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 two chapters, the development of Indonesian investment management and Indonesian pension funds were explored and analysed with the result that a relationship between the Indonesian trustee and the Indonesian investment manager was seen to exist. The relationship is the result of the trustee having the authority to hire an investment manager and the ability of the investment manager to provide investment products and services to the trustee. There are several processes used to select and hire an investment manager: one of these is to assess the trustworthiness of an investment manager. In this chapter this assessment is explored and analysed from the perspective of the Indonesian trustee.

The primary data used in researching for the trustworthiness of the Indonesian investment manager were collected by conducting interviews with the trustees and then analysing the results in two stages. Firstly, using the Summary of Interview Data (Appendix 8), the researcher applies the pattern coding technique of Miles and Huberman (1994) to determine the categories of the trustworthiness
of the investment manager. These are considered as an observational pattern. Secondly, the researcher uses the pattern-matching technique proposed by Trochim (1989), to match the observational with the theoretical pattern of the trustworthiness of the investment manager, derived from the theoretical model of trust developed by Mayer, Davis, and Schoorman (1995). Explanations of the pattern matching results are given.

The data analysis provides several important results. Firstly, it confirms that the interviewees viewed as the main reasons for the trustee to hire an investment manager was to gain a transfer of investment knowledge and a high return on the investments. Secondly, the reason for hiring more than one investment manager is the reduction of risk from using a single investment manager. This enables the trustee to compare their performances. Thirdly, it confirms that trust is a key component for building a relationship between the trustee and the investment manager. Fourthly, Indonesian trustees use the components of trust as criteria for selecting and hiring an investment manager. Fifthly, this thesis found that the trustworthiness of Indonesian investment managers from the perspective of the trustee are ability, benevolence, integrity and communication.

This chapter is organised around two topics: case data collection and case data analysis. The case data includes the profiles of the trustee interviewees and the primary data collection data activities. The results of data collection are analysed and include: (i) the analysis of the reasons for the Indonesian trustee to hire one or more investment managers, and (ii) the analysis of the trustworthiness of
Indonesian investment manager from the perspective of the Indonesian trustee. Explanations are provided for the results of this analysis.

2. Case Data.

The number of trustees interviewed was 11 from 10 pension funds. However, the profiles of trustee interviewees are varied because: (i) the size of pension funds is in the range of small to large, measured by the funds invested in the stock market; (ii) the number of investment managers hired by the trustee is in the range of 1 to 4; and (iii) the duration of the relationship with the investment manager is in the range of 1 to 4 years. These varieties of trustee profiles allow the data analysis to be divided into a small to large, and a short to long-term relationship.

2.1. The Profile of Trustee Interviewees

The interviewees are Indonesian trustees who have: (i) the responsibility of managing investment funds, (ii) authority to hire an investment manager, and (iii) experience in a relationship with an investment manager who manages active investments on behalf of the trustee. The number of trustee interviewees is 13 from 12 pension funds but interviewees reported in this study is only 11 from 10 pension funds. It was found that the other 2 selected interviewees invested their funds in securities without formally hiring an investment manager. This small number of interviewees resulted from the Indonesian pension funds industry being in its early stages of development. Only 159 pension funds invested their funds in the stock market and were listed in the Annual Report of the Indonesian Pension Funds 1996. A few of the trustees of those pension funds have hired an
investment manager because a large funds is required to be managed by investment manager. However, there was no detailed report about trustees hiring Indonesian investment managers.

The profiles of the Indonesian trustee interviewees meet the criteria for analysis in this study. Firstly, the position of the trustee varies depending on the size and the organisational structure of the pension funds. They all have named positions, such as President Director, Chairman, Investment Director, General Manager, or Treasurer. Secondly, although the trustee has the authority to select and hire one or more investment managers to manage the active investments, the trustee is still responsible to the members of the funds for the performance of the funds. Thirdly, the trustee has experienced a relationship with one or more investment managers in the range of 1 to 4 years. Because pension funds and investment management are emerging industries, only 7 trustees in this study had hired more than one investment manager in their careers to date.

The pension funds in this case study originate from several business sectors. 4 are in the banking sector, 2 in the gas and oil sector, 1 in the publishing sector, 1 in the telecommunication sector, 1 in the postal sector, and 1 in the insurance sector. All these pension funds have investments in securities that are reported in the Directory of Pension Funds. The amount of funds invested in securities traded on the Jakarta stock market was in the range of 5% to 10% of the total investment funds. The amount of funds invested by the selected 10 pension funds was Rp
1,210 billion, that is, 47.5% of the total funds invested by the 159 pension funds in securities at the end of 1996 (see Table 8.1).

2.1.1. The Amount of Funds Invested in Securities.

The investment activities of the pension fund must comply with the Law Pension Fund Act 1992 and the decrees of the Minister of Finance of the Republic of Indonesia. According to these regulations, the pension funds are only permitted to invest their funds in securities to a maximum of 10% of the total investment funds available. In this case study, of the 11 interviewees from 10 pension funds, 4 invested their funds in securities above Rp 100 billion, and 6 below Rp 100 billion (see Table 8.1). This wide range of funds under the management of the trustees is expected to reveal a great deal of information, including their perception about the trustworthiness of the investment manager.

Table 8.1: Profile Investment in Securities of 10 Pension Funds
Year 1996 (Rp million)

Please see print copy for image

Source: Annual Report of Pension Fund - Year 1996

Trustees are able to manage their investment funds in two ways: passive investment management, and/or active investment management. Firstly, most trustees of small pension funds, as measured by total net assets, manage their investment in securities in the form of passive investment management, that is, pension funds buy particular stocks in firms at the initial public offering and hold these stocks for a given period. This is because, at the initial public offering, the trustees can receive free information from experts who deal with public offerings and they will follow these experts' opinions on the wisdom of buying stocks. Secondly, most of the large pension funds have both passive and active investments. For their active investments, most of the trustees hire investment managers for active securities investment management, or buy mutual funds that are managed actively by an investment manager. Trustees, who hire investment managers, are the target interviewees in this study.

2.1.3. The Duration of the Relationship with the Investment Manager.

The formal relationship between the trustee and the investment manager begins with an investment management contract of one year's duration. The trustee has two options: to discontinue the relationship within the contract period, or to continue the relationship at the end of the contract period by renewing the investment manager's contract. The researcher conducted interviews with trustees who had experienced a relationship with their investment managers in the range of 1 to 4 years, for two reasons. First, the regulations concerning investment in the stock market for pension funds was only issued in 1993. Second, the
investment management business on the Jakarta stock market only began in 1992. Thus, a four-year relationship between the trustee and the investment manager is considered here as a 'long-term relationship'. In this relationship, both parties had agreed to renew their contract at least 3 times. A one-year relationship between the trustee and the investment manager is considered here a 'short-term relationship' because both parties have agreed to renew their investment contract once. The varying length of time of the relationship between the trustee and investment manager is important to the researcher in analysing: (i) the trustworthiness of investment managers from the perspective of the trustee, and (ii) a short or a long-term relationship between them.

Table 1: The Duration of the Relationship.

<table>
<thead>
<tr>
<th>Interviewee</th>
<th>Position in Pension Funds</th>
<th>Duration of the Relationship</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Mr. 'A'</td>
<td>President Director</td>
<td>about 4 years</td>
</tr>
<tr>
<td>2. Mr. 'T'</td>
<td>President Director</td>
<td>about 4 years</td>
</tr>
<tr>
<td>3. Mr. 'L'</td>
<td>Chairman</td>
<td>about 1 year</td>
</tr>
<tr>
<td>4. Mr. 'C'</td>
<td>Chairman</td>
<td>about 2 years</td>
</tr>
<tr>
<td>5. Mr. 'Y'</td>
<td>Investment Director</td>
<td>about 1 year</td>
</tr>
<tr>
<td>6. Mr. 'B'</td>
<td>Investment Director</td>
<td>about 4 years</td>
</tr>
<tr>
<td>7. Mr. 'M'</td>
<td>Treasurer</td>
<td>about 2 years</td>
</tr>
<tr>
<td>8. Mr. 'N'</td>
<td>Treasurer</td>
<td>about 2 years</td>
</tr>
<tr>
<td>9. Ms. 'J'</td>
<td>General Manager</td>
<td>about 3 years</td>
</tr>
<tr>
<td>10. Mr. 'N'</td>
<td>Investment Manager</td>
<td>about 3 years</td>
</tr>
<tr>
<td>11. Mr. 'I'</td>
<td>Investment Manager</td>
<td>about 1 year</td>
</tr>
</tbody>
</table>

2.2. Primary Data Collection.

The researcher used semi-structured interviews ranging in duration from 40-75 minutes to explore the perceptions of the trustee about the qualities to be
considered before hiring an investment manager. In conducting interviews with the trustees, the researcher undertook several activities:

(a) sending letters to the target interviewees seeking their cooperation in being interviewed. In this letter, the major interview questions were stated. Target interviewees were selected based on their amount of investment funds in securities, and the duration of their relationship with their investment manager. The number of interviewees who fulfilled the criteria were selected during the process of primary data collection. The total number of letters sent to trustees was 18. The results of the response were that 6 of the 18 refused to participate because they were ‘very busy’ but finally 13 trustees from 12 pension funds agreed to be interviewed. However, the number of interviewees reported in this study is only 11 from 10 pension funds because it was found that the other 2 selected interviewees invested their funds in securities without formally hiring an investment manager.

(b) the researcher used a pilot study which was used to interview the key informant selected for this study, Mr ‘A’, the trustee of ‘A’ pension fund, one of Indonesian’s largest pension funds. On the basis of the results of this interview, the researcher revised the pilot interview questions and redefined the definitive interview questions (see Appendix 8.5: Lists of Interview Questions). These research questions were used as a guide to interview the trustees (see Appendix 8.4: List of Interviewee).

(c) interviews were conducted with 1 trustee for 75 minutes, with 5 trustees for 50 minutes, and with the remaining trustees for 35 minutes each. The duration of the interviews reflects the length of the relationship between the trustee and
the investment manager. A short-term relationship for example produced an interview of about 35 minutes. All interviews were conducted in the interviewee's office for the convenience of the interviewee. The aim of the interview was to obtain relevant information for the thesis and to ensure its reliability. For example, every interview began by stating the purpose of the interview and then waiting for the interviewee to answer the questions in his/her own way. The researcher always noted the body language of the trustee in answering the questions. However, all interviewees gave both relevant and irrelevant information because they lack experience in this type of interview.

(d) 10 of the 11 trustees were willing to be recorded during the interview process, but 1 interviewee was unwilling so notes were taken during that interview.

(e) the transcript of the interview data was presented by using a data reduction method in which the whole interview data were reduced to a verbal summary of the essential themes in the form of a Summary of Interview Data.

3. Indonesian Case Analysis

The answers of the trustee interviewees are given in question- and-answer format in the Summary of Interview Data (Appendix 8.1 to 8.3) using the questions of the interview. On the basis of this data, the Indonesian case analysis is divided into three parts (Figure 1). These are:

(1) an analysis of the reasons for Indonesian trustees of pension funds for hiring one investment manager.
(2) An analysis of the reasons for Indonesian trustees of pension funds for hiring more than one investment manager.

(3) An analysis of the perceived trustworthiness of Indonesian investment managers.

Figure 1: Indonesian Case Analysis

Summary of Interview Data

The reasons for the trustees to hire one investment manager (Appendix 8.1)

Pattern-coding is used to find the observed pattern of the reasons for the trustees to hire one investment manager (section 3.1)

Pattern-matching is used to match the observed and the theoretical patterns (section 3.3.2)

The explanations of the trustworthiness of Indonesian investment managers (section 3.3.3)

The criteria for selecting and hiring an investment manager (Appendix 8.3)

Pattern-coding is used to find the observed pattern of the trustworthiness of the Indonesian investment manager (section 3.3.1)

The reasons for the trustee to hire more than one investment manager (Appendix 8.2)

Pattern-coding is used to find the observed pattern of the key reasons for the trustees to hire one investment manager (section 3.2)

3.1. Indonesian Case Analysis 1: The Reasons for Indonesian Trustees of Pension Funds Hiring One Investment Manager

The Indonesia trustees hire investment managers who are employed by an investment management firm especially to manage active securities portfolios. The investment manager has the responsibility of managing the funds in a stock portfolio, keeping to the investment guidelines, submitting monthly reports of the portfolio's performance and providing explanations of the performance of the
stock portfolio. The trustee has the responsibility of paying the fee for the investment services provided by the investment management firm, providing investment guidelines and evaluating the performance of the investment manager. Although it is agreed that many of the reasons for trustees to hire an investment managers are the same, there are also individual differences.

In order to explore the reasons for the Indonesian trustees to hire an investment manager, the following question was asked of the trustee interviewees: 'would you explain your reasons for hiring an investment manager?'. Their answers are summarised in Appendix 8.1 (Reasons for Trustees Hiring an Investment Manager). For the purpose of data analysis, the answers of the interviewees are grouped together so that similar answers are in the same category and regrouped on the basis of the amount of funds invested in securities.

In the first analysis, the answers provided by the trustee interviewees are grouped 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 trustee interviewees can be condensed into three categories. These are:

- **transfer of knowledge** (70% of interviewees).
- **returns on investment** (50% of interviewees)
- **learning active investment management** (40% of interviewees)
The second analysis divides the trustees into three groups on the basis of their amount of funds invested in securities. These groups include: (i) those who have large funds invested in stocks and bonds more than Rp 100 billion; (ii) those who have medium funds invested in stocks and bonds in the range of Rp 25 billion to Rp 100 billion; and (iii) those who have small funds of less than Rp 25 billion. The reasons given by the trustees according to their group can be condensed into two categories, as follows:

<table>
<thead>
<tr>
<th>The amount of investment</th>
<th>The reason for hiring an investment manager.</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Large funds</td>
<td>* receiving transfer of knowledge (all interviewees)</td>
</tr>
<tr>
<td></td>
<td>* to obtain returns (25% of interviewees)</td>
</tr>
<tr>
<td></td>
<td>* to learn active investment (75% of interviewees)</td>
</tr>
<tr>
<td>• Medium funds</td>
<td>* receiving transfer of knowledge (67% of interviewees)</td>
</tr>
<tr>
<td></td>
<td>* to obtain returns (33% of interviewees)</td>
</tr>
<tr>
<td></td>
<td>* to learn active investment (33% of interviewees)</td>
</tr>
<tr>
<td>• Small funds</td>
<td>* to obtain returns (all interviewees)</td>
</tr>
<tr>
<td></td>
<td>* receiving transfer of knowledge (33% interviewee)</td>
</tr>
<tr>
<td></td>
<td>* investment services (33% of interviewees)</td>
</tr>
</tbody>
</table>

The trustees of small funds invested in securities are more concerned with returns than with the transfer of knowledge because the trustees realise that their performance is measured by the increasing returns on investment; and the number of staff in the pension funds is limited for the administrative work involved. The investment manager is expected to provide returns that are higher
than the fees paid to him/her and the expenses for bank custody. Therefore, the majority of small funds claim that a high return is their main reason for hiring an investment manager. For example, Mr. 'D', Indonesian trustee of 'H' small pension funds, hires an investment manager to obtain reasonable returns on investment (Appendix 8.1).

Trustees of medium and large funds invested in securities are more concerned with the transfer of investment knowledge than returns on investment because the trustees realise that an active investment management requires an expert who is knowledgeable, experienced and has first class research facilities. To set up in-house management would be expensive, thus hiring an investment manager is a better option. In attempting to set up an in-house active investment management, some trustees spends money in buying hardware and software to manage the active investment. However, they have difficulties in recruiting employees with the necessary expertise to act as in-house investment managers. Therefore, most trustees of medium and large pension funds claim that the transfer of knowledge from the investment manager to the employees of the pension funds is the main reason for them hiring an investment manager. For example, Mr. 'A', Indonesian trustee of 'A' pension funds, hires an investment manager to obtain a transfer of knowledge and to learn how to manage active investments (Appendix 8.1).

In conclusion, regardless of the amount of funds invested in securities, this thesis found that the Indonesian trustees hire investment managers for gaining: (i) a transfer of knowledge, and (ii) high returns. According to the amount of funds
invested in the securities, the trustees of medium and large funds are more concerned with the transfer of knowledge than with the returns on investment. The trustees of small funds are more concerned with high returns than with the transfer of knowledge. These research findings can be seen by an investment manager as additional knowledge in understanding the investment objective of the trustee. This is important because understanding the need of the client is the first rule of investment management (Damodaran, 1998).

3.2. Indonesian Case Analysis 2: The Reasons for Indonesian Trustees of Pension Funds Hiring More than One Investment Manager

Most Indonesian trustees of large and medium pension funds hire more than one investment manager and allocate funds to each. The investment managers have contracts that define the target rate of returns on investment, investment guidelines and investment services. However, the trustees may have similar or different reasons to persuade them to hire more than one investment manager.

In order to explore the reasons for Indonesian trustees of medium and large pension funds to hire more than one investment manager, the following question was asked of the trustee interviewees: 'would you explain your reasons for hiring more than one investment manager?'. Their answers are summarised in Appendix 8.2 (Reasons for Trustees Hiring more than one Investment Manager). For the purpose of data analysis, the answers of the interviewees are grouped together so that similar answers are in the same category.
The reasons given by the interviewees can be condensed into three. These are:

- **the investment managers performances comparison**
  (90% of interviewees)

- **the investment managers’ transfer of knowledge**
  (60% of interviewees).

- **Risk reduction from a single investment manager**
  (40% of interviewees)

A trustee needs to hire more than one investment manager because he/she has no control over an investment manager’s selection ability and timing decisions that will have impact on the investment performance. When more than one investment manager is hired, the trustee can expect to reduce the risk of error made possible by a single investment manager, and to make a performance comparison among them. For example, Ms. ‘Y’, Indonesian trustee of ‘I’ pension funds hires four investment managers and aims at comparing the performance of these investment managers in terms of returns, ability for buying and selling decisions, reducing risks from a single investment manager, and to obtain the strong point of each investment manager (Appendix 8.2)

The Indonesian trustee interviewees measure the performance of the investment managers by using returns on investment. However, they do not have an appropriate benchmark to measure the whole performance of the investment manager. For this reason, the trustee prefers to compare each investment manager’s performance against the others, as a basis for judging which investment manager’s performance is good or bad. For example, Mr. ‘A’.
Indonesian trustee of ‘A’ pension funds, hiring of four investment managers is aimed at comparing the investment manager’s performance against the others (Appendix 8.2).

It is concluded here that there are two key reasons for trustee of medium or large pension funds to hire more than one investment manager. These are: (i) to have an appropriate benchmark which is derived from performance comparison, and (ii) the need for the trustee to reduce the risk from a single investment manager. These findings can be seen as additional knowledge to understand the reasons for the trustee of the pension fund to hire more than one investment manager. This knowledge is important because understanding the needs of the trustee, as a client, is the first rule of investment management (Damodaran, 1998).

3.3. Indonesian Case Analysis 3: The Trustworthiness of Indonesian Investment managers

The Indonesian trustee hires an investment manager based on his/her degree of trustworthiness such as ability and honesty because the ability of the investment manager will have an impact on the benefits -returns on investments- obtained from the relationship; the honesty of the investment manager will reduce the risk of cheating.

3.3.1. The Observed Patterns of Trustworthiness of Indonesian Investment Managers.

The criteria for an Indonesian trustee to select an investment manager may include the reputation of the investment management firm, the client network,
research facilities, safety of funds and the trustworthiness of the investment manager. These criteria are important to the trustee for the purpose of screening the candidate for the possible appointment as an investment manager.

In order to explore the criteria used by Indonesian trustees for hiring an investment manager, the following question was asked of the trustee interviewees: 'would you explain your criteria for hiring an investment manager?'. Their answers are summarised in Appendix 3 (Criteria for Hiring an Investment Manager). For the purposes of data analysis, the answers of the interviewees are grouped together so that similar answers are in the same category, and regrouped on the basis of the amount of funds invested in securities.

In the first analysis, the answers of the trustees are grouped together so that similar answers are in the same category. By using the pattern coding technique (Miles and Huberman, 1994), the criteria for selecting an investment manager given by the trustee can be condensed into 10 categories. Of these, 5 relate to the investment manager and 5 to the investment management firm. These categories are summarised below:

1. The criteria relating to the investment manager:
   a. **Expertise** (100% of interviewees) expressed in terms of ability, performance, and investment experience.
   b. **Honesty** (40% of interviewees) expressed in terms of true information, and keeping promises.
c. Communication (30% of interviewees) expressed in terms of willingness to meet regularly, to make personal visits and easy to contact.

d. Concern (50% of interviewees) expressed in terms of providing transfer of knowledge and giving investment services.

e. Openness of investment manager (50% of interviewees) expressed in terms of the willingness to discuss and to give explanation about the reason for buying or selling stocks.

2. The criteria relating to the investment management firm.

a. Reputation of investment management firm (33% of interviewees)

b. The number of clients (50% of interviewees)

c. The amount of funds under management (33% of interviewees)

d. Research facility (33% of interviewees)

e. Research Team (33% of interviewees)

From the criteria summarised above, it can be inferred that the trustees use the performance and experience of an investment manager to assess his/her ability to provide reasonable returns. For example, Mr. ‘I’, Indonesian trustee of ‘L’ pension funds, uses historical performance and length of experience as criteria to assess the ability of an investment manager (Appendix 8.3). The trustee also assesses the honesty of the investment manager to reduce potential loss from cheating and to keep the promises in the investment management agreement. For example, Mr. ‘N’, Indonesian trustee of ‘K’ pension funds, uses keeping promises as criteria to assess the honesty of the investment manager (Appendix 8.3). They also need to assess the willingness of the investment manager to be concerned with the interests of the trustee, such as, transfer of knowledge and to assess the willingness of the investment manager to be monitored by his/her clients through regular communication and discussion, and being easy to contact. For example,
Mr. 'A', Indonesian trustee of 'A' pension funds, uses the willingness of the investment manager to communicate regularly as a criterion for hiring an investment manager (Appendix 8.3).

The trustee also needs to assess the investment management firm which employs the investment manager. This is aimed at assessing the reputation of the firm. A firm with a high reputation will usually have good investment managers. This information will be used to cross check the performance record of the particular investment manager, to assess the number of clients and the amount of funds under management. For example, Ms. 'Y', Indonesian trustee of 'I' pension funds, uses the number of clients and the amount of fund under management to assess the reputation of the investment management firm (Appendix 8.3).

In the second analysis of the criteria to hire an investment manager, the trustee interviewees are divided into three groups on the basis of the amount of funds invested in securities. These groups are: (i) large invested funds of more than Rp 100 billion, (ii) medium funds in the range of Rp 25 billion to Rp 100 billion, and (iii) small funds of less than Rp 25 billion. The criteria for hiring an investment manager given by the trustees can be condensed into several categories as follows:

<table>
<thead>
<tr>
<th>The amount of investment</th>
<th>The criteria for hiring an investment manager</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large funds</td>
<td>* expertise (100% of interviewees)</td>
</tr>
<tr>
<td></td>
<td>* communication(50% of interviewees)</td>
</tr>
<tr>
<td></td>
<td>* honesty (25% of interviewees)</td>
</tr>
</tbody>
</table>
Analysis of interview data identified four key factors of trustworthiness of an investment manager that critically influenced pension fund trustees to trust in him/her.

The trustee interviewees agreed that *expertise* is a key factor of the trustworthiness of an Indonesian investment manager although they have different reasons for believing this. Trustees of small pension funds expect the investment manager to have a good investment performance. The returns on investment is important to increase the total amount of investment funds to meet liability in the future. For example, Mr. 'D', trustee of small 'H' pension funds, uses good performance record as a criterion for hiring an investment manager (Appendix 8.3). Trustees of medium pension funds expect the investment manager to provide the returns which are important to increase the liquidity of the pension funds to meet current retirement liability. Trustees of large pension funds expect the investment manager to provide returns that are important to increase the retirement benefits of
the members and to reduce the employer's contribution because most of large pension funds have reached their liquidity requirement.

The trustee interviewees agreed that concern is a key factor of trustworthiness in an Indonesian investment manager although they have different reasons for believing this. Trustee of small pension funds expect the investment manager to educate the trustee on how to manage active investment in order to be able to discuss the investment manager's report. The trustee of medium pension funds expects the investment manager to be concerned with the trustee's target return on investment. For example, Mr. 'P', Indonesian trustee of 'F', medium pension funds, expects the investment manager to be concerned with the returns on investment (Appendix 8.1). Trustees of large pension funds expect the investment manager to provide a good investment services in order to learn how to manage active investment. For example, Mr. 'B', Indonesian trustee of 'B' large pension funds, expects the investment manager to give investment services to learn how to manage active investment (Appendix 8.1).

The trustee interviewees agreed that honesty is a key factor of trustworthiness of an Indonesian investment manager. Trustees of small pension funds expect the investment manager to be honest and keep promises in order to reduce the fear of the trustee about the safety of the funds from the manipulation for personal reasons by the investment manager. Trustees of medium and large pension funds expect investment managers to act honestly and adhere to the investment management agreement. This allows trustees to evaluate the activities of the
investment managers in managing active investment and whether the investment manager was considered the investment risks, objectives, and restrictions.

The trustee interviewees agreed that communication and openness in communication is a key factor of trustworthiness in an Indonesian investment manager. The main reason is that the trustees of large and medium funds expect the investment manager to provide accurate information, adequate explanations and to open in communication. These are important for the trustee to be able to monitor and evaluate the performance of the investment manager in managing active investment on his/her behalf because the trustee of a large or medium fund realise that the amount of the funds under the management of their investment manager is large when it is measured against the total funds available for investment. Therefore, communication and openness in communication of the investment manager is an important criteria for the trustee to reduce the risk of the loss of funds due to lack of information.

In conclusion, regardless of the amount of funds invested in securities, the trustee interviewees agreed that the major criteria for hiring an investment manager were, in order of importance:

- expertise
- concern
- openness
- honesty.
- communication.
These criteria are important for the trustee to reduce the risks in the relationship with the investment manager. These five criteria are considered as the observed pattern of the trustworthiness of Indonesian investment managers.

The trustee’s trust in the investment manager takes into consideration the reputation of the investment management firm which employs the investment manager. This finding needs further research.

3.3.2. Matching The Observational and Theoretical Patterns of The Trustworthiness of an Investment Manager.

The pattern matching technique of Trochim (1989) is used to analyse the relationship between Indonesian trustees and investment managers by matching the observational pattern with the theoretical pattern, as follow:

(i) The **theoretical pattern** of the trustworthiness of an investment manager is derived from the theoretical model of trust developed by Mayer, Davis, and Schoorman (1995) which was discussed in chapter 4. They define a theoretical pattern of the trustworthiness of an investment manager as:

- ability
- benevolence
- integrity.

(ii) The **observed pattern** of the trustworthiness of an investment manager from the perspective of the trustee interviewees was discussed in the previous section. The trustworthiness of an investment manager includes:
• Expertise
• Concern.
• Openness
• Honesty
• Communication

(iii) Matching the theoretical and observed patterns of the trustworthiness of the investment manager provides several results which are as follows:

The observed pattern of expertise is similar to the theoretical pattern of ability. If ability is a category, then its property is expertise.

The observed pattern of honesty is similar to the theoretical pattern of integrity. If integrity is a category, then its properties are keeping promises, and honesty.

The observed pattern of concern is similar to the theoretical pattern of benevolence. If benevolence is a category then its property is concern.

The two observed patterns of openness and communication, do not match any of the three theoretical patterns. These two observed patterns are not the properties of any one of the three theoretical patterns. Thus, these two observed patterns could be considered as additional key factors in the trustworthiness of investment managers. If communication is a category, then its property is openness in communication.
On the basis of matching the observed and the theoretical patterns, it is concluded here that the four key factors of trustworthiness of an Indonesian investment manager are:

- Ability
- Integrity
- Benevolence
- Openness in communication

These four key factors are components of a trustworthy person (Mayer, Davis, and Schoorman, 1995; Shaw, 1997; Whitener, Brodt, Korsgaard, and Werner, 1998). Thus, the relationship between Indonesian trustees and investment managers is based on trust. There are three reasons for this. Firstly, Indonesian trustees expect investment managers who have ability: to produce reasonable returns on investments, to provide a transfer of knowledge, to act benevolently, to keep promises, to be honest, and to provide accurate and up-to-date market information. Secondly, Indonesian trustees are willing to take risks in their relationships even if an investment manager fails to fulfil the trustee's expectations. The trustee is responsible for the performance of the investments to the members. Thirdly, the Indonesian trustees' trust in the investment manager begins with an assessment of the investment manager's trustworthiness, including his/her ability, benevolence, integrity and communication (openness in communication).

In conclusion, this thesis proposes that the propositions used to explain the relationship between Indonesian trustees and investment managers will be as follows:
Trust is a key component of the relationship between Indonesian trustees and investment managers.

The Indonesian trustees' trust in the investment manager is a function of the investment manager’s perceived ability, integrity, benevolence and openness in communication.

The development of the trust relationship is a function of the key activities performed by both the Indonesian trustees and the investment managers.

The four key factors of the trustworthiness of Indonesian investment managers are explained in the next section. The key activities performed by both Indonesian trustees and investment managers are analysed in chapter 9.

### 3.3.3. Explanations: Trustworthiness in Indonesian Investment Managers.

The research findings show that the trustworthiness of Indonesian managers as perceived by the Indonesian trustee interviewees includes *ability, benevolence, integrity, and openness in communication*. The first three key factors provide empirical evidence to the argument of some scholars (Mayer, Davis, and Schoorman, 1995 and Shaw, 1997). Mayer, Davis, and Schoorman (1995) argued in their theoretical model of trust that the trustworthiness of a person includes ability, benevolence, integrity and the interactions of these three factors. Shaw (1997) argued that a trusted person, such as an investment manager, is defined by his/her achieved results, acting with integrity, and demonstrating concern with the interest of trustee. Butler (1991) found from his study that openness in communication can enhance the perception of trust. Sapienza and Korsgaard (1996) argues that adequate explanation and information will influence the level
trust of trustee. The quality of trustworthiness in a trusted person is important to the trustee because it reduces his/her risk in the relationship, such as the risk of cheating (Sheppard and Sherman, 1998).

3.3.3.1. Ability.

Ability is that group of skills, competencies, and characteristics that enable a party to have influence within some specific domain (Mayer, Davis, and Schoorman, 1995, p.717).

In this thesis, the term ability is used to denote the extent to which the investment manager produces reasonable returns and transfers investment knowledge to the trustee of the pension funds. This thesis found that ability is as a key factor of trustworthiness of the Indonesian investment manager. This finding confirms the previous studies of Swan, Trawick, and Silva (1995); Crossby, Evans, and Cowles (1990); Moorman, Deshpande, and Zaltman (1993). These researchers indicate that a person gains trust from others by demonstrating his/her competency, ability, and expertise.

The trustee of small, medium, and large pension funds agreed that ability is a key factor of trustworthiness of an investment manager. For example, Mr. 'A', the Indonesian trustee of 'A' a large pension fund, uses expertise as a criterion for hiring an investment manager (Appendix 8.3). The responsibility of the trustee is therefore to select and hire a skilful investment manager (Stewart, 1998) for two reasons. First, a good investment performance come from superior skills in stock selection, exploiting price fluctuation, increasing trading frequency, cutting transaction costs, cutting information gathering and increasing risks (Ang, Chen,
and Lin, 1998). Second, the ability of an investment manager will reflect in his/her efforts to improve performance by increasing his/her activities in relation to stock selection and trading, cost reduction, and risk taking (Ang, Chen, and Lin, 1998).

Indonesian trustee interviewees assess the ability of investment managers by using the criterion of investment knowledge as demonstrated by investment qualifications and an official license; investment experience by the number of years in managing stocks and bonds on behalf of clients; reputation judged by the number of clients under his/her management; and past performance record by the history of returns performance.

The reason for the trustees of small, medium and large pension funds hiring an investment manager is to obtain higher returns than interest rates on term deposits. For example, Mr. D, the Indonesian trustee of 'H' a small pension fund, gives his reason for hiring an investment manager as obtaining a reasonable return on investments (Appendix 8.1). Returns on investment is one major source of increasing the amount of invested funds and one of the major performance indicators of the investment manager in managing active investments. If the returns on investment can increase the amount of the investment fund, the increase of the pension funds' liquidity ratio will be raised. If the liquidity ratio reaches 120%, the employer and the employees will not need to pay their contributions. If the actual returns on investment exceed the target returns, the trustee will continue the relationship with the investment manager and the trustee
may add to the amount of funds under management by the investment manager. The ability of the investment manager is therefore a key factor to be considered by the trustees in trusting the investment manager.

In conclusion, ability is a key factor of the trustworthiness of an Indonesian investment manager who expect to demonstrate his/her ability in term of providing the best returns, and improving investment performance, knowledge. These are for the benefit of the trustee and therefore enhancing the level of trust of trustee in an investment manager.

3.3.3.2. Benevolence.

Benevolence is the extent to which a trustee is believed to want to do good to the trustor, aside from an egocentric profit motive (Mayer, Davis, and Schoorman, 1995, p.718).

In this thesis, benevolence is defined as the extent to which an investment manager gives protection and is concerned with the trustee’s interest. This thesis found that benevolence is a key factor in the trustworthiness of an investment manager. This finding confirms the findings of previous studies conducted by Gabaro (1978), Posner and Schimdt (1984) and Butler (1991). The results of these studies indicate that loyalty, supportiveness and concern are important in building a trust relationship.

The trustee interviewees expect the investment manager to act benevolently. For example, Mr. 'I', trustee of 'L' a small pension fund, gives as the criterion for hiring an investment manager the willingness to transfer investment knowledge
to the trustee (Appendix 8.3). The responsibility of the trustee is therefore to select and hire an investment manager who demonstrates his/her concern for the benefit and interests of the trustee (McAlister 1995; Mishra, 1996). Demonstrating his/her concern can be shown in several ways (Whitener, Brodt, Korsgaard, and Werner, 1998). These are: showing considerations for the trustee’s target returns and the trustee’s interest in the transfer of knowledge; acting in a way so as to safeguard the trustee’s funds and refraining from taking benefits for personal gain.

The Indonesian trustee assesses the benevolence of the investment manager by using criteria such as: the investment services on offer as shown by the number and quality of investment services provided to the clients, and the willingness to transfer investment knowledge to the trustee or the staff. This thesis argues that the reasons for using these criteria for assessing the benevolent of an investment manager are: (i) to receive transfer of knowledge, and (ii) to know the depth of concern of the investment manager for the safety of the funds.

The first reason for the trustee of large pension funds to hire an investment manager is to obtain a transfer of knowledge from the investment manager to the employees of pension funds about how to manage an active investment. For example, Mr. ‘B’, the Indonesian trustee of ‘B’ a large pension fund, gives two reasons for hiring an investment manager. These are to learn how to manage an active investment and to receive transfer of knowledge (Appendix 8.1.). Most trustees of large pension funds want to train their employees to manage active investments in order to set up in-house management. The trustees are therefore
willing to pay a fee for hiring investment managers who are willing to include the transfer of investment knowledge and experience in managing active investments to staff of pension funds. The ability of the investment manager is a key factor to be considered by the trustees in trusting investment managers.

The second reason for an Indonesian trustee of a small pension fund to hire an investment manager is concern with the safety of the funds under the investment manager. Safety of the funds means that the funds are free from the effect of fraud or a personal profit motive of the investment manager. The trustee, therefore, selects and hires an investment manager who is willing to protect the trustee’s funds against losses. Thus, the benevolence of the investment manager is a key factor to be considered by the trustee in trusting the investment manager.

It is concluded here that benevolence is a key factor of trustworthiness of Indonesian investment manager who is expected to demonstrate his benevolence in term of providing a good investment services, transferring investment knowledge and providing safety of funds from personal gains.

3.3.3. Integrity.

Integrity is adherence to a code of ethics or set of values. It also involves how well our actions match our beliefs. It suggests a wholeness or coherence in our philosophies and values, in our public and private statements, and in our actions across a variety of situations (Shaw, 1997, p. 61).

In this thesis, integrity is defined as the extent to which the investment manager acts consistently with what he/she says and adheres consistently to the investment
management agreement. This thesis found that integrity is a key factor of trustworthiness of the investment manager. This finding confirms the previous studies conducted by Gabaro (1978), Butler and Cantrell (1984), and Schindler and Thomas (1993). The results of these studies indicate that integrity is an important determinant of trust in interpersonal and group relationships.

The trustee expects the investment manager to be honest, to provide true information and to keep promises. For example, in appendix 8.3, Indonesian trustee interviewees give as their criteria for hiring an investment manager: (i) given true information (Mr. 'D' of 'H' pension fund) and (ii) keeping promises (Mr. 'N' of 'K' pension fund). It is the responsibility of the trustee to select and hire an investment manager who is honest in what he/she says and consistent in how he/she acts (Shaw, 1997). Consistent actions serve to reduce the trustee's perceived risk in trusting his/her investment manager (Whitnerr, Brodt, Korsgaard, and Werner, 1998). If the investment manager acts consistently, the trustee can predict the investment manager's future actions based on his/her past actions and can measure their reliability. Thus, if the investment manager has integrity, he/she will act reliably and deliver that which has been promised.

Indonesian trustees assess the integrity of Indonesian investment managers by using criteria such as honesty as demonstrated by the past record of truthful information being provided by the investment manager to the trustee; keeping promises as shown by the past records of the investment manager and adhering to the trustee's investment guidelines. This thesis argues that the Indonesian trustee
has at least two reasons for using these criteria for assessing the integrity of the investment manager: (i) ensuring that the investment manager adheres to the investment management agreement, and (ii) reducing the risk of cheating.

The first reason is that the Indonesian trustee has a responsible to the members to increase the value of investment and returns on investments under the management of the chosen investment manager. The trustees, therefore, select and hire an investment manager who is willing to provide honest information and who provides adequate explanations about the value of the trustee's investment portfolio and the management of this investment. Thus, honesty in the investment manager is necessary as so that the trustee is assured of reducing the risk of dishonesty from the investment manager.

The second reason is that the Indonesian trustees have a responsible to the fund members to ensure the investment manager managing the active investment is following the trustee's investment guideline. This guideline includes the investment risks, objectives and restrictions. The trustees, therefore, select and hire an investment manager who is willing to keep the promises given in the investment management agreement. Thus, keeping promises as a manifestation of integrity is a key factor to be considered by the trustee in trusting the investment manager.

It is concluded here that integrity is a key factor of trustworthiness of Indonesian investment manager who is expected to demonstrate his/her integrity in term of
providing true information, keeping promises, and maintaining and adhering to investment management agreement.

3.3.3.4. Openness in Communication

Three aspects of communication that affect perceptions of trustworthiness are: (1) accurate information, (2) explanations for decisions, and (3) openness (Whitener, Brodt, Korsgaard, and Werner, 1998, p.517).

In this thesis, communication is considered to be the extent to which an investment manager willing to provide an accurate market information and adequate explanations for buying and selling stocks and bonds. Openness in communication is considered to be the extent to which an investment manager willing to provide all relevant information to manage active investment. This thesis found that openness in communication is a key factor of trustworthiness of Indonesian investment manager interviewees which confirm the previous studies of several researchers. The results of their studies indicate that accurate communication is an indicator of a trustworthy manager (O'Reilly, 1977); adequate explanations lead to higher levels of trust (Sapienza and Korsgaard, 1996); and open communication enhances the perception of trust (Buttier, 1991).

The trustee expects the investment manager to provide adequate information and explanations for his/her decision to buy and sell stocks. For example, Mr. 'B', Indonesian trustee of 'B' pension fund, uses the willingness of an investment manager to explain the reason for buying and selling stocks as a criterion for hiring him/her (Appendix 8.3). 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 of the investment manager in the trustee’s interests.

The trustees also expect the investment manager to be open with relevant information used in managing active investment on behalf of the trustee. For example, Mr. ‘N’, Indonesian trustee of ‘K’ pension fund, uses openness as a criterion for hiring an investment manager (Appendix 8.3). The reason is that by receiving the relevant information, the trustees are able to monitor and evaluate the performance of the investment manager. This finding supports the argument of Zand (1997) that “openness is especially important when the other person has low competence for the task at hand” (p.114).

Indonesian trustees assess the value of the communication by investment managers by using criteria such as the willingness of the investment manager to meet regularly with the trustee (as shown by agreeing to a meeting schedule), the willingness of the investment manager to provide adequate explanations, to discuss and respond to questions and feedback and the willingness to share ideas with the trustee as shown by discussions of the investment plan for improving the managed portfolio performance, for several reasons.

Firstly, one reason the Indonesian trustees hire an investment manager is to obtain as much information as possible about the stock market, stock selection, and
information to make buying and selling decisions because the trustee has the responsibility for monitoring and evaluating the performance of the investment manager. The trustees, therefore, select and hire an investment manager who is willing to provide information which is both timely and accurate; who is willing to provide adequate explanations for buying and selling stocks and the performance of the investment. Thus, accurate information and adequate explanations are key factors to be considered by the trustee in trusting the investment manager.

Secondly, another reason for the Indonesian trustees hiring an investment manager is to share the thoughts and ideas of the investment manager in managing active investments and improving the investment performance because the investment manager is implementing the trustee's investment plan. Trustees, therefore, select and hire an investment manager who is willing to share ideas, information, and exchange thoughts related to managing an active investment. This is useful for the trustee in reducing his/her perceived risk in the relationship with the investment manager. Thus, open communication is a key factor to be considered by the trustee in trusting the investment manager.

It is concluded here that open communication is a key factor in the trustworthiness of investment managers who is expected to provide relevant information used in buying and selling stocks, adequate explanations, and sharing ideas and exchange thoughts.
The key activities performed by both the investment manager and the trustee for building an early relationship, and for developing this relationship into a long-term relationship will be explored and analysed in chapter 9.

3.3.3.5. Interaction Amongst the Key Factors of the Trustworthiness of an Investment Manager.

The main result of this thesis is that it has isolated four key factors in the trustworthiness of Indonesian investment managers. These key factors are:

(a) **Ability**: knowledge and experience

(b) **Integrity**: honesty and keeping promises

(c) **Benevolence**: concern

(d) **Openness in communication**

These four factors are not separable, but they combine multiplicatively in determining the over-all level of trustworthiness of Indonesian investment managers because a low level of one factor will be offset by a high level of another. For example, one interviewee, President Director of ‘A’ investment management firm, claims that the trustee still continues the relationship with an investment manager, who has moderate investment performance but shows his/her high integrity and benevolence to the trustee, and regularly communicates with the trustee. However, if the investment manager does not show any effort to improve his/her investment performance, the trustee will discontinue the relationship.
Mayer, Davis, and Schoorman (1995) argued that trustworthiness should be thought of as a continuum, rather than the investment manager being either trustworthy or not. Shaw (1997) suggested that, in order to achieve and to maintain a level of trustworthiness, the investment manager must perform sufficiently in each of the four factors of the trustworthiness of an investment manager. His suggestion translates into an equation as follows:

\[
\text{Quality of Trustworthiness of the Investment Manager} = \text{Ability} + \text{Integrity} + \text{Benevolence} + \text{Openness in Communication}
\]

From this equation, it can be inferred that the quality of the trustworthiness of an investment manager can be maintained by making the balance of all four factors meet the requirements of the trustee.

4. Summary.

In this chapter, the reason for the trustee to hire one or more investment managers, and the trustworthiness of the investment manager, were explored and analysed. The primary data was collected by conducting interviews with Indonesian trustees. The results of this exploration indicate that:

(i) the degree of trustworthiness of an Indonesian investment manager is a function of the his/her perceived ability, integrity, benevolence and openness in communication.

(ii) trust is a key component of the relationship between Indonesian trustees and investment managers.
The trustee uses the component of trust as the criterion for selecting and hiring an investment manager for three reasons. Firstly, the major reason for the trustee to hire an investment manager are to obtain a transfer of knowledge and to obtain high returns. Secondly, the major reasons for the trustee to hire many investment managers are to reduce the risk from hiring only one investment manager, to allow the trustee to compare the performance of investment managers and to obtain transfer of knowledge from them. Thirdly, the criteria used by the trustee for hiring an investment manager are the expertise, honesty, concern and openness of the investment manager in communication. These criteria indicate that the key factors in the trustworthiness of Indonesian investment manager includes ability, benevolence, integrity and openness in communication.

In the next chapter, the key activities performed by both trustee and investment manager will be discussed.