

Issues and Challenges of Fund Manager Sophistication: An Overview of Indonesian Mutual Fund Industry

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Abstract: Indonesian capital market players are still dominated by Foreign investors. This will cause a high sensitivity of Indonesian capital market toward Foreign investor's movement. Mutual fund is an alternative way to increase the amount of domestic investors. Mutual fund is managed by a sophisticated fund manager. Sophisticated fund manager has much more information and takes the diversification of portfolio successfully. Sophisticated fund manager is always ready to invest much funds in various investment instruments. Sophisticated fund managers will not conduct any bias in their investment. As a sophisticated fund manager their investing decision must be rational and accountable.

Key words: Fund manager, sophistication, mutual fund, investment, accountable

INTRODUCTION

Indonesian capital market players are still dominated by foreign investors. The amount of domestic and Foreign investors must be balanced in the capital market (Hermuningsih, 2012). Imbalanced composition of domestic and Foreign investors will cause sensitivity of Indonesia capital market toward Foreign investor's movement. Domestic investors have an important role to drive the stability of Indonesian capital market. Regarding this, Nurhaida, the Executive Head of Capital Market Monitoring-Indonesia Financial Service Authority (FSA) said that the Indonesia FSA will conduct every approaches to boost the amount of Indonesian domestic investors in order to eliminate the independency of Indonesian capital market on foreign investors.

An alternative way to increase the amount of domestic investors is via mutual fund. Mutual fund is a simple investing instrument for investors community especially small and private investors (households) which do not have much times and skills to compute their investment returns and risks. Mutual fund is planned for a means to collect funds from the society as funds provider which have interest in investing but have no times and knowledge. Furthermore, mutual fund is very vital to boost the amount of domestic investors concerning that Indonesian capital market trading activities are still dominated by Foreign investors (Jake, 2000).

Investment business such as mutual fund is managed by a fund manager (investment company). This investment business is a trust business. Clients give their

trust to a fund manager for investing their funds in an appropriate portfolio. Unfortunately, this trust was abused as many investment crime cases happened in Indonesian capital market (Hendrayana, 2013). The transparency of fund management is an important thing. There are no high potential returns without high risks in an investment. Untransparent fund management is an indication that something bad has left behind in that fund management.

There are various deceitful investment cases in Indonesia which caused high losses to many clients, e.g., Qurnia Subur Alam, Add Farm, Sarana Perdana Indoglobal, Wahana Global Bersama, Gama Smart, Investasi Amanah, Koperasi Langit Biru, PT Gradasi Anak Negeri, PT Golden Traders Indonesia Syariah, Raihan Jewellery and Virgin Gold Mining Corporation (Herlianto, 2013). These companies offered investment products in favourite commodities with high returns but without transparency and finally, it was found out that these investments are just deceitful investments.

Fund manager (investment company) is very secured because the portfolio of funds is managed by a professional team. So, team members are called as fund managers or portfolio managers. Every investment company must employ at least two portfolio managers with licences from Indonesia FSA (Jake, 2000). Indonesia FSA will monitor every fund managers (investment companies) tightly. Investment business as a trust business has a high exposure of client's bad experiences in investing. These bad experiences will make a trauma for some clients who experienced much losses from it and an anxiety for some potential investors who listen that bad

investment news. The tight monitoring of Indonesia FSA will increase the society trust on investment companies and make a safety feel in Indonesian capital market.

Fund manager (investment company) is classified as institutional investors group. Institutional investor is defined as specific financial institution which manages collective funds for small investors with objectives to maximalize returns and maturity of claim for a limited certain accepted risks. Institutional investor receives funds from third party and invests it for the institution but on the behalf of the third party such as pension fund mutual fund and insurance companies. Institutional investor has characteristics such as:

- The availability of risk pooling for small investors offers a better trade-off between risks and returns
- The size of institution offers economies scale to be able in a transaction for higher trading volumes with cheaper transaction costs
- The investment portfolio set on the behalf of client offers a fiduciary relationship and needs a careful treatment in portfolio strategy to limit the risks

Institutional investor is also characterized as sophisticated investor. Sophisticated investor has a better ability to use current information to predict the future earnings (Jiambalvo *et al.*, 2002). Sophistication is a quality of sophisticated thing which is having an experience and knowledge about many things, working in smart and complex ways and understanding some complicated and difficult ideas (Hornby, 2010). This general definition can be used in a context of fund manager. Fund manager sophistication is a quality of the sophisticated fund manager which is managing the client's funds in a complex portfolio by difficult professional judgments and considerations due to prior experiences and updated knowledges. Fund manager sophistication is the central theme of this study.

MATERIALS AND METHODS

Issues and challenges of mutual fund industry: Nurhaida the Executive Head of Capital Market Monitoring Indonesia FSA said that Indonesian individual mutual fund investors are approximately only 161,000 and institutional mutual fund investors are approximately 960. The percentage of this individual mutual fund investors per population is only 0.07% of the population (241.03 million). So, it is important to increase the market from the two approaches, both size and product type. Currently, there are 400,000 accounts of investors and 300,000 accounts of mutual fund investors. The domestic

investors amount is still below 1% of 250 million population. This condition is not analogous with the increasing average trading values and the growing composite capital market indexes in Indonesia. The growth of Indonesian capital market is very good. But this growth is not supported by domestic investors which is very few in amount. The mutual fund product is expected to be the solution in increasing the amount of domestic investors.

Based on FSA data, mutual fund investors per December 2013 is approximately 539,000. But the real investors are estimated <170,000. This amount is very smaller than the Indonesian potential population (235 million). It is also very smaller than banking customers amount (>140 million). Based on Indonesia Deposit Insurance Corporation (IDIC) data, Indonesian potential investor are very much in great numbers. At the end of year 2013, there are 2.73 million population have bank deposit more than Rp. 100,000,000 each, 1,450,000 have bank deposit Rp. 100-200 million each, 965,000 have bank deposit Rp. 200-500 million each, 403,000 have bank deposit Rp. 500-1 billion each and 208,000 have bank deposit Rp. 1-2 billion each. At the upper level, there are 108,000 have bank deposit Rp. 2-5 billion each and 63,000 have bank deposit above Rp. 5 billion each.

Freddy Pielor, a financial planner, said that based on the net asset value of mutual fund compiled by Indonesia FSA, mutual fund industry was stagnant throughout the year 2013. The net asset values of total mutual fund decrease 2.33% from Rp. 224.67-219.42 trillion. The net asset values of conventional mutual fund decrease from Rp. 190.59-190.01 trillion. The main reason of this decreasing net asset values in year 2013 was the decreasing value of various assets in the mutual fund portfolio. The composite capital market index as indicator of equity price movement was also going down in year 2013. The obligation price felled too in year 2013. Based on Indonesia FSA data about mutual fund investment unit, this net asset values of mutual fund were not related with the redemption happened in year 2013. Throughout year 2013, the investment unit was increasing 6,96% from 112,24-120,64 billion unit.

Prihatmo Hari Mulyanto, Director of Danareksa Investment Management dan Division of Infrastructure and Organization Development of Indonesian Mutual Fund Management Association (IMFMA) said that year 2013 is not an impressive year for mutual fund industry. Challenges at that year for the investment company as fund manager are much which the growth of mutual fund market was only 4-5% because of the bad condition in bonds and stocks market. Money market fund is better as the increasing central bank interest rate. Now a days

mutual fund investors are more mature and calm so, they do not follow the various redemption actions. Nevertheless, the growth of Indonesian mutual fund industry is still more inferior than the growth of other financial industries such as insurance or banking. This is a challenge for mutual fund industry to develop its investor basis.

Net asset values of mutual fund (Rp.199,88 trillion) are still far away from the target set by IMFMA. Denny Taher, the President of IMFMA said that IMFMA's vision is having 5 million investor in year 2017 with Asset under Management (AUM) approximately Rp. 1,000 trillion. Nurhaida, the Executive Head of Capital Market Monitoring-Indonesia FSA explained that beside the less amount of mutual fund investors, the distribution of mutual fund investors is uneven. More investors are concentrated in big cities only. Investment companies is expected to develop many branches in other areas to reach market outside Jakarta, the capital city. Based on previous facts, it can be concluded that challenges faced in mutual fund industry are as follow:

- Untransparent fund management will decrease trust in mutual fund industry and cause the decreasing mutual fund investors amount. This will influence the going concern of fund manager (investment company)
- Domestic investors amount is imbalanced compared with foreign investors amount. This will cause a high sensitivity of Indonesian capital market toward foreign investor's movement
- Individual mutual fund investors are still very less than the total population in Indonesia. This needs a certain program to enhancing the amount of individual mutual fund investors
- Mutual fund performance is not impressive. This is indicated that the fund manager sophistication must be improved by increase the quality of human capital, i.e., professional skill in fund management
- The growth of mutual fund industry is still far behind the growth of other financial industries such as insurance and banking
- There are many investment companies operate for a very less assets under management whereas there are many Indonesian potential investors with a high deposit in banking
- Various deceitful investment cases in Indonesia cause high losses to clients and decrease trust of society on investment business

These challenges demand an increasing fund manager sophistication in order to have a well managed funds and to attract the domestic investor to invest in mutual fund product.

Growth in mutual fund industry: The development of mutual fund industry is quite significant, based on the effective amount of mutual fund, assets under management, and mutual fund investors as unit holders (Eduardus, 2010). Nevertheless, the mutual fund performance of year 2013 is still not very impressive. There are various mutual fund products report negative returns, especially equity mutual fund.

The development of global mutual fund industry is also very rapid. In the third quartal of year 2013, global mutual fund assets grow 5.1% to US\$28.87 trillion. The global composition was 43% equity mutual fund and 25% fixed income mutual fund. The first position was the American area with assets under management US\$16.45 trillion or over 57% of global funds. United States of America contributes assets under management US\$14.30 trillion. The increasing assets under management in America was followed by the amount of investors 96 million. The annual Investment Company Institute (ICI) survey result found that owners of mutual fund were 56.7 million or 46.3% households in United States of America.

In Indonesia, 25 fund managers (investment companies) have the 93.62% market share of assets under management Rp 173.6 trillion of total Rp 185.49 trillion from 75 investment companies. Many small fund managers (investment companies) operate at a minimum level assets under management. Hence, the general performance in mutual fund industry was still not followed by performance of each fund managers (investment companies). This is indicated the urgent and special demand of increasing fund manager sophistication.

Opportunities in mutual fund industry: Nurhaida, the Executive Head of Capital Market Monitoring Indonesia FSA and Gonthor Ryantori Aziz, the Director of Capital Market Regulation Indonesia FSA said that in order to develop the mutual fund industry, the investment company and the sales agents of mutual fund units must develop a good and sound business so that they can run their role as good fund managers. The good performance of mutual fund will attract investors to invest in the mutual fund product. The higher investors amount, the higher assets under management. The product of mutual fund must be diversified with many alternatives which can be chosen to attract potential investors. To enlarge the domestic investor basis Indonesia FSA support the implementation of e-channel in mutual fund industry by preparing various related regulations.

In order to develop Indonesian capital market, fund managers (investment companies) have very important role. A fund manager has duty to manage a portfolio for their clients. Clients as funds provider give their funds to be managed professionally by the investment

company. The investment company will set a portfolio contained various investment instrument. Every fund managers must have a legal permission from Indonesia FSA and have a competence team to support the investment decision. Prihatmo Hari Mulyanto Director of PT Danareksa Investment said that investment in a mutual fund is a legal and registered investment then clients will be secured by laws.

Indonesia FSA has some initiatives that encourage domestic investors to invest in mutual fund unit. These initiatives include reducing minimum investment levels to help lower-income investors come in the market as well as aggressively running some mutual fund road shows in public places, e.g., office buildings, shopping centers, and universities. These initiatives are very positive for the mutual fund industry in Indonesia. Indonesia has the fourth-largest population in the world and the middle class population keeps growing continuously. The accelerated growth of Indonesia economic and the increasing purchasing power of Indonesia people will improve the risk appetite of every potential investors, so that trust and confidence in Indonesian capital market will be maintained well. There are many potential investors to be introduced in the good chance of mutual fund investment. There are much more opportunities in developing mutual fund industry particularly in Indonesia.

RESULTS AND DISCUSSION

This study is trying to identify the problem of fund manager sophistication as the central theme. Fund manager (investment company) as institutional investor is a sophisticated investor which devotes much times and attentions for the right investing decision and have an ability to analysis every related information. Consequently, they are easier to learn much from the available information and get the most benefit from it. But sophistication can be differ because of the different opportunity cost of time and ability to acquire and analyze information (Kalay, 2013).

Sophisticated fund manager will decide an investment portfolio to manage funds based on rational consideration and look carefully at various factors, i.e., extrinsic intrinsic and target investor factors. Extrinsic factors consist of economy, politic, social, technology and perceived uncertainty from the general business environment. Intrinsic factors consist of profitability, size, technology control, business philosophy and perceived uncertainty from the behaviour of company. Target investor factors consist of expected return, security, pleasure, control and accepted risks (Saaty, 1993).

Factors influence this investment decision need to be traced. Investment object must be concerned highly. The

market condition is also concerned, i.e., price fluctuation, trading volume and other's investing action both actual and estimated. The limitation is concerned too, i.e., portfolio strategy, organization condition, legal and finance (external cash flow) (Hellman, 2000).

Sophisticated fund manager invests all assets under management based on knowledge from qualified and up-to-date financial research and employed educated staff. Investment decision of sophisticated fund manager will be more well founded (Menkhoff, 2002). Sophisticated fund manager have much more information and take the diversification of portfolio successfully. Sophisticated fund manager is always ready to invest much funds in various investment instruments.

Sophisticated fund managers will not conduct a bias in their investment. But behavioural finance research result found various bias in investment decision. Mentioned 16 bias of investing decision i.e., representativeness, insensitivity to prior probabilities of outcomes, insensitivity to sample size, misconception of change, insensitivity to predictability, illusion of validity, misconception of regression, availability, biases due to retrievability instances, biases due to the effectiveness of search of set, biases due to imaginability, illusory correlation, anchoring and adjustment, insufficient adjustment, biases in the evaluation of conjunctive and disjunctive events, dan anchoring in the assessment of subjective probability distribution (Khresna *et al.*, 2012).

As a sophisticated fund manager, their investing decision must be rational and accountable. Fund manager sophistication can be measured by the tendency of fund manager to avoid bias in investing decision. The higher tendency of avoiding the bias, the higher sophistication of the fund manager (Menkhoff *et al.*, 2010).

Sophistication of fund manager is reflected by the ability of fund manager to interpret and analysis various available information so that the information with economic value can be separated from non-economic value (Marfuah, 2006). Sophisticated fund manager can determine whether an information has a valid and reliable signal (Jogiyanto, 2005). Sophisticated fund manager can collect and process all public information to support the investment decision in the certain portfolio.

Sophisticated fund manager decides investment based on a reliable sources such as analyst recommendation or fundamental research (Dumistrescu and Gil-Bazo, 2016). Sophisticated fund manager will respond properly to released information in the marketplace (Coram, 2010). Level of sophistication can be distinguished based on superior or private information and skillful diversification (Nofsinger and

Varma, 2013). Sophistication is also visible from investing experience and knowledge gathered from various practices, e.g., business work experience, finance and accounting courses and financial certification (Victoravich, 2010).

Fund manager sophistication is a central determinant of superior performance in a certain mutual fund. Further, empirical research to examine various factors influence the fund manager sophistication is recommended highly. Empirical research on fund manager sophistication is still very rarely conducted, especially in Indonesia. However, this research is very important because sophisticated fund managers have a crucial role in increasing the domestic investors amount.

CONCLUSION

Fund manager (investment company) have a specific characteristic which classified as sophisticated professional institution investor. Investors delegate their funds to a sophisticated fund manager for some benefits as follows:

- Fund manager has much more better information and can realize a superior investment performance
- Fund manager can conduct a larger diversification because of much more funds to be managed with relative less transaction costs
- Large scale of economic makes fund manager bears less operational cost

Sophisticated fund manager will give superior active fund management services with the best return/risk track record, the very unique portfolio composition and the exclusive fundamental analysis. Competition in mutual fund industry will drive to a high sophistication of fund manager. Sophisticated fund manager will avoid any bias in investing, e.g., excessive turnover, home bias, reluctance to loss realization, disposition effect and herding (Menkhoff *et al.*, 2010). No bias in investing will take investors to the best performance of mutual fund.

SUGGESTIONS

Further empirical research is suggested to explore the fund manager's characteristic of sophistication. The specific characteristic of sophistication is an important thing to be developed continuously in order to achieve high performance of mutual fund. The better performance of mutual fund, the more funds invested by potential investors for that mutual fund. Sophisticated fund manager has a substantial mission to give the most benefit for mutual fund investors. This mission is aligned with the expectance of more domestic investors amount in

Indonesian capital market. The high returns received by mutual fund investors will attract other potential investors to invest their fund in the mutual fund product. Finally, the domestic investors amount will increased beyond the Foreign investors amount in Indonesian capital market.

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