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 9

Case Study Analysis - Part 2
The Key Activities Performed by Indonesian Trustee and Investment Manager for Building Their Relationship

1. Introduction.

This thesis explores two important aspects of the relationship between the trustee of the pension fund and the investment manager: (i) the key activities factors of trustworthiness of the investment manager important to the pension fund trustees in Indonesia, and (ii) the key activities performed by both the trustee and the investment manager for building their relationship which can be divided into an early and a long-term relationship. In the previous chapter, the key factors of trustworthiness of the Indonesian investment manager were explored and analysed. The results showed that the relationship between the Indonesian trustee and the investment manager is based on trust; and the trustworthiness of investment manager as demonstrated by his/her ability, benevolence, integrity, and openness in communication.

In this chapter, the key activities performed by the trustee and investment manager in building their relationship are explored. The relationship can be divided into an early and a long-term relationship. The first aim is to explore the key activities performed by trustees and investment managers in building their early relationship (less than 2 years); and their long-term relationship (more than 2
years). The second aim is to analyse the key activities by matching them to the theoretical pattern that is derived from the stages of the development of a trust relationship outlined by Lewicki and Bunker (1996).

The primary data on the key activities performed by the trustee and the investment manager for building their relationship were collected by conducting interviews with Indonesian trustees and investment managers. The data were analysed in two stages. Firstly, using the Summary of Interview Data (Appendix 9), the researcher applied the pattern coding technique of Miles and Huberman (1994) to determine the categories of the key activities performed by both trustees and investment managers. These were then cross analysed to determine the key categories of the activities involved in building the relationship. The results are termed the 'observed pattern'. Secondly, the pattern-matching technique proposed by Trochim (1989) was used to match the resulting observed pattern with the theoretical pattern.

The primary data analysis provide several important results. Firstly, the key activities for building an early relationship between the trustees and the investment managers gives benefits to both in their relationship and builds strong communication links between them. Secondly, in a long-term relationship, the key activities are shown to include the conducting of regular and close communication; and the maintenance by the investment manager of the quality of his/her trustworthiness. The supporting activity in a long-term relationship is the improvement of the investment performance.
This chapter is organised around three topics: case study data, case analysis using pattern coding and case analysis using pattern matching. The case study data includes a profile of the interviews and the collected primary data. The pattern coding analysis is used to find the 'observed pattern' of the activities performed by both the trustee of the pension funds and the investment manager for building an early relationship, and for developing it into a long-term one. The pattern matching analysis is then used to match the observed and the theoretical patterns.

2. Case Data.

The primary case data were collected by conducting interviews with trustees and investment managers. The interviews were focused on the activities of Indonesian trustees and investment managers for building their relationship.

2.1. The Profiles of The Interviewees.

The interviewees consisted of trustees of pension funds and investment managers licensed to manage active investments on behalf of the trustees. The profiles of the trustee interviewees has been discussed in chapter 8. The profiles of the investment manager interviewees are given below.

There were 11 investment managers from 11 different investment management firms (Appendix 6.6.: List of Interviewees of Investment Managers). 4 of the 11 investment managers had a professional relationship with a trustee of more than 2 years duration, and 7 of the 11 investment managers had a relationship in the
range of 1 to 2 years. These duration of relationship met the criteria to be included by way of analysis in this study.

The formal relationship between the investment manager and the trustee begins with an investment contract of one year. At the end of this period, the trustee can decide to continue or to discontinue the relationship with the investment manager. In this study, the duration of a relationship in the range of 1 to 2 years is considered an early relationship, and a duration more than 2 years is considered long-term because the Indonesian investment management industry only commenced in 1992 and therefore longer term relationships are not available for inclusion in this study.

The position of the investment manager varies depending on the size and organization structure of the investment management firm. Named positions include: president director; director; associate director; assistant director, and investment manager. Regardless of the title of the position, they all deal with trustees by performing similar activities. However, depending on the number of clients, the investment managers may deal directly with the trustee or via the client relation/services manager who provides investment management services.

2.2. The Primary Data Collection.

The case data were collected by conducting interviews with 11 investment managers, 8 with the title of investment manager and 3 with the title of client relations manager. The case data were also collected by interviewing the trustees.
Semi-structured interviews were used to explore the activities that are performed by the trustees and the investment managers to build their early and long-term relationships. The duration of the interviews with the investment manager ranged from 30 to 45 minutes. The activities of the researcher in conducting interviews with the investment managers were as follows:

Firstly, a letter was sent to the target interviewees seeking their cooperation in agreeing to be interviewed. A total number of 16 letters were sent to investment managers. This small number canvassed was because, in the early stages of the development of the Indonesian investment management industry, only a few investment managers had experienced the building of a relationship with trustees of pension funds; of this number only a few were willing to be interviewed and to share their information. In the letter, the major interview questions were stated. Targeted interviewees were selected based on the reputation of the investment management firms in the stock market, the amount of funds under management and the duration of the relationship between the investment manager and his/her clients. The number of interviewees was selected during the process of primary data collection. 5 of the canvassed 16 investment managers refused to participate because they were ‘very busy’. Finally, 11 investment managers were interviewed and used as the basis for the case analysis. The amount of funds under the management of the 11 investment managers from 11 different firms was Rp 3,906.08 billion in 1997, that is, equal to 45% of funds under the management of 46 investment management firms.
Secondly, a pilot study to test the validity of the prepared research question was conducted. One key informant Mr ‘A’, the chairman of the Indonesian Investment Manager Association, agreed to be the subject of the pilot study. As a result, research questions were revised and then used as a guide to interview the others 10 investment managers who had agreed to be interviewed.

Thirdly, the duration of the interviews was as follows: 1 of 45 minutes, 4 of 40 minutes each, and 6 of 30 minutes each. The duration of the interviews reflects the length of the relationship of the investment managers with the trustees. The interviews relating to short-term relationships were approximately 30 minutes. All interviews were conducted in the interviewees' offices, mostly in the late afternoon after trading on the Jakarta stock market had closed. In conducting the interviews, the researcher’s aim was to obtain relevant information and to ensure its reliability. For example, every interview opened with a statement by the researcher of the purpose of the interview which permitted the interviewees to answer the questions in his/her own way. However, most interviewees gave both relevant and irrelevant information because they were inexperienced in being interviewed.

Fourthly, 7 of the 11 investment managers were willing to be recorded during the interview process but the other 4 were not. The researcher took notes during these latter interviews.
Fifthly, the transcript of the interview data was presented in the form of 'Summary of Interview Data (Appendices 9) by a using question-and-answer format. The questions used to summarise the interview data were based on the research questions and the theoretical framework of the stages of trust relationship.

The case analysis is based on the Summary of Interview Data and divided into two parts. The first part analyses the key activities performed by Indonesian trustees and investment managers for building an early relationship (section 3). The second part of the analysis focuses on the key activities performed by Indonesian trustees and investment managers in developing a long-term relationship (section 4).

3. Case Analysis 1:
The Key Activities Performed by Indonesian Trustees and Investment Managers in Building an Early Relationship

A relationship between Indonesian trustees and investment managers begins with a one year investment contract between them which is reached through several processes. The first is the initial meeting between the trustee and the investment manager in order to define the investment needs of the trustee and the capability of the investment manager to meet those needs. The needs of the trustee may include the safety and the returns on the investment funds, as well as the investment services provided by the investment manager. The investment manager presents his/her performance record in managing a stock portfolio, the research facilities available, the credentials of the team of investment managers
and the proposal of an investment plan for the trustee. Secondly, is the evaluation by the trustee of all information provided by the investment manager. For this he may request experts, such as independent consultants and information from existing clients of the investment manager. Thirdly, if the trustee and the investment manager reach mutual understanding they might proceed with an investment contract for one year. Fourthly, the investment manager implements the investment contract and the trustee monitors the process and the results of this implementation.

For the purposes of data analysis, the answers of the trustee and the investment manager interviewees were gathered together using the question-and-answer format as shown in the Summary of Interview Data (appendix 9.1 and 9.2). The case analysis for building an early relationship consists of four stages (figure 1): (i) to define the observed pattern of the activities performed by trustees, (ii) to define the observed patterns of the activities performed by investment managers, (iii) to make cross analysis of the observed pattern, and (iv) to match the observed with the theoretical patterns.

These four stages of case analysis are appropriate for finding the key activities performed by both trustees and investment managers for building an early relationship.
3.1. Observed Pattern 1:

The Activities Performed by The Indonesian Trustee of Pension Fund for Building an Early Relationship with the Investment Manager

The Indonesian trustees were expected to perform several activities that were useful for building an early relationship with the investment manager. In order to explore these activities, the following question was asked of the trustee interviewees: 'would you explain your activities in building an early relationship with the investment manager?'. Their answers are summarised in Appendix 9.1 (The Activities of the Trustee of the Pension Funds in Building an Early Relationship). The resultant data were analysed in two ways: (i) the answers of the interviewees were grouped together so that similar answers were in the same...
category, and (ii) regrouped on the basis of the duration of their relationship with the investment manager.

In the first analysis, by using the pattern coding technique (Miles and Huberman, 1994), the activities performed by the trustees can be further condensed into three major categories:

a. Evaluating investment performance including the ability of investment manager (all interviewees = 100%)

b. Evaluating investment services including transfer of knowledge and reporting (70% of interviewees)

c. Building communication with the investment manager including his/her explanation (70% of interviewees)

This thesis argues that three key activities performed by trustees for building an early relationship with an investment manager is consistent with their reasons for hiring an investment manager for a number of reasons, as follows:

(a) The trustee of small, medium, and large pension funds need to evaluate the investment performance of investment managers. This performance would be compared with the costs paid by the trustee to the investment manager. For example, Ms. 'C', Indonesian trustee of 'E' small pension funds, evaluates the investment performance and asks for adequate explanations (Appendix 9.1).

(b) The trustee of large pension funds needs to evaluate transfer of knowledge provided by investment manager to understand the level of concern of the investment manager to the interests of the trustee. For example, Ms. 'Y'.
Indonesian trustee of large 'I' pension funds evaluate the transfer of knowledge from the investment manager (Appendix 9.1).

(c) The trustee needs to build communication links with the investment manager to understand the level of openness of the investment manager in communication. This is also important for the trustee to reduce his/her risk in the relationship with investment manager such as: risk of cheating because of information asymmetry. For example, Mr. 'D', Indonesian trustee of small 'H' pension funds, need to evaluate the willingness to provide clear explanations and build a close relationship (Appendix 9.1).

In the second analysis, the trustees were divided into two groups on the basis of the duration of their relationship with the investment manager. These groups were long-term relationships, that is, where the duration of the relationship was more than 2 years; and short-term relationships of less than 2 years. The activities performed by the trustees can be condensed into 3 categories.

<table>
<thead>
<tr>
<th>The duration</th>
<th>The Activities Performed by the Trustees.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Long-term relationship</strong></td>
<td>1. Evaluating investment performance (100% of interviewees)</td>
</tr>
<tr>
<td></td>
<td>2. Evaluating investment services (100% of interviewees)</td>
</tr>
<tr>
<td></td>
<td>3. Building communication (75% of interviewees)</td>
</tr>
<tr>
<td><strong>Short-term relationship</strong></td>
<td>1. Evaluating investment performance (100% of interviewees)</td>
</tr>
<tr>
<td></td>
<td>2. Evaluating investment services (50% of interviewees)</td>
</tr>
<tr>
<td></td>
<td>3. Building communication (70% of interviewees).</td>
</tr>
</tbody>
</table>
Analysis of the interview data in this second analysis identified several key activities central to the development of on-going trust between pension fund trustees and investment managers in Indonesia.

The trustees who have experienced short-term and long-term relationships with an investment manager agreed that evaluating the investment performance of an investment manager is important for building their relationship because the trustee uses the return on investment to pay the costs of investment such as fees for the investment manager, stockbrokers and custodian. The trustee's decision to hire an investment manager is right if the returns on investments are higher than the costs of investment; and the net returns on investment are used to increased the amounts of investment funds, or to increase the benefit for the members.

Trustees who had an experienced long-term relationship with stated that they needed to evaluate both the investment performance and the quality of investment services because the returns on investment obtained may be up and down but the quality of investment services must be increased or maintained. For example, Mr. 'B', Indonesian trustee of large 'B' pension funds and who has a long-term relationship with investment managers, evaluates regularly the investment performance and investment services provided by the investment manager (Appendix 9.3).

Trustees who had a long-term relationship with an investment manager also emphasise building communication as a key activity for building an early
relationship. They intimated that quarterly meetings of 1 to 3 hours, with the investment manager were not sufficient for any close understanding. Regular communication in addition to quarterly meetings was essential. For example, any significant information about the stock market should be relayed immediately if there was an impact on the trustee's portfolio.

The trustees who had experienced a short-term relationship with an investment manager, also emphasised the importance of building communication with the investment manager, because the trustees realise that they have no idea about how an investment manager manages the investment portfolio. Therefore, this group of trustees is concerned with detailed explanations to be provided by the investment manager. For example, Ms. "C", Indonesian trustee of 'E' pension funds and who has short-term relationship with an investment manager, ask for adequate explanations from the investment manager (Appendix 9.1).

In conclusion, the trustees who have experienced both long and short-term relationships with investment managers agree that the key activities for building an early relationship include:

- Evaluating the investment performance
- Evaluating investment services
- Building communication

These activities are important to the trustee to obtain maximum benefits and to reduce the costs of the relationship with the investment manager. These activities
are now considered as the observed pattern of key activities performed by the trustees for the building an early relationship.

If the trustee is satisfied with the investment performance obtained in the short-term relationship the trustee will consider continuing the relationship into a long-term one.

3.2. Observed Pattern 2:
   **The Activities Performed by The Indonesian Investment Manager for Building an Early Relationship with the Trustee.**

The investment manager performs several activities for building an early relationship with the trustee. In order to explore these activities, the following question was asked of the investment manager interviewees: ‘would you explain your activities for building an early relationship with trustees?’ Their answers are summarised in Appendix 9.2 (The Activities of the Investment manager in Building an Early Relationship). The analysis of the answers of the investment manager interviewees, are treated together so that similar answers are in the same category.

By using the pattern coding technique (Miles and Huberman, 1994), the activities performed by the investment manager in building an early relationship with a trustee can be condensed into three major categories that are now considered as the observed pattern of the key activities performed by the investment managers for building an early relationship, a follow:
(a) demonstrating the ability in managing active investment on behalf of the trustee (100% of interviewees).

(b) providing investment services including transfer of investment knowledge and reporting (80% of interviewees).

(c) building communication including providing explanation (60% of interviewees).

The investment manager realises that he/she is hired by the trustee of the pension funds because of his/her ability to provide maximum investment benefits to the trustee. These major benefits consist of the returns on investment, the investment services, and the transfer of investment knowledge.

3.3. Cross Analysis of The Observed Pattern for Building an Early Relationship.

The aim of the cross analysis is to find the activities that has been agreed upon by the trustees and the investment managers as necessary for building an early relationship; and to find the minor activities that are derived from those activities and either performed by the trustee of the pension funds or the investment manager. The results of the cross analysis are considered as the observed pattern that would be matched to the theoretical pattern derived from the activities to develop trust relationship of Lewicki and Bunker (1996).

Three key activities for building an early relationship performed by the trustee are:
(1) evaluating the investment performance

(2) evaluating the investment services

(3) building communication with the investment manager.

Three key activities for building an early relationship performed by the investment manager are:

(1) demonstrating the ability in managing active investment on behalf of the trustee.

(2) providing investment services including the transfer of investment knowledge and reporting.

(3) building communication including providing explanation.

The results of the cross analysis between the activities performed by trustees and investment managers show that there are two key activities in building an early relationship between the Indonesian trustee and the investment manager. These key activities are performed by both the trustee and the investment manager, as follows:

(1) providing benefits for the parties in the early relationship.

(2) building communication links between the parties in the early relationship

The benefits for the trustee include the returns, the investment services and the transfer of knowledge from the investment manager. The benefit for the investment manager is the fees paid by the trustee. These two key activities above
are now considered as the observed pattern for building an early relationship between the trustee of the pension funds and the investment manager.

3.4. Matching Theoretical and Observational Patterns of The Activities for Building an Early Relationship

The researcher here uses the pattern matching technique to analyse the observed pattern of the key activities performed by the trustee and the investment manager for building their early relationship. This technique was proposed by Trochim (1989) and suggested by Yin (1994) to use in case study analysis because a pattern matching technique allows the researcher to match the observed and the theoretical patterns. The pattern matching technique consists of three steps: defining the theoretical pattern, defining the observed pattern and matching the observed with the theoretical pattern (see Chapter 5).

The theoretical pattern of the key activities for building an early trust relationship is derived from the first stage of trust development, a calculus-based trust, developed by Lewicki and Bunker (1996). In the stage of calculus-based trust, the key activities for building a trust relationship are given in chapter 4, but replicated here for clarity:

- to identify the benefits and the costs of the relationship.
- to set a punishment for the investment manager’s untrustworthy behavior
- to monitor the investment manager’s behavior regularly.
The **observed pattern** of the key activities for building an early trust relationship is derived from the cross analysis of the categories of activities performed by the trustee of the pension funds and the investment manager (see previous sections).

The observational pattern of the key activities for building an early trust relationship are given in section 3.1.3 but replicated here for clarity:

- **to provide benefits for the trustee and the investment manager in the early relationship.**

- **to build communication links between the trustee and the investment manager in their early relationship**

The **matching** between the theoretical and observed patterns of the key activities in building an early trust relationship provided several results, as shown below:

(1) The observed pattern shows the benefits for both parties, the trustee and the investment manager, similar to the theoretical pattern of the benefits of a trust relationship. The benefits for the trustee can be in the form of returns on investment, investment services and transfer of knowledge. The benefit for the investment manager is the fee paid by the trustee.

(2) The observed pattern of the effort of building communication between the trustee and the investment manager is similar to the theoretical pattern of regularly monitoring the behavior of the investment manager. However, building communication is not only to monitor the behavior but also to monitor the trustworthiness of the investment manager such as: honesty, openness, and integrity.
(3) The theoretical pattern of setting punishment for an investment manager's untrustworthy behavior is stated in the investment management agreement. The trustee of the pension funds can discontinue the relationship with the investment manager by giving one month's notice.

In summary, the key activities agreed upon by the Indonesian trustee and investment manager interviewees for building an early relationship between them are:

- to evaluate benefits from the relationship.
- to build communication into the relationship.

3.5. Explanations of The Key Activities Performed by Both Indonesian Trustees and Investment Managers for Building an Early Relationship

The main characteristic of an early trust relationship between the trustee and the investment manager is costs and benefits analysis, that the relationship is the results of the costs are lower than the expected benefits. This characteristics provide empirical evidence to calculus based trust as defined by Lewicki and Bunker (1996) who argue that the characteristics of calculus-based trust is based on rational rather than emotional decisions, and that the aim of the party in building an early relationship is to gain benefits and to reduce risks in the relationship with the other. This thesis found that building communication link is a key activity for building an early relationship between Indonesian trustees and
investment manager. This activity can be considered as an additional key activity for building a relationship at the stage of calculus-based trust of Lewicki and Bunker (1996).

3.5.1. Evaluating the Benefit for the Indonesian Trustees From an Early Relationship with the Investment Manager

The early relationship between the Indonesian trustee and the investment manager is built on the basis of the trustee's economic calculation of benefits and costs in trusting the investment manager. The trustee can obtain at least two major benefits from hiring one or more investment managers, these are: active investment management (Radcliffe, 1994), and, if more than one investment manager is hired, risk diversification is achieved (Sharpe, Alexander, and Bailey, 1999). An active investment management means that there is a continuous monitoring of the factors likely to affect the investment returns and adjustments made to the composition of stocks and bonds in the portfolio to increase the value of the portfolio or to decrease the risk to the portfolio (Carew and Hoffman, 1997).

An active investment management involves several processes and is complex (Sharpe, Alexander, and Bailey, 1999). This is the impetus for the trustee to hire an investment manager who has knowledge, experience and skill in managing active investments. By hiring more than one investment manager the trustee can reduce any risks in the relationship. If the investment manager fails to fulfil the trustee's expectation, other investment managers may be more successful. This risk can also be reduced by hiring investment managers with different styles and
skills and by comparing theirs to the other investment managers (Sharpe, Alexander, and Bailey, 1999). Thus, from the point of view of the trustee, hiring an investment manager is a wise decision.

The Indonesian trustee interviewees expected to obtain some benefits from the building of an early relationship with their investment managers. For example, 'Mr. D', Indonesian trustee of 'H' pension fund, asks the investment manager to provide true explanations, and to meet trustee's investment objectives (Appendix 9.1). In another example, Mr. 'B', Indonesian trustee of 'B' pension funds, evaluates the benefit of the relationship with the investment manager in terms of performance and transfer of knowledge (Appendix 9.1). It is therefore confirmed by these examples, that regardless of the size of the pension funds, Indonesian trustees define the two major benefits from their relationship with the investment manager as returns on investment and the transfer of knowledge (see chapter 8). It has been noted in the literature that these benefits will be produced by the investment manager, if he/she has a high degree of trustworthiness (Shaw, 1997), because the investment manager will give his/her best effort to achieve the target returns, to demonstrate his/her concern and to act with integrity.

3.5.2. The Benefits and The Factors of Trustworthiness.

The benefits from building a trust relationship depend on the degree of the trustworthiness of the investment managers hired (Shaw, 1997). Firstly, the investment manager's ability will determine the extent of the gains of the trustee's returns. In achieving the target returns, the investment manager performs
several actions such as establishing the trustee's target returns, considering the
trustee's constraints on investments and utilising the support and research
facilities. For example, Mr. 'D', Indonesian investment manager of 'IIB' 
investment management firm, manages active investments on the basis of the 
trustee's investment guidelines (Appendix 9.2).

Secondly, the investment manager with a high degree of benevolence will
determine the extent of the transfer of knowledge gained by the trustee and will
protect the funds from fraud. In demonstrating his/her benevolence, the
investment manager performs several actions such as adhering to the investment
guidelines and providing safeguards for the funds. For example, Mr 'A',
Indonesian investment manager of 'NBA' investment management firm,
implements the trustee's investment plan in order to provide the best returns and
investment services possible (Appendix 9.2)

Thirdly, the investment manager with a high degree of integrity will determine the
extent to which the trustee gains accurate information and adequate explanations
of buying and selling stocks and bonds. In acting with integrity, the investment
manager performs several activities such as keeping promises and providing
adequate explanations. For example, Mr. 'I', Indonesian investment manager of
'IST' investment management firm, has the responsibility for maintaining a good
relationship with the trustee by providing up to date information (Appendix 9.2).
3.5.3. Monitoring the Benefits.

The Indonesian trustees use the investment management agreement as a basis for monitoring and evaluating the benefits provided by the investment manager. Some trustees set up in-house investment teams, and a few trustees use an independent consultant in monitoring and evaluating the duties of their investment manager. For example, Mr. 'M', Indonesian trustee of 'G' pension funds, uses the services of independent consultants to evaluate the ability of an investment manager (Appendix 9.1). These services include the evaluation of the returns performance by using the consultants' benchmark, buying and selling decisions, the quality of investment reports and prompt reporting.

In in-house monitoring and evaluation, the trustee may perform several activities, such as asking the investment manager to submit monthly investment reports, evaluating these reports including the checking of the buying and selling transactions, checking the information used to make buying or selling decisions, checking the decision making processes of the investment manager, checking the research facilities to support the investment manager, evaluating and discussing the actual returns of investment and the investment plan to improve the performance. These activities are aimed at ensuring that the returns provided by the investment manager are the result of the best efforts and ability of the investment manager.

3.5.4. Evaluating The Costs of the Relationship for the Trustee

The trustees realise that their decision to hire one or more investment managers to manage active investments on their behalf involves some cost. The trustee bears
at least two costs, excluding the fees for an investment manager. These are:
transaction costs and custodian fees (Rodriguez and Kolb, 1996). The transaction
costs include brokerage commission and bid-ask spreads that have an impact on
the returns of the portfolio (Rodriguez and Kolb, 1996) because the size of the
brokerage commission depends on both the volume and the value of the
transactions. The size of the bid-ask spread depends on active stocks and the
volatility of stock prices. Custodian fees are paid by the trustee for services
provided by the custodian in physically maintaining and controlling the stocks
and bonds in the portfolio. Besides paying monetary costs, the trustee must spend
his/her time in dealing, monitoring and evaluating the activities of the investment
manager in managing investments on behalf of the trustee (Rodriguez and Kolb,
1996). The trustee may also have psychological costs which take the form of
regret in choosing the wrong investment manager who has performed consistently
below the benchmark, provided poor investment services and breached the
investment agreement.

The Indonesian trustee interviewees, regardless of the size of their pension funds,
considered the costs in building an early relationship with the investment
manager. The trustee pays management fees, transaction costs and custodian
costs. These costs will be high if the investment manager has a low degree of
trustworthiness. Furthermore, any lack of integrity in the investment manager will
increase the costs of the relationship. These costs could be derived from fraud
and the degree of the personal interest of the investment manager. Moderate
ability of the investment manager in managing active investments may cause an
increase in costs of transactions and custodian fees. Thus, any lack of integrity and moderate ability of the investment manager will also increase the cost of monitoring by the trustee. For example, Mr. ‘L’, Indonesian trustee of ‘C’ pension funds, sets up a team to monitor and control the activities of the investment managers by checking the transaction reports and the accuracy of the information (Appendix 9.1).

3.5.5. Building Communication in an Early Relationship.

In order to increase the benefits and reduce the costs of the relationship, both the trustee and the investment manager need to build strong communication links between them because “communication is a primary factor in the trust relationship” (Danford, 1987, p.46). The communication could be in the form of meetings, both formal and informal, discussions, reporting and conversations via the telephone. By building communication links, the trustee can explain his/her expectations, constraints and financial conditions in a way that cannot be misunderstood by the investment manager in managing active investments on behalf of the trustee. The trustee can also obtain adequate information to monitor and evaluate the performance of the investment manager, and evaluate the costs of transactions and the cost of the custodian. For example, Mr. ‘A’. Indonesian trustee of ‘A’ pension funds, gives his reasons for hiring an investment manager as including to obtain returns on investments and transfer of knowledge, and to learn how to manage active investment (Appendix 8.1).
By building communication, the investment manager can also explain the responsibilities and the duties of the investment manager and his/her team in managing active investments on behalf of the trustee, the limitation of the investment manager in managing an active investment, the investment reports and explanations provided to the trustee. For example, Mr. 'E', Indonesian investment manager of 'MIS' investment management firm, performs an important activity. This is to manage the trustee’s portfolio by considering the trustee’s investment objectives, risks, and to provide good investment services, and to educate the trustee (Appendix 9.2)

Building communication in an early relationship is important to both parties. For the investment manager, communication is a means of proving his/her ability, benevolence, and integrity in implementing the investment management agreement. For the trustee, communication is a useful way to monitor and to evaluate the implementation by the investment manager of an investment management agreement.

In summary, the key activities performed by both Indonesian trustees and investment managers for building an early relationship are to evaluate the benefit for the relationship that is derived from the degree of trustworthiness of the investment manager, and to build communication in order to demonstrate the investment manager’s trustworthiness.
4. Case Analysis 2:
The Key Activities Performed by Indonesian Trustees and Investment Managers in Developing a Long-term Relationship

The relationship between the trustee and the investment manager will move into a long-term relationship if the trustee is satisfied with the benefits obtained in the early relationship. In a long-term relationship, the trustee is more dependent on the investment manager because the trustee recognises the potential risk of cheating and in order to reduce this risk, he/she must consider several activities, such as communicating regularly, hiring more than one investment manager and hiring an independent consultant. The investment manager realises that he/she must be closely concerned with the interests of the trustee which are not only the returns.

Figure 2: Case Analysis The Key Activities Performed by Both Indonesian Trustees and Investment Managers For Developing a Long-term Relationship.

Summary of Interview Data:
The activities performed by the trustees for building a long-term relationship with the investment manager (Appendix 9.3).

Pattern Coding is used to find the 'observed patterns' of the activities performed by the trustees for building a long-term relationship with the investment manager (section 4.1).

Cross Analysis of The Observed Patterns for Building a long-term Relationship (section 4.3)

Pattern Matching is used to match The Observed and The Theoretical Patterns (section 4.4)

The Explanation The Key Activities For Building A Long-term Relationship (section 4.5)
but also the investment services and the attitude of the investment manager. Thus, both the trustee of the pension funds and the investment manager have the responsibility for developing a long-term relationship.

For the purposes of the case data analysis, the answers of the trustees and the investment managers were gathered together using the question-and-answer format as shown in the Summary of Interview Data (Appendix 9.3 and 9.4). The case analysis for developing a long-term relationship consists of four stages (figure 2): to define the observed pattern of the activities performed by the trustees, to define the observed pattern of the activities performed by the investment managers, to cross analyse the observed patterns, and to match these observed with the theoretical patterns. These four stages of case data analysis are appropriate for finding the key activities performed by both the Indonesian trustees and the investment managers for developing a long-term relationship.

4.1. Observed Pattern 1: The Activities Performed by The Indonesian Trustees for Developing a Long-term Relationship with the Investment Manager.

The Indonesian trustees perform several activities that are useful for developing a long-term relationship with the investment manager. In order to explore these activities the following question was asked of the trustee interviewees: 'would you explain your activities for developing a long-term relationship with the investment manager?'. Their answers are summarised in Appendix 9.3 (The Activities Performed by Trustees for Developing a Long-term Relationship). The answers
of 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 activities performed by the trustees for building a long-term relationship can be condensed into four major categories:

(a) conducting regular communication with the investment manager which could be in the form of meetings, discussions, and sharing information (100% of interviewees).

(b) evaluating the ability of the investment manager in managing active investment on behalf of the trustee which can be in the form of investment returns (75% of interviewees).

(c) evaluating the concern of the investment manager which can be in the form of transfer of investment knowledge and providing good investment services (75% of interviewees).

(d) evaluating the honesty of the investment manager which can be in the form of keeping to the investment agreement (25% of interviewees).

4.2. The Key Activities Performed by The Investment Manager for Developing a Long-term Relationship with the Trustee

Investment managers perform several activities that are useful for developing a long-term relationship with the trustees. In order to explore these activities the following question was asked of the investment manager interviewees: 'would
you explain your activities for developing a long-term relationship with the trustee?'. Their answers are summarised in Appendix 4 (The Activities of the Investment Manager for Developing a Long-term Relationship). The analysis of the answers of the investment manager interviewees are grouped together so that similar answers are in the same category.

The activities given by the investment managers can be condensed into three categories as follows:

   (a) regular communication with the trustee for providing explanations and enhancing the confidence of the trustee in investing (100% of interviewees)

   (b) demonstrating the ability of investment manager in managing active investment on behalf of the trustee (100% of interviewees)

   (c) demonstrating the concern of the investment manager to the trustees' interest such as good investment services, and good reporting (67% of interviewees).


The aims of the cross analysis is to find the major activities for developing a long-term relationship that are agreed upon by the trustee and the investment manager and are reflected in the similarity of their proposed activities; and thereby finding the supporting activities that are derived from the activities either performed by
the trustee or the investment manager. The results of the cross analysis are considered as an observational pattern to be matched with the theoretical pattern.

Four key activities for building a long-term relationship performed by the trustee of the pension funds are:

(a) regular communication with the investment manager.
(b) evaluating the ability of the investment manager.
(c) evaluating the concern of the investment manager to the trustees' interest
(d) evaluating the honesty of the investment manager.

Three key activities for building a long-term relationship performed by the investment manager are:

(a) regular communication with the trustees.
(b) demonstrating the ability of the investment manager to manage active investment on behalf of the trustee.
(c) demonstrating the concern of the investment manager to the trustees' interest.

The results of the cross analysis between the key activities performed by both trustees and investment manager are that the two key activities for building a long-term relationship between the trustee and the investment manager are:

(1) to communicate regularly
Either the Indonesian trustee or the investment manager can take the initiative to communicate regularly. This may be in the form of meetings, discussions, sharing information or sending of regular reports. The investment manager must maintain the degree of his/her trustworthiness such as ability and concern, because that is important to the trustee as a means of reducing risks in the relationship. The Indonesian trustee also emphasises the need for the honesty of the investment manager as a mean of reducing risk in the relationship.


The pattern matching technique is used here to analyse the observed pattern of the key activities performed by the trustee and the investment manager for developing their long-term relationship. The pattern matching technique consists of three steps: defining the theoretical pattern, defining the observed pattern and matching the observed with the theoretical pattern (see Chapter 5).

The theoretical pattern of the key activities for building a long-term relationship is derived from the second stage of trust development called by Lewicki and Bunker (1996) 'knowledge-based trust' (chapter 4). In the knowledge-based trust, the key activities for developing a trust relationship were found to include:
• to communicate regularly
• to maintain the quality of the trustworthiness of the investment manager
• to evaluate the performance of investment manager.

The observed pattern of the key activities for building a long-term relationship are derived from the results of the cross analysis of the activities performed by the trustee and the investment manager. This analysis has been discussed in the previous section. The observed pattern of the key activities for building a long-term relationship are (section 3.2.3):

• to communicate regularly.
• to maintain the quality of the trustworthiness of the investment manager.

Matching between the theoretical and observational patterns of the key activities for developing a long-term relationship produced several results. These are:

(1) The observational pattern of conducting regular communication is a match to the theoretical pattern for regular communication. The type of communication may be in the form of reporting, discussion and sharing information. The regularity of communication is more important than the type of communication.

(2) The observational pattern of maintaining the quality of the trustworthiness of the investment manager match the theoretical
pattern of the trustworthiness of the investment manager. The factors of the trustworthiness of the investment manager include the ability in managing investment on behalf of the trustees, the concern for the trustees' interest, and the honesty of investment manager.

In summary, the two key activities agreed upon by the interviewees for developing the long-term relationship between the Indonesian trustee and the Indonesian investment manager are:

- to conduct regular communications.
- to maintain the quality of trustworthiness of the investment manager.

One supporting activity is:

- to evaluate the investment performance

These results indicate that Indonesian trustees of the pension funds and Indonesian investment managers are concerned with regular communication and the key factor of the trustworthiness of the investment manager.

4.5. Explanations for The Key Activities Performed by Both Indonesian Trustees and Investment Managers for Developing a Long-term Relationship

The characteristics and the key activities for developing a long-term relationship between the Indonesian trustee and the investment manager are shown by the interviewees to be similar to that of the knowledge-based trust as defined by
Lewicki and Bunker (1996) who argued that the characteristics of a long-term relationship between the parties are based on both rational and emotional elements and that the aim of the trustee in developing a long-term relationship is to gain benefits from a close relationship and to be able to predict the behavior of the investment manager based on past experience. They further argue that two key activities must be performed by both parties for the development of a knowledge-based trust. These are: to communicate regularly and to maintain the trustworthiness of the investment manager.

4.5.1. Regular Communication

The relationship between the trustee of the pension funds and the investment manager will depend on the satisfaction of past interaction and future prediction. These are the reasons that regular communication is a key activity for developing a long-term relationship (Donney, Cannon, and Mullen, 1998; Good 1988). For example, Donney, Cannon and Mullen (1998) suggest that one party in the relationship must be able to have information about the other party’s past actions in order to predict that party’s future actions. Shapiro, Sheppard and Cheraskin (1992) provide the following suggestions in establishing mutual understanding and predictability actions of the parties in the relationship: regular communication and courtship, in the sense of developing close personal ties, and consciously pleasing each other. Lewicki and Bunker (1996) also argue that without regular communication one can lose touch with the other not only emotionally but also in the ability to predict the future actions of the other party.
In conducting regular communication, the Indonesian trustees set a meeting schedule with the investment manager in their early relationship to discuss and evaluate the quality of their past interactions. Their discussions and evaluations emphasise the returns performance, the investment services and the investment plan. *For example, Mr. ‘B’, Indonesian trustee of ‘B’ pension funds, conducts regular meetings to evaluate the investment performance and services provided by the investment manager (Appendix 9.3).*

It has been found by means of this regular communication that the Indonesian trustee gains a great deal of information about the past and future actions of the investment manager. If the trustee is satisfied with the past and is confident of future actions, he/she will continue to develop a long-term relationship with the investment manager. On the other hand, if the trustee is dissatisfied with the past or fearful of any future actions, he/she will discontinue the relationship or stay in the early relationship.

The trustee acknowledges that regular communication with the investment manager is needed for a long-term relationship in order to reduce the risk of cheating and so that both the trustee and the investment manager fully understand his/her role in the long-term relationship.

**4.5.2. Maintaining the Trustworthiness of the Investment Manager.**

The trustworthiness of the investment manager is important to the trustee for enhancing their long-term relationship. *For example, Ms. ‘E’, Indonesian*
investment manager of 'MIS' investment management firm, demonstrates her concern to the interest of the trustee, keeps promises and provides good explanations (Appendix 9.4). The trustee monitors and evaluates regularly the investment report and services to decide whether the investment manager's performance reflects his/her ability; whether the investment manager provides true information; whether the investment services reflect the investment manager's concern with the interests of the trustee; whether the investment manager has transferred his/her knowledge to the staff of the pension funds and whether the investment manager has kept his/her promises.

If the behavior of the investment manager still shows his/her trustworthiness, the trustee will continue to develop their long-term relationship.

It is concluded here that:

if there is no trustworthiness, the trustee of the pension funds will lose his/her ability to predict the outcome or relationship with the investment manager.

In conclusion, regular communication and maintaining the trustworthiness of the investment manager, are more important than the effort to improve returns performance to Indonesian trustees of pension funds and investment managers. However, these activities are not separate but together determine the duration of the relationship between the trustee of the pension funds and the investment manager.
• Indonesian trustees will continue the relationship with the Indonesian investment managers, if the investment manager communicates regularly and maintains his/her trustworthiness, even though the performance of the return on investment is below the return's benchmark.

• Indonesian trustees of pension funds will discontinue the relationship with Indonesian investment managers if the investment manager maintains regular communication and continues to be trustworthy and the performance of the return on investment is consistently below the return's benchmark.

In summary, the key activities performed both by the Indonesian trustees and the investment managers are that they must communicate regularly in order to establish mutual understanding and to predict the future activities of the investment manager, and to monitor the degree of trustworthiness of the investment manager who has agreed to maintain his/her trustworthiness.

5. Summary.

In this chapter, the activities performed by both the trustees of the pension funds and the investment managers were explored and analysed. The exploration focused on finding the observed pattern of the activities performed by the trustees of the pension funds and the investment managers for building an early relationship and for developing a long-term relationship. The case study data were
both primary and secondary. The primary data were collected by conducting interviews with the trustees and investment managers. The case study data analysis was conducted in three stages: preparing a summary of interview data, pattern coding analysis in order to find the observed pattern and pattern matching analysis in order to match the observed with the theoretical pattern. The results of this exploration support the contention that there are key activities performed by both the trustee of the pension funds and the investment manager for building and developing their relationship.

(i) the key activities performed by the trustees of the pension funds and the investment managers for building an early relationship are to provide benefits from the relationship and to build communication into the relationship.

(ii) the key activities performed by the trustees of the pension funds and the investment managers for developing a long-term relationship are to communicate regularly and to maintain the quality of the trustworthiness in the investment manager.

In the next chapter, the research findings and conclusions will be presented.