is to regulate the Indonesian stock market, as stated in Presidential Decree Number 53, 1990. The mission of BAPEPAM relates to the investment management business in the stock market, such as encouraging the public to participate in the stock market by acting as investment managers, brokers, and/or investment advisers; encouraging the public to participate in the stock market by acting as investors; and increasing the protection of investors’ interest in the stock market (Annual Report BAPEPAM, 1992).

The authority of BAPEPAM relating to investment management in the stock market includes: the granting and revoking of business or individual licenses to the players in the stock market, such as investment managers, brokers, investment advisors and underwriters; and providing guidance to the players in the stock market in managing their business and investigating the record of the players’ business concerning the relationship between them and their clients (Annual Report BAPEPAM, 1992). These licenses and guidance are aimed at providing the protection for the interests of investors by providing professional investment managers, brokers and investment advisers.

The functions and duties of BAPEPAM relating to investment management in the stock market include: the processing of licenses, providing guidance and supervising the institutions or individuals who conduct business in the stock market; preparing rules for investment management; and enforcing their implementation (Annual Report BAPEPAM 1992). BAPEPAM also has the
responsibility of developing; monitoring, and managing the Indonesian stock markets (Jakarta and Surabaya), so that securities can be offered, traded and conducted efficiently, orderly and fairly.

3.3. The Responsibilities of Indonesian Investment Managers.

The definition of Indonesian investment manager is found in BAPEPAM's Annual Report 1992, as follows:

Investment manager means a person whose business activities include managing securities, portfolio for clients, or collective investment portfolio for a group of clients (Annual Report BAPEPAM 1992, p.26)

The Indonesian Securities Association (1996) divides the responsibilities of the investment manager, in relation to investment fund management in the interests of his/her clients, into five areas: establishing a managed account, management fees, customer reporting, funds or securities handling, and record keeping. These areas of responsibility are based on a number of regulations issued by the regulators, such as BAPEPAM and the Ministry of Finance of Republic of Indonesia, these regulations include the handling of funds or securities of clients by the investment manager, the obligation of the investment manager to keep and maintain records and investment fund reports and prohibiting certain acts by investment managers and investment advisers. The aim of defining the responsibility of an investment manager is to enhance the professionalism of the investment manager and to provide protection for the investors' interests. Increasing protection to the investors' interests is expected to deepen the
relationship between the investment manager and the investors such as pension funds.

The first responsibility of the Indonesian investment manager is to establish a managed account for the client (Indonesian Securities Association, 1996). The investment manager must specify, in the investment management agreement, his/her investment functions, actions and authority to manage the client's account. The client can use these specifications to evaluate the implementation of the investment management agreement. As a consequence, the investment manager is responsible for the loss of funds under his/her management as a result of his/her abuse of authority or carelessness. In maintaining the responsibility to the client's account, the investment manager must be concerned with the individual interests of each of his/her clients, separate the securities of respective clients, consider each client's financial condition, keep notes of the basis of each investment decision, and treat all clients equally.

The second responsibility of the investment manager is to set management fees (Indonesian Securities Association, 1996). The investment manager must specify, in the investment management agreement, precisely all those components to be paid by clients (Indonesian Securities Association, 1996). As a consequence, the investment manager is prohibited from accepting rewards from others, in relation to buying or selling securities, or for requesting very high fees without providing sufficient information about these fees to the client.
The third responsibility of the investment manager is the responsible for providing regular reports, and relevant information to the client regarding his/her investment status (Indonesian Securities Association, 1996). In maintaining the responsibility for providing reports, the investment manager must submit to the client, at least quarterly reports in detail that indicate the securities transactions, the composition of the portfolio, and the risk and returns of the portfolio.

The fourth responsibility of the investment manager refers to the proper management of the funds and securities of the client (Indonesian Securities Association, 1996). The investment manager must deposit the securities with the custodian, notify their customer about the place and method of depositing funds or securities, and appoint an independent public to audit the funds and the securities of the client at least once a year.

The fifth responsibility of the Indonesian investment manager is to be responsible for keeping and maintaining records of the investment management on behalf of the client (Indonesian Securities Association, 1996). In maintaining the responsibility of record keeping, the investment manager must compile and maintain the documents that support the accuracy and reliability of the records.

3.4. The Function of Indonesian Investment Manager

On the basis of the above five areas of responsibility of the investment manager in managing investments on behalf of clients, it can be inferred that the major functions of the Indonesian investment manager are to manage active investments,
to manage operating costs and to provide investment services. The first function is to manage active investments on behalf of his/her clients (individual or institutional investor). In order to outperform the market, an investment manager must be able to identify mispriced stocks and bonds and to forecast accurately future price movements (Spencer, 1997). As a consequence, an investment manager must actively research a market or a sector, and take a decision on stocks based on the results of that research (Skelton, 1997). Indonesian investment managers offer active investment management to their clients in the form of mutual funds and/or discretionary investment management. Mutual funds are offered to a large number of investors who have similar investment objective and risk preferences. Discretionary investment management is offered to institutional investors, such as the trustees of pension funds, who have specific investment objectives, investment constraints, and risk preferences.

The second function is to manage, efficiently, the operational costs of an active investment management, such as, transaction and custodian costs. The investment manager charges fees for his/her services rendered to the clients, but in the discretionary investment management the client is asked to pay the custodian’s costs. Therefore, the investment management fee and other costs are important determinants in selecting an investment manager, as suggested by Deacon (1997).

The third function is to provide administrative services, such as, providing regular reports, providing up-to-date market information, collecting dividends, handling
legal fees such as capital gains tax and providing investment education services to the clients.

3.5. The Benefits of an Investment Manager.

The trustee may gain at least two major benefits by hiring one or more investment manager: (i) active investment management, and (ii) risk diversification. Firstly, the trustee of the pension funds may realise that he/she has not enough investment knowledge, experience, or staff to manage active investments in-house. He/she may also realise that the cost of active investment management is high for stock selection, asset allocation, and market timing. On the other hand, he/she expects that the returns on active investment will exceed the fees paid. Thus, the trustee may prefer to hire an investment manager who already has expertise in active investment management, this will be pursued further (chapter 8). Secondly, the trustee may limit the maximum funds that can be managed the manager. To deal with this limitation the trustees allocate part of the funds to many investment managers. The potential benefits of hiring more than one investment manager are that it reduces the risk of the failure of a single investment manager and allows for comparisons of the performance between managers and their investment services. For example, Mr. 'AD', Indonesian trustee of 'A' pension fund hires four investment managers for this reason (Appendix 8.2)

The Jakarta Stock Market obtains benefits from the activities of investment managers who manage the trustee's investments, in the form of mutual and/or
discretionary funds. The benefit is in the form of increasing market liquidity as measured by trading volume, value and frequency. For example, the trading volume of stocks on the Jakarta stock market grew from 5,292.58 million in 1994 to 50,622.85 million in September 1997 (Table 6.3). The trading value grew from Rp. 25,482.80 billion in 1994 to Rp.93,646.67 in September 1997 (Table 6.3). The trading frequency grew from 373,867 in 1994 to 2,258,578 in September 1997 (Table 6.3). The increasing market liquidity provides indications that the investors are able to trade their stocks on the stock market at a reasonable price and at the desired time (Schwartz, 1991), to execute small orders without affecting the stock price significantly (Massim and Pjelps, 1994), and enhance the amount of information contained in the stock price (Holmstrom and Tirole, 1999).

There are at least three activities of the Indonesian investment manager that impact on the Jakarta stock market liquidity. For the investment manager, the more liquid the market, the easier it is for him/her to gain profits by utilising the information available (Gammill and Perold, 1989). The first activity of an Indonesian investment manager is to construct the clients' securities portfolio. This activity has the effect of increasing the trading volume and value of the stock market. The second activity is to rebalance the portfolio. The impact on the stock market of this activity is shown by the increase of the trading volume, value, and frequency of trading. The third activity is to take action from special events. This activity impacts on the trading volume, value, and frequency in the stock market. The fourth activity is to liquidate the portfolio that impacts on the trading volume, value, and frequency of the stock market.
4. The Development of Mutual Funds in Indonesia.

Mutual funds consist of two types: closed and open-ended. The later is generally called collective investment contracts. The development of mutual funds can be shown by several indicators: the number of mutual funds on offer to investors; the classification of mutual funds, such as equity funds, fixed income funds and mixed funds; the number of investors or unit holders of mutual funds; and the loyalty of unit holders.

The result of an analysis of the development of mutual funds in Indonesia shows that the key factors in developing mutual funds include the ability of investment managers to develop the mutual funds needed by investors; the willingness of retail investors to take risks by investing their funds in mutual funds; and the willingness of large institutional investors, such as large pension funds, to be sponsors of mutual funds. It can be argued here that the development of mutual funds increases the relationship between the investment managers and their clients (e.g., the trustees of pension funds who are willing to be the sponsors of mutual funds or to invest their funds in mutual funds).
4.1. The Number of Mutual Funds

The growing importance of mutual funds on the Jakarta stock market is reflected in a dramatic increase in numbers from 1995 to 1997 (Table 6.4). In 1995, Indonesia's mutual fund industry was established by the issuing of BDNI's mutual funds. This is a close-end mutual fund which was sold to the investors for Rp. 500 per share, that is, equal to its par value. The characteristics of the funds are: the unit participation of the funds listed on the stock market and the unit holders can sell or buy the funds from the stock market. A company within the Gajah Tunggal Group, for example, bought 200 million shares, and other investors bought 400 million shares. However, no other firm was interested in issuing close-end funds during the period 1995 to 1998.

4.1.1. Open-End Mutual Funds

In 1996, the first open-end mutual fund as a collective investment contract, was offered to investors by BDNI Securities. The main characteristics of this fund are: it is not listed or traded on the Jakarta stock exchange and investors can only buy or sell through the investment manager. A number of investment management firms, both domestic and joint venture, are interested in issuing open-end mutual funds as a collective investment contract. As a result, the number of funds which were offered to investors increased rapidly to 24, from August to December 1996 (Table 6.4). The 24 funds consist of 12 fixed income funds, 5 equity funds, 6 mixed funds, and 1 money fund. The 24 funds are issued by 6 domestic and 6 joint venture investment management firms. This means that one investment management firm may issue more than one type of mutual fund. For example,
Bira Asset Investment Management, a domestic firm, issued four types of mutual funds. These were Bira Flexible Funds, Bira Fixed Income Funds, Bira Equity Funds, and Bira Cash Funds. ABN-Amro Investment Management, a joint venture firm, issued four types of mutual funds. These were ABN-Amro Indonesia Equity Funds, ABN-Amro Indonesia Fixed Income Funds, ABN-Amro Indonesia Rupiah (Indonesian Currency) Funds, and ABN-Amro US Dollar Funds (see Appendix 6.4: The Development of Mutual Funds in Indonesia for the Year 1996).

In 1997, 13 domestic and 10 joint venture investment management firms issued 52 open-end mutual funds (Table 6.4). These funds consisted of 19 fixed income funds, 16 equity funds, 15 mixed funds and 2 money funds (see Appendix 6.5: The Development of Mutual Funds in Indonesia for the year 1997). For example, Trimegah Investment Management, a domestic firm, issued three types of mutual funds. These were Megah mixed funds, Megah fixed income funds, and Megah equity funds. GTF Indonesia Asset Management, a joint venture firm, issued 1 fixed income fund, and 3 equity funds. Danmon GT Management, a joint venture firm, issued 2 equity funds.

As a result of the development of mutual funds during 1996-1997, 77 mutual funds were issued and offered to investors by the end of December 1997 (see Table 6.4). The funds consisted of 1 close-end mutual fund and 76 collective investment contracts as open-end mutual funds. The 77 funds were issued by 18 domestic and 12 joint venture investment management firms. This means that the
mutual fund industry has experienced tremendous growth for the last two years, 1996-1997.

**Table 6.4: The Development of Indonesian Mutual Funds.**


4.1.2. The Reasons for Issuing Mutual Funds

In order to explore the investment manager's reason for issuing mutual funds, the following question was asked of the investment manager interviewees: 'would you explain your reasons for issuing mutual funds?' Their individual answers are summarised in Appendix 6.1 (Reasons for the Investment Managers for Issuing Mutual Funds). For the purpose of data analysis, their answers are treated together so that similar answers are in the same category. By using the pattern coding
technique (Miles and Huberman, 1994), the reasons given by the investment managers can be condensed into 3 categories as the major reasons for issuing mutual funds. These are:

- **serving the investment need of retail investors** (100% of interviewees).
- **good support by the regulator of stock market** (30% of interviewees).
- **the willingness of institution investors to be the sponsor of mutual funds** (20% of interviewees).

There are a large number of investors with small investment funds, and inexperienced investors who want to invest their funds in the stock market by buying mutual funds because the interest rate on term deposits is lower than that of the returns on stock and the government gives tax exemption to the returns on fixed income mutual funds. This finding supports the argument of Indro, Jiang, Hu, and Lee (1998) that mutual funds are a popular form of long-term investment by retail investors. The second reason is that there are a number of institution investors who are willing to be sponsors of mutual funds because they will receive free transaction costs and investment services.

4.2. The Classification of Mutual Funds in Indonesia.

DiBartolomeo and Witkowski (1997, p. 32-33) stated that "a mutual classification system is necessary to aid institutions and individuals in allocating their
investment assets in a way that is consistent with their investment objectives and to help form peer groups within which relative performance of funds may be fairly compared while taking investors' objectives into account”. They further argue that misclassification has a negative impact on the investment objectives of retail investors. For example, a retired person prefers to invest in fixed income funds that have a low risk and stable returns, so if the fixed income funds contain some proportion of growth-oriented stocks, the risk and returns profiles will be inappropriate for this person.

Mutual funds can be classified by either objectives, style, strategy, or asset class. However, the most common classification system and the most familiar to the investors is that based on the fund's objectives or the investment manager's style (Brown and Goetzmann, 1997). Using the objectives of the funds, Indonesian mutual funds are classified into equity, fixed income and mixed funds. At the end of December 1997, the 77 mutual funds consisted of 31 fixed income funds issued by 24 investment management firms, 21 equity funds issued by 18 investment management firms, 21 mixed funds issued by 18 investment management firms, 3 money funds issued by 2 investment management firms and 1 closed-end mutual fund issued by 1 investment management firm (Table 6.5).

4.2.1. Equity Funds

The equity fund is expected to provide investors with a high growth investment in the long-term. The characteristics of equity funds are that the returns depend on
the Jakarta stock market's condition being either bullish or bearish; the equity funds are a high risk investment; a net assets value decrease or increase and the major proportion of funds are invested in stocks. Therefore, the investment policy of equity funds is to invest the funds in stocks in the range of 80% to 100% of total daily net asset value, and to invest in fixed income securities in the range of 0% or 20% of total daily net asset value. The number of equity funds grew from 5 funds in December 1996, to 21 funds in December 1997 (Table 6.5).

Table 6.5
The Number and Classification of Mutual Funds

|----------------------------------------------------------|

4.2.2. Fixed Income Funds

The purpose of fixed income funds is to provide stable returns for investors. The characteristics of fixed income funds are such that the returns depend on the changing interest rate, a low default risk, a total net asset value which grows steadily and a major proportion of the funds invested in fixed income securities. The investment policy of fixed income funds is therefore, to invest the funds in fixed income securities for a range of 50% to 90% of the total net asset value, and
to invest the funds in the instrument money market, such as term deposits, for a range of 10% to 50% of the total net asset value. The number of fixed income funds grew from 12 in December 1996 to 31 in December 1997 (Table 6.5).

4.2.3. Mixed Funds

Mixed funds are a combination of equity and fixed income funds, which are expected to provide returns that are higher than the interest rate of a term deposits. The characteristics of this fund are that returns on investment are influenced by the interest rates on term deposits, the investment risk is medium and the major portion of the funds is invested in stocks and bonds. The investment policy of the funds, therefore, is to invest these funds in fixed income securities in the range of 10% to 40% of total net asset value, and invest in stocks in the range of 60% to 90% of total net asset value. The number of mixed funds, a combination of fixed income and equity funds, grew from 6 in December 1996 to 21 in December 1997 (Table 6.5).

4.2.4. The Reason For Issuing More Than One Type of Mutual Funds.

In order to explore the reasons for the investment manager to issue more than one type of mutual fund, the following question was asked of the investment manager interviewees: 'would you explain your reasons for issuing more than one type of mutual fund?' Their individual answers are summarised in the Appendix 6.2 (Reasons for the Investment Managers for Issuing More Than One Type of Mutual Funds). For the purpose of data analysis, their answers are treated together so that similar answers are in the same category. By using the pattern
coding technique (Miles and Huberman, 1994), the reasons given by the investment managers can be condensed into 2 categories. These are:

- **return objectives** (100% of interviewees)
- **risk preferences** (100% of interviewees)

These two reasons confirms the study of mutual funds that the investment objective of the funds is a good indicator of its risk (Prather, 1998). There are a number of institutional investors, such as banks, which are not permitted by regulation to invest in high risk mutual funds for example equity funds. Therefore, most banks are the sponsors of fixed income funds that have a low risk but most experienced investors are willing to accept a high risk with high returns. They prefer therefore to invest in equity funds. Other groups of investors are willing to accept a moderate risk for moderate returns. It can be concluded that the major reason for the issuing many types of mutual funds is to meet the various returns and risk preferences of both institutional and retail investors.

4.3. **Total Number of Unit Holders.**

Indonesian investors, both individuals and small institutions, are interested in buying mutual funds as a vehicle for learning how to invest in the Jakarta stock market. As a result, the number of unit holders has grown from 2,441 in December 1996 to 20,077 in December 1997 (Table 6.6). There were 4,994 unit holders of the 22 mutual equity funds (including 1 close-end fund) as at
December 1997 (Table 6.6). The highest number of these unit holders was 705 holders of BDNI equity funds issued by BDNI Securities, a domestic investment management firm. The lowest number of unit holders of equity funds was 9 (M.P. Finas Invasta Pesona Equity Funds) issued by Meespierson Finas Investment, a joint venture investment management firm. It is concluded from this information that an investment management firm prefers to attract retail investors and small institutional investors.

There were 4,375 unit holders of the 31 fixed income funds as at December 1997 (Table 6.6). The highest number of these unit holders of fixed income funds was 921 holders of BILLIS Superpundi fixed income funds issued by BII Lens Lease Securities, a joint venture investment management firm. The lowest number of unit holders of fixed income funds was 12 (M.P. Finas Invasta Lestari) issued by Meespierson Finas Investment, a joint venture investment management firm. It is concluded from this information that some investment management firms prefer to serve retail investors, and other firms prefer to serve institutional investors for their mutual funds.

There were 10,708 unit holders of the 21 mixed funds as at December 1997 (Table 6.6). The highest number of unit holders of mixed funds was 6,935, holders of DUIT mixed funds issued by Eficorp securities, a domestic investment management firm. The lowest number of unit holders of mixed funds was 22, holders of SAM Dana Pasti equity funds issued by SAM Securities, a domestic investment management firm. It is concluded that some investment management
firms prefer to serve retail investors, and other firms prefer to serve institutional investors. These retail and institutional investors prefer to obtain moderate returns and to bear moderate risks.

4.4. Loyalty of the Unit Holders.

The loyalty of unit holders to their investment manager may be shown by two indicators that move in opposite directions. The first is a decreasing net asset value of mutual funds (Table 6.7). The second is the increasing number of unit holders of mutual funds (Table 6.6). For example, the total net asset value of mixed funds decreased from Rp. 1,275.17 billion at the end of July 1997 to Rp. 862.37 billion at the end of December 1997. However, the total number of unit holders of mixed funds increased from 3,438 at the end of July 1997 to 10,798 at the end of December 1997. In another example, the total net asset value of fixed income funds decreased from Rp 5,961.46 billion to Rp 3,438.46 billion. On the other hand, the total unit holders of fixed income funds increased from 4,039 to 4,375. It is concluded that some investors do not consider the decreasing net asset value as the most important factor as a basis for developing a long-term relationship with the investment manager. The activities of investment manager may enhance the loyalty of investors.

<table>
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<th>Table 6.6. Number of Unit Holder of Indonesian Mutual Funds</th>
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Table 6.7. Net Assets Value of Indonesian Mutual Funds


In order to explore the activities performed by the investment manager aimed at building a long-term relationship with the unit holders, the following question was asked of the investment manager interviewees: 'would you explain the activities you perform to assist you to build a long-term relationship with the unit holders?' Their individual answers are summarised in the Appendix 6.3 (Activities Performed by The Investment Managers for Building Long-term Relationship With The Unit Holders). For the purposes of data analysis, their answers are treated together so that similar answers are in the same category. By using the pattern coding technique (Miles and Huberman, 1994), key activities for enhancing the loyalty of the unit holders performed by the investment manager can be condensed into three categories. These are:

- **showing trustworthiness of investment manager:**
  - ability: (80% of interviewees)
  - honesty: (30% of interviewees)
  - openness: (45% of interviewees)
- **sending regular reports:** (70% of interviewees)
- **providing investment services:** (45% of interviewees)

These findings indicate that the investment manager is concerned with providing investment services to the unit holders, such as providing training about investment in mutual funds and interpreting the investment reports for them. This
is because most unit holders of mutual funds, individuals or institutions, have little experience in investing in mutual funds. The investment services enhance the investment knowledge of the unit holders so that they can understand the reasons for the fluctuation of net asset value of the mutual funds. Indonesian investment managers also show trustees their trustworthiness in terms of ability in managing active investments, honesty in implementing the prospectus of the mutual funds, and openness in providing information. These investment manager's activities are important for the trustee to trust in him/her.

4.5. The Key Factors to Develop Mutual Funds

In summary, it is concluded that many important factors have arisen from the development of mutual funds in Indonesia between 1996 and 1997. The first was the support of BAPEPAM to the investment management firms issuing mutual funds: (i) the provision of fast service to the investment management firms for every application for the issuing of mutual funds, and (ii) the provision of free training on mutual funds to potential investors. The second factor was the willingness and ability of the banks to be sponsors of mutual funds, especially of fixed income funds: for example, Bank Dagang Negara sponsored Indovest's fixed income funds. The third factor was a tax free facility provided by the Director General of Tax giving tax exemption on the returns of mutual funds. For example, a fixed income interest received by an investor is free from income tax. The fourth factor was the low interest rate on term deposits. For example, the interest rate for a one-year term deposit is 15% per year. The fifth factor was the availability of many types of mutual funds that match the investment motives of
investors. For example, fixed income funds are designed to satisfy the investor who prefers a regular and stable income. The sixth factor was the increasing product knowledge of investors about mutual funds; some potential investors asked the investment manager about risk, safety, the benchmark, and investment guide lines for mutual funds.

5. The Development of Discretionary Funds Management.

The development of discretionary funds or an individually managed portfolio can be shown by several indicators: (i) the growth of potential institution investors, such as the pension funds and life insurance companies, (ii) the pattern of the investment of institution investors, and (iii) the funds managed by investment management firms.

The development of discretionary funds management or individually managed funds in Indonesia are influenced by several factors such as, the ability of the investment manager to convince large institution investors (e.g., pension funds); the benefits of individually-managed portfolios or active investments management; and the willingness of the trustee to take risks by investing funds via the investment manager. It can be argued that the development of discretionary funds management creates a relationship between the investment manager and the institution investor, for example, the trustee of a pension fund hires and gives a mandate to the investment manager to manage active investments on his/her behalf.
5.1. The Clients

The major potential clients of discretionary funds management are institutional investors such as pension funds and life insurance companies. Firstly, the clients must have huge funds if they want to use the services of an investment manager. Secondly, long-term investment in securities is expected to support the business of pension funds and life insurance companies. For example, investment in securities can be used to meet the long-term liability of pension funds and life insurance firms. Thirdly, pension funds and life insurance companies lack experts to manage active investments in-house. The fourth reason is that major pension funds and life insurance companies are willing to hire investment managers to manage their securities portfolios.

5.1.1. The Institutional Investors: Pension Funds.

The number of pension funds grew from 188 at the end of December 1995 to 262 at the end of December 1996 (Table 2 - chapter 7). The 262 pension funds consist of 240 pension funds established by employers, and 22 pensions funds established by financial institutions. The investment pattern of pension funds is: (a) 54.1% in term deposits, (b) 20.4% in securities, (c) 10.9% in private placement, (d) 13.9% in property, and (e) 0.7% in property (see Table 6.8). This investment pattern indicates that pension funds have invested 20% of their total investment funds in securities. Some of the investment funds are managed by an investment manager on behalf of the trustee.
5.1.2. The Institutional Investors: Life Insurance Firms.

The number of life insurance companies also grew from 47 in 1994 to 53 in 1997 (Table 6.9). The 53 life insurance companies consist of 38 national and 15 joint ventures between foreign and national firms. Total assets of life insurance companies grew from Rp 3,983 billion at the end of 1994 to Rp 10,255 billion at the end of 1997 (Table 6.9).

Table 6.9

The amount of funds invested by the life insurance companies in securities and mutual funds grew from Rp. 797 billion at the end of December 1996 to Rp. 1,020 billion at the end of December 1997 (Table 6.10). The majority of life
insurance firms invested their funds in term deposits, direct placement and securities. For example, in 1997, the majority of insurance firms, on average, invested 46.97% of their funds in term deposits, 19.47% in direct placement, 12.85% in securities & mutual funds, 8.14% in loans, 5.38% in property and 3.75% in promissory notes.

Table 6.10
The Investment Pattern of Indonesian Life Insurance Firms
(In Billion Rupiah)


5.2. Managing the Clients’ Investment.

In managing the trustee’s securities portfolio, the investment manager realises that he/she must help the trustee in preparing investment guidelines that outline the trustee’s investment objectives, investment constraints, investment policy and strategy because the trustee lacks investment knowledge and experience. For example, one interviewee from the investment management firm IIB, suggests that the investment manager must assist clients to prepare investment guidelines that consist of state the investment objectives and limitations (Appendix 6.8).

The trustee of the pension fund informs the investment manager about the pension fund’s objectives and constraints. This information is important for
preparing an investment guideline that states the target returns, the investment limitations, the level of acceptable risks, and the investment services. This investment guideline is part of the investment management contract that will be implemented consistently by the investment manager. For example, Mr. 'E', investment manager of "MIS" investment management firm, said that many factors must be considered in preparing an investment guideline, these are: the objectives of pension funds, the maturity of liabilities, risks preference, expectations of returns, investment allocation, and cash flow (Appendix 6.8).

The trustee gives a mandate to the investment manager to translate the trustee’s investment objectives and constraints into an investment strategy that states the composition of the securities portfolio, the composition of the sectors, the risks and returns, the stocks and sector selections process, and the organization of investment management. The investment manager must implement this investment strategy consistently. For example, Mr. 'E, investment manager of 'MIS' investment management firms, suggests that in the development and implementation of the investment strategy, the investment manager has full authority to manage the portfolio with support from the investment management team, research analysts, and other facilities (Appendix 6.8)

5.3. The Key Factors for Developing Discretionary Funds Management.

Many factors were important for the development of discretionary funds management in Indonesia from 1995 to 1997. The first factor was the increasing support of regulators in establishing regulations for pension funds to invest in the
stock market. For example, the Minister of Finance issued decree number 78/KMK.017/1995 concerning investment pension funds. The second factor was the increasing potential of pension funds and life insurance companies as institutional investors. For example, the number of pension funds grew from 188 in 1996 to 262 in 1997. The third factor was the increasing amount of funds invested in securities by life insurance companies and pension funds. For example, the amount of funds invested by pension funds was Rp 2,546 billion at the end of December 1996. The fourth factor was the changing investment style of pension funds and life insurance companies from passive to active investment. For example, the trustee of 'A' pension funds hires four investment managers to manage his funds. The fifth factor was the necessity for a good relationship between the trustee, the executives of the insurance company and the investment manager.

6. The Development of Indonesian Investment Advisory Business

The development of the investment advisory business was slow. This is shown by:
(a) small number of investment advisers, (b) small number of clients, and (c) some barriers to developing an investment advisory services.

6.1. The Number of Investment Advisers.

'Investment adviser' means a person whose business activities include providing advice, analysis and reports regarding securities to at least 15 persons but not including underwriters, and brokers. Investment advisers receive fees for their services to their clients. A license as an investment adviser is granted by the
Chairman of BAPEPAM, both to an individual and to securities firms. The number of firms providing investment advisory services was 23 at the end of December 1997. The 23 firms consisted of 13 domestic and 10 joint venture investment management firms.

6.2. The Clients of Investment Advisers.

The number of clients of the 23 investment advisory firms was 196 at the end of December 1997. These 196 clients consisted of 36 foreign investors and 160 domestic investors. The 196 clients can be divided into 89 institutional investors and 107 individual investors. The number of clients of the investment advisory service are only a few compared with the unit holders of mutual funds because most stock brokers provide free investment advice daily to their investors.

6.3. The Key Barriers to Develop an Investment Advisory Business.

There were several key factors during the years 1995 to 1997 which acted as barriers to developing an investment advisory service in Indonesia. The first was free investment advice which was provided by stock brokers. They provide regular, sometimes daily, investment advice to investors free of charge. For example, a stockbroker provides investment advice to investors to buy a particular stock and as a result the investors only pay the commission to execute a buy or sell transaction. The second was that the investors has authority to make investment decisions. The investment advise provides investment advice to investors, then the investors make their decision to reject or accept the investment advice. It is difficult, therefore, to measure the performance of the investment
adviser only on the basis of the investment advice itself. The third barrier was the returns on investment advice. Most investors argue that the fee paid to the investment adviser is higher than the returns on their investment advice.

7. Summary.

In this chapter, the development of Indonesian investment management was explored and analysed. The exploration focused on the responsibility and duties of the investment manager for the trustees of the pension funds, the development of mutual funds and the development of discretionary funds. The exploration supports the suggestion that the development of mutual funds and discretionary funds management in Indonesia encourages the trustee to: (i) hire an investment manager, (ii) increase the number of investment managers hired by the trustee of large pension funds, and (iii) increase the duration of the relationship between the Indonesian trustee and the investment manager.

These appears to be considerable evidence to support these contentions. First, the key factors for developing the mutual funds include the commitment of regulators to support their development, the ability of investment managers to manage mutual funds and the willingness of institutional and individual investors to take risks by investing in mutual funds via the investment manager. Second, the key factor for the development of discretionary funds include the ability of the investment manager to convince institution investors, such as trustees of the benefits of active investments, the willingness of the trustees to take risks by hiring investment managers to manage an active investment on their behalf. Third,
the regulator, BAPEPAM, has issued several regulations to control the investment manager’s duties, and to protect the interest of investors. In the next chapter the development of Indonesian pension funds will be explored and analysed.