INSTITUTIONAL REMEDIES OF AGENCY CONFLICTS IN THE PROPERTY INVESTMENT PROCESS

Evidence from Investment Activities of Pension Funds and Foreign Investors in Tanzania

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1.0 Introduction

Real property is a complex form of investment. This is mainly due to the idiosyncratic features of real estate. Some of the features differentiating real estate from other forms of investment include lack of market transparency, specialist management requirement, large number of parties involved in concluding a transaction, high investment value, fixity, illiquidity, lumpiness, high government control, localised market, specialist valuation requirement, existence of few buyers and sellers and long investment cycles (Brown and Matysiak, 2000; Hoesli and MacGregor, 2000; Brueggerman and Fisher, 2005). Real estate investment process is therefore normally lengthy and involves a large number of people. The various people taking different roles in the process perform their roles as principals or agents.

The complex relationships of people arising in the property investment process can generally be analysed using institutional theory. Over the recent years, the institutional theory has received noticeable attention from scholars amongst economists, sociologists and political scientists (Greif, 2006; Shapiro, 2005). Some renowned economists have come up with a vigorous theoretical analysis incorporating institutional theory into neoclassical economic theory thereby paving a way for a new economics perspective named New Institutional Economics (e.g. Williamson, 1975; Coase, 1998; Klein, 1999; North, 1990; Eggertsson, 1990). New Institutional Economics (NIE) is mainly centred on three theories namely, property rights theory, transaction cost theory and agency theory (Kim and Mahoney, 2005; Junker, 2005; Cieleback, 2004). This study contextualises some aspects of the new institutional theory to the field of property investment. In particular, the study employs agency theory in an attempt to explain agency relationships in the property investment process in an environment characterised by weak formal institutions.

The study is based on an infant property investment market setting which is characterised by weak formal institutions. Tanzania, being one of the reforming infant markets in Africa, provides a suitable setting for the purpose of this study. Over the last two decades, property investment activities in Tanzania have recorded a noticeable growth. This is mainly a result of institutional reforms which have been taking place since the mid 1980s. During the period, many formal institutions catering

for a wide range of activities have been formed. Growth in property investment activities has promoted growth of real property related professions and consultancy activities. The number of property management agents and the use of outsourced property management services have increased remarkably over the recent years. Owing to the capital intensiveness of property investment, the market is nevertheless still largely dominated by institutional investors, particularly pension funds and a few foreign investors. Indirect property investment vehicles are still at their infant stage of development and are mainly in the form of private equity vehicles sponsored by large investors. For these reasons, this study is centred on property investment activities of these large investors namely, pension funds and foreign investors.

2.0 Problem of the study

Agency conflict is a common phenomenon in many forms of associations (Jensen and Meckling, 1976), but the extent of the problem and its effects differ depending on a number of factors. Information asymmetry is particularly the defining factor of agency problem. The problem occurs when information asymmetry exits i.e. when one party in a transaction has more or superior information compared to another. Whereas virtually all common forms of investment activities are subject to agency conflicts, property investment owing to its idiosyncratic characteristics is more vulnerable to the problem (Garmaise and Moskowitz, 2004; Ling and Archer, 2007, Cieleback, 2004; Rowland, 1997; Rottke, 2004; Naubereit and Gier, 2002; Graff and Webb, 1997). The property investment process usually involves many people, who in most cases execute their duties in the form of agency relationships.

Robust conceptual literature and empirical studies into agency conflicts over the recent decades have culminated into agency theory. One of the main underlying assumptions of agency theory is that individuals are rational and self-interested utility maximisers prone to opportunism (Temel-Candemir, 2005; Shapiro, 2005). This assumption has been widely criticised though, and is indeed considered to be one of the major limitations of the institutional theory as a whole (High and Pelling, 2005; Frank, 2004). Agency theory is also criticised for not addressing different contexts of cultural behaviour (Johnson and Droege, 2004). The theory overlooks the role of informal institutions in constraining human behaviour (Brennan, 1994). Another

oversight of agency theory is observable in the remedies for agency conflicts. Scholars propose a variety of remedial measures of agency conflicts. Some of these remedies include performance incentives, stock options, and long term job contracts (Parkin et al, 2008). The effectiveness of some of these remedies remains to be theoretical and a subject of contention (Padilla, 2002). For instance, the economic analysis of incentives is widely criticised for disregarding the role of indirect incentives (Casadesus-Masanell and Spulber, 2005). The proponents of indirect incentives insist on the role of informal institutions in checking the opportunistic human behaviour in business transactions.

It is apparent that property investment activities of pension funds and foreign investors are highly vulnerable to agency conflicts. This is due to high involvement of agents in their investment decision process. Pension funds in Tanzania have invariably been criticised for some of their property investment decisions (Mpogole, 2006). The common concern has been whether or not such investment decisions reflect the best management of members' funds (Mgwabati and Mjasiri, 2009). Foreign investors, on the other hand, owing to their little knowledge of the local market, have also inevitably been engaging many agents in their investment activities. Apparently, agency conflicts have in some cases resulted into serious problems to investors such as delays in project completion, failure to raise finance from local sources, and major re-organisation of activities. Some foreign property investment projects have been non-starters altogether. It is mainly the complexity of the property investment process of pension funds and foreign investors that exposes them to more agency conflicts. Theoretically, the agency problem faced by these investors is much higher owing to fact that their investment activities are carried out in a market setting which is dominated by high market imperfections and weak formal institutions.

Despite the relative vulnerability of property investment to agency conflicts, most of the existing strands of literature on various issues of agency theory have mainly focused on corporate finance and managerial economics aspects of general businesses (Junker, 2005; Kim and Mahoney, 2005; Gunasekarage and Reed, 2008; Ang et al, 2000). There are relatively few studies focussing on agency theory issues

in property investment activities (e.g. Lee and Lee, 2005; Rutherford et al, 2005; Zietz and Newsome, 2001; Klingenberg and Brown, 2006; Gibler and Black, 2004; Rosenberg and Corgel, 1990; Rottke, 2004). Besides, most of these studies have been carried out in relatively developed real estate markets of Europe and USA. These markets have significantly different institutions from those obtaining in less developed countries' settings.

The present study is an attempt to fill the knowledge gap and address practical problems faced by investors. The study investigates the contribution of agency conflicts in perpetuating sub-optimal property investment activities. It also examines whether or not informal institutions mitigate agency conflicts. This study is based on a real life setting which is characterised by weak formal institutions and high market imperfection to extend the discussion on the main limitations of agency theory. Apart from its contribution to knowledge, the present study will also help real estate investors in less developed markets in dealing with agency conflicts. The study will also be helpful to policy makers in devising appropriate remedial institutions to address agency conflicts in property investment activities and other business activities.

3.0 Objective of the study

The general objective of this study is twofold i.e. firstly, to test the robustness of agency theory in explaining sub-optimal property investment activities, and secondly to determine the effect of informal institutions in mitigating agency conflicts in property investment activities. Below are the specific objectives and the corresponding research questions:

(i) To describe the nature of agency conflicts in the property investment process.
Question: How do agency conflicts arise in the property investment process?

(ii) To examine the mechanism used by property investors in mitigating agency conflicts.
Question: How do property investors deal with agency conflicts?

(iii) To describe the link between the property investment process and the institutional environment.

Question: How is the property investment process linked with the institutional environment?

(iv) To examine the effect of informal institutions on the behaviour of agents in the property investment process.

Questions:

a) Do the prevailing informal institutions discourage the opportunistic behaviour of agents?

b) Are the existing informal institutions more effective in controlling the behaviour of agents than the existing formal institutions?

c) How do informal institutions relate with other human behaviour drivers namely education, age and gender in controlling the behaviour of agents?

4.0 Literature review

4.1 Institutions

Agent's behaviour, formal institutions and informal institutions are the key variables defining this study. It is posited in this study that the behaviour of agents involved in real estate investment activities is a function of the prevailing formal and informal institutions. By definition, institutions are society's rules of the games, or more precisely, the constraints that we have devised to shape human behaviour i.e. they are rules, norms and regulations by which a society functions (North, 1990). Institutions reduce uncertainty to social interaction by providing a structure to every day life (Ebohon et al, 2002). Institutions serve a number of important economic functions, such as handling situations with missing or asymmetrical information, facilitating and enforcing market and non-market transactions, substituting for missing markets, co-ordinating the formation of expectations, encouraging cooperation and collective action and reducing transaction costs (Mooya and Cloete,

2007). Institutions are developed by human activity and, therefore, reflect the power and interests within the society (Viruly, 2009).

Institutions comprise both formal and informal constraints. Formal institutions are constraints comprising norms and rules devised by the society to govern the conduct of its members and their sanctions are guaranteed through formal processes (Ebohon et al, 2002). Formal institutions are officially codified and are mostly enforceable through legal recourse or arbitration (Lauth, 2004). Informal institutions, on the other hand, are much more difficult to define. The term 'informal' may refer to almost anything that is not formal and appears in the context of a dizzying array of phenomena, including personal networks, clientelism, corruption, clans, civil society, traditional culture, and a variety of legislative, judicial, and bureaucratic norms (Helmke and Levitsky, 2004). It is however common in many disciplines to define informal institutions as social norms that represent evolved practices with stable rules of behaviour that are outside the formal system (Sen, 2006). They are institutions which are not formally codified in official documents, but they reflect acceptable behaviour which is governed through a set of known sanctions or through powerful processes of internalisation without recourse to sanctions (Lauth, 2004; Sen, 2006).

The key difference between formal and informal institutions is that while the former are centrally designed and enforced the latter remain in the private realm (Williamson, 2009). Whilst formal institutions are guaranteed by state agencies and their violation is sanctioned by the state, most of the informal institutions are based solely on their existence and effectiveness. The sanctioning possibilities they imply are largely due to social mechanisms of exclusion or are based on the condition that its non-utilisation minimises the chances of gaining access to needed goods and services (Lauth, 2004). Although informal institutions are not codified in the formal documents such as laws and constitutions, they are normally implied in such documents. This is important because the enforcement and the effectiveness of such formal institutions are dependent on the informal institutions prevailing in the society in question (Casadesus-Masanell and Spulber, 2005).

A number of formal institutions are in place to address agency conflicts. These include policies, laws and regulations. Agency laws, contract laws, financial markets laws, professionals' codes of conducts, professional bodies and, employment contracts are some of the formal institutions which, among others, regulate the conduct of agents. To assess the effectiveness of formal institutions in checking agency conflicts in property investment activities of pension funds and foreign investors in Tanzania, this study focuses on how such formal institutions control the actions and omissions of agents and principals in discharging their duties.

Cognizant of the infancy of formal institutions, this study assigns equally significant weight to informal institutions as complimentary institutions in regulating the actions of agents. In assessing the effectiveness of informal institutions in mitigating agency conflicts existing amongst key actors in property investment activities of pension funds and foreign investors, *culture* is the main informal institution variable adopted in the current study. Tabellini (2008) identifies four distinct components of culture that constrain behaviour. These components are *trust, respect, individual self determination, and obedience*. The four categories of culture have also been used by Williamson (2009) and Tabellin (2008) to assess the effectiveness of informal institutions in economic development.

4.2 Agency and agency theory

Agency is simply a legal relationship in which one party, the principal, authorises another, the agent, to act on behalf of the principal. Agency relationships exist in all forms of organisations. Essentially, all contractual arrangements, ranging from the one between employer and employee to that between the state and the governed, contain important elements of agency (Ross, 1973). This implies that, agency relationships exist in all organisations and in all cooperative efforts and at every level of management in firms, in universities, in mutual companies, in cooperatives, in governmental authorities and bureaus, in unions, and in relationships normally classified as agency relationships such as those common in the performing arts and the market for real estate (Jensen and Meckling, 1979).

The relationship of agency is one of the oldest and commonest codified modes of social interaction (Ross, 1973). The origin of agency relations in business activities is also associated with pre-modern international traders. Greif (2006) cites examples of the 11th century merchants namely Maghribi traders from the Muslim world and 12th century Genoese traders from the Latin world, to show the risk of using agents and how such a risk can be mitigated by introducing institutions. Historical cases of agency in international trade are also reported in Africa. Cohen (1969) documents agency relationship in the Hausa trade diaspora where landlords in Ibadan, Nigeria employed agents to sell cattle from dealers located elsewhere in the trade route. Being owners of immovable and illiquid real estate, the landlords were considered reliable agents, as they could not easily sell their real estate and leave after embezzling the money of traders.

Common examples of agency relationships in a corporate setting are those involving shareholders, managers and workers. The first scenario, is that in which shareholders are the principals while managers are the agents. In the other scenario, managers may be principals while workers are the agents. There is a chain of principal-agent relationship within the firm. A noticeable documentation of agency relationship and the associated conflicts in firms was done by Adam Smith (1776)[1]. Presupposing existence of an invisible hand coordinating all individual actions through the price mechanism, Adam Smith maintained that, the welfare of all will be maximised if each individual maximises his or her own welfare. The assumption was however that all individuals work within a legal structure where there is complete and accurate information. Unfortunately, in reality, markets are not always that efficient. Mindful of this reality, Adam Smith acknowledged existence of a problem in agency relationships. Commenting on the agency problem experienced by limited companies, whose management is separated from ownership, Adam Smith wrote:

> The directors of such [joint stock] companies, however, being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give

[1] An Inquiry into the Nature and Causes of the Wealth of Nations, Edinburgh, 1776

> themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.

The salience of Adam Smith's work on agency conflicts in business was not realised until the expansion of capitalism in the late 1880s and 1900s which led to a wide spread separation of ownership and control functions of the firm (Nicholson and Kiel, 2007). In the modern business environment which is dominated by large business organisations, the use of agents in the execution of various activities has become inevitable. The work of Jensen and Meckling (1976) is widely cited as one of the pioneering works on agency conflicts which have culminated into agency theory. The theory deals with the analysis of legal contractual relationships when ownership and control are separated and market information asymmetries are present (Cieleback, 2004). In the context of new institutional economics, agency theory is viewed as an economic analysis of cooperation in situations where externalities, uncertainty, limited observability, or asymmetric information exclude the pure market organisation (Bamberg and Spremann, 1989).

In agency relationship, principals assign agents to perform some service on their behalf, which involves delegating some decision making authority to the agent. Agents are expected, and indeed obliged, to act in the best interest of their principals, but this is not always the case. Mindful of the world with imperfect and inaccurate information, Jensen and Meckling (1979) commenting on Adam Smith's proposition, argue that if both principal and agent are utility maximisers, there is a good reason to believe that the agent will not always act in the best interests of the principal. The agents to whom the principal delegates authority have an objective function that diverges from that of the principal (Jensen and Meckling, 1992). Agents tend to pursue their own goals, which may be conflicting with those of their principals, thereby imposing costs on the principals. In other words, when agents maximise their welfare by pursuing actions which conflict the goals of their principals, they undermine the welfare of their principals. The costs that arise when there is a conflict of interest between principals and agents are referred to as agency costs (Berk and DeMarzo, 2007). Owing to the complexity of agency relationships, agency costs can be pecuniary or non-pecuniary.

Development of agency theory has forced some scholars to reconsider the traditional economists' outlook of a firm. The traditional economists have regarded a firm as a profit maximising 'black box' that simply converts inputs into output, thereby disregarding the behavioural implication of the human beings involved in production and management process (Jensen, 1998). Mindful of the complexity of human behaviour, a firm is now widely viewed as a social sub-system of interacting individuals that process information and coordinate activities with a view to achieve some predefined objective (Kulkami and Heriot, 1999). The capacity to achieve this objective is however limited by the inherent conflicts of interest among the parties to the firm (Temel-Candemir, 2005).

Despite the negative aspects of agency relationships emanating from the opposing effects of the objective functions of the principals and those of the agents, the use of agents in modern business cannot be avoided. Apart from the large size of business activities, agents are also used because of their better skills, knowledge, information, professional qualifications and experience compared to that of their principals (Bendor et al, 2001). Various remedies have been devised to address agency conflicts. These include stock options, performance incentives and long term agency contracts (Parkin et al, 2008). Studies have shown that alignment of interests of the agents and those of the principals can be achieved by giving agents some shares (ownership), or by rewarding them for good performance and vice versa, and by improving agents' security of tenure by granting long time employment contracts.

4.3 Empirical studies on agency theory

Agency theory has also attracted many empirical studies especially in the fields of corporate finance and managerial economics (Junker, 2005; Kim and Mahoney, 2005; Gunasekarage and Reed, 2008; Ang et al, 2000; Lang et al, 1995; La Porta et al, 1999; Jassim et al, 1988). Most of the literature has focussed on investigating how agency conflicts affect the performance of firms. It is clear from most of the literature that corporate investment decisions are fraught with agency conflicts (Kaymak and Bektas, 2008; Shin and Kim, 2002). Such agency conflicts result in sub-optimal business decisions, which undermine firms' performance (Deephouse and Wiseman, 2000; Bricker and Chandar, 1998). The approach taken by most of the studies has

been to compare performance of corporations which are managed by owners and those managed by outsiders. Many studies confirm that agency conflicts have negative effects on the performance of firms (Danielson and Scott, 2007; Nicholson and Kiel, 2007; Shleifer and Vishny, 1997; Guilding et al, 2005; Rosenberg and Corgel, 1990).

There are however some studies which do not find conclusive evidence that firms managed by owners perform better than those managed by non-owners (Bucholtz and Ribbens, 1994), or that firms managed by non-owners perform better than those managed by owners (Beatty and Zajac, 1994). However, most of the studies showing opposite findings are those based on firms whose members of the boards or executive management are also shareholders, but not the only owners of the firms. Such owner-managers, apart from managing the firms which are considered to be their own, they also represent other shareholders who are not in the management. Such a representative role of the owner-managers turns them into agents of the remaining shareholders, thereby creating agency conflicts between them. Failure of some studies to isolate other firms' performance variables, and reliance on small samples are also some of the other reasons that explain such abnormal findings (Rowland, 1997).

Some other strands of agency theory literature have focused on corporate governance issues. Corporate governance is mainly concerned with the design of institutions that induce management in their actions to take into account the welfare of stakeholders, investors, employees, communities, suppliers, and customers (Shleifer and Vishny, 1997; Ayogu, 2001). It is simply the mechanism through which outside investors are protected against expropriation by insiders. Expropriation by managers can take many forms including outright theft of assets, transfer pricing, excessive executive compensation and diversion of funds to unsuitable projects that benefit one group of insiders (Nganga et al, 2003). To check the actions of managers, the Boards of Directors are put in place. The Boards are widely regarded as a monitoring device whose job is to review and evaluate the performance of management in running the firm, and is ultimately responsible for ensuring that shareholder wealth is maximised and agency problems are minimised (Donnelly and

Mulcahy, 2008). Ironically, many studies show that agency conflicts also exist between boards and shareholders, which implies that more remedies for agency problems are needed (Nicholson and Kiel, 2007, Kaymak and Bektas, 2008).

The use of incentives as a remedy for agency conflicts has been widely recommended. A large body of literature supports the effectiveness of incentives in aligning the interests of agents and those of principals (Jensen and Kevin, 1990; van Ees et al, 2009; Aboody and Kasznik, 2000, Nagar et al, 2003). Nevertheless, there are some cases which suggest that incentives may also have opposite effects. For instance, Coffee (2004) notes that changes in executive compensation in the 1990s in the USA, which was designed to align executives' interests with those of shareholders, provided irresistible incentives to managers to inflate reported earnings. The case of Enron is cited in most of the recent corporate governance literature to demonstrate the negative effects of incentives (Healey and Palepu, 2003; Clarke, 2005; Coffee, 2004). The generous stocks options given as incentives to Enron executives provided a powerful incentive to manipulate short term corporate earnings than to improve long term performance (Clarke, 2005).

4.4 Limitations of agency theory

Agency theory is still at its early development stage. The theory has been subject to a number of criticisms for some of its oversights. For instance, the theory is criticised for not considering the context in which the agency relationship is undertaken or the context in which the transaction takes place (Temel-Candemir, 2005). Dealing with behaviour aspects of human beings, the theory ought to have considered the differing institutional aspects shaping behaviour of a human being. Focusing investigation on the agency relationship and disregarding the institutional background, which dictates and shapes the human relationship, is a major oversight of the theory. Social, economic, legal and political factors play an important role in shaping the behaviour of the members of the society in question. As a result, the behaviour of people from different societies differs according to the institutions prevailing in their environment. This is an important consideration in the administration of incentives to agents (Johnson and Droege, 2004).

Some important aspects shaping human behaviour such as age, gender, level of income, level of education have not been given due consideration in the development of the agency theory. The theory insists on a human being driven by self-interest rationality, which disregards altruism in a human being behaviour (Brennan, 1994; Casadesus-Masanell and Spulber, 2005; Temel-Candemir, 2005). Ridley (1996) notes that, although individuals behave with self-interest foremost in mind, they also do that in ways that do not harm, and sometimes even benefit, others. To identify self-interest with rationality represents an oversimplification of an economic individual and is not descriptive of human behaviour (Brennan, 1994).

Agency theory is also criticised using stewardship theory. While agency theory assumes that principals and agents have divergent interests and that agents are essentially self-serving and self-centred, stewardship theory takes a diametrically opposite perspective (Bathula, 2008). Proponents of stewardship theory posit that stewards, referred to as agents in the agency theory, derive a greater utility from satisfying organisational goals than through self-serving behaviour (Davis et al, 1997). The main argument is that the attainment of organisational success also satisfies the personal needs of the stewards (Davies et al, 1997). Stewardship theory therefore insists that managers should be given autonomy based on trust, which minimises the cost of monitoring and controlling behaviour (Bathula, 2008).

The economists' treatment of incentives as a remedy of agency conflicts is another main source of disagreement in the agency theory. Scholars from other fields of study, especially law, sociology, psychology and political science, have different views, especially on the types of incentives and their effectiveness. Whereas all scholars generally agree on the effectiveness of incentive in mitigating agency problems, the economists' perspective of incentives is criticised for focusing only on contractual incentives and failing to capture social, legal and market contexts of incentives. In other words, incentives are administered without due regard of social institutions prevailing in the different societies. Considering the importance of informal institutions, Casadesus-Masanell and Spulber (2005) among others, provide a broader perspective of incentives, as illustrated in Figure 1.

Figure 1: Agency performance incentives

		Explicit and implicit incentives
Contract	Contract terms	*Contractual incentives:* Rewards and penalties based on performance
Legal context	Legal duties	*Legal remedies:* Penalties for breach of duty and breach of trust
Social context	Social norms	*Social pressures:* Violating norms affects social status and conscience
Market context	Market standards	*Market remedies:* Penalties based on reputation, future transactions, access to market network

Source: Modified from Casadesus-Masanell and Spulber, 2010

Apart from classifying incentives into explicit or implicit categories, Casadesus-Masanell (2004) also groups incentives into four main categories i.e. contract terms, social norms, legal duties and market standards. Contractual incentives are those provided in the agency contract or agreement. These are mainly in the form of rewards or penalties based on performance. Social norms are customary rules of behaviour that coordinate interactions in the society. Social norms reduce the transaction costs of forming agency relationships by specifying standards of behaviour. Examples of social norms include loyalty, reciprocating favours and gifts, and abiding by the terms of unwritten agreements.

Legal duties, on the other hand, refer to the rules of the law of agency. By specifying the duties of service, loyalty and remedies for breach, agency law reduces the transaction costs that stem from moral hazard and adverse selection. Market standards on the other hand, refer to established specific market norms to which individual agents are expected to conform. Market incentives are valuable when monitoring actions require industry knowledge and where remedies that affect future business dealings are more effective than legal remedies. Agents are expected to uphold honesty in order to earn reputation in the market, which could yield greater returns to future business relationships as well as greater numbers of business referrals. Penalties for failure to conform to market standards can be exclusion from the market or blacklisting.

A close look at most of the incentives, especially the implicit incentives suggests that their effectiveness is a function of the level of institutional development of the society in question. In the absence of well established institutions, most of the incentives are hard to implement. An oversight of implicit incentives in the development of the agency theory is one of the major limitations of the theory. Institutions dominating the environment in which agency relation or transaction takes place are paramount to the extent and effect of agency conflicts and the effectiveness of incentives in mitigating the problem. Less developed countries, owing to their lack of institutional remedies and oversight coupled with business traditions that enable managers to follow diffuse and vague goals, are more vulnerable to agency problems (Kaymak and Bektas, 2008).

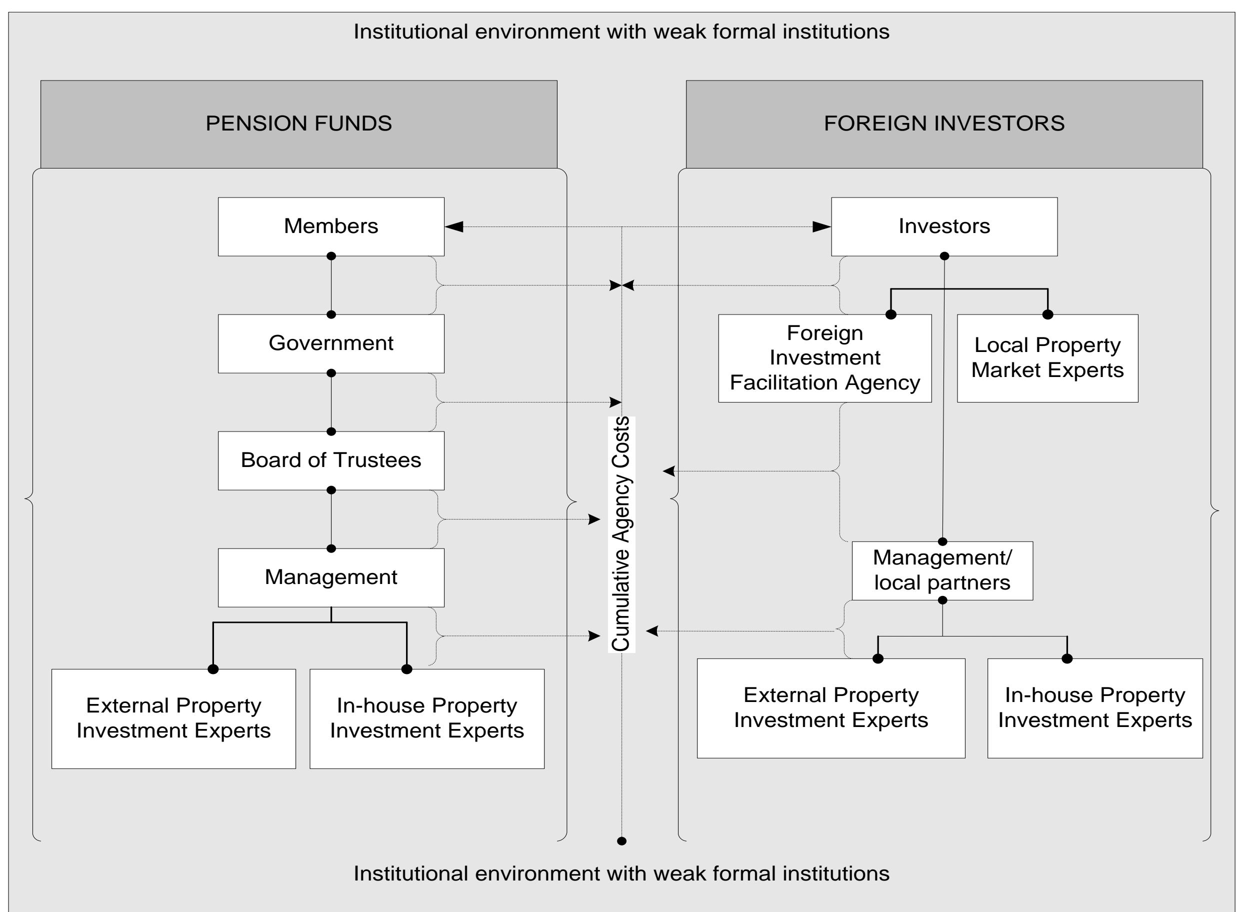
5.0 Agency conflicts in real estate investment and the focus of study

Substantial developments in the new institutional economics over the last few decades have spurred a surge in both theoretical and empirical studies on agency theory and other aspects of institutional theory. Most of agency theory studies have mainly focused on corporate finance, corporate governance and managerial economics. There is a dearth of robust literature on the application of institutional theory, particularly agency theory, in the field of real estate investment. Few studies have focused on agent conflicts in property management (Klingenberg and Brown, 2006; Guilding et al, 2005; Gibler and Black, 2004; Rosenberg and Corgel, 1990), sales of properties (Lee and Lee, 2005; Rutherford et al, 2005; Zietz and Newsome, 2001), and real estate market inefficiency (Graff and Webb, 1997). Some authors have looked at the problem from ethical point of view (Pheng and Tan, 1995). Others investigate agency problems in some forms of investment vehicles, such as securitized real estate vehicles (Naubereit and Gier, 2002), real estate opportunity funds (Rottke, 2004), non-listed indirect real estate investment (Cieleback, 2004).

Although agency conflicts are pervasive in all forms of association, their extent and effect differ from one economic setting to another and from one activity to another. In a corporate set up, three generic agency problems arise as reflected in potential conflicts between owners and managers, trustees and beneficiaries, majority and minority owners, and between the firm itself and contracting parties such as creditors,

employees and customers (Casadesus-Masanell and Spulber, 2005). The focus of the present study is on the agency conflicts arising in the property investment process of pension funds and corporate foreign investors in Tanzania. These investors use agents in most of their property investment activities. For each activity in which agents are involved there is a potential for agency conflicts. Figure 2 illustrates the scenario under which investment decisions take place and the ensuing agency relationships, and thus potential areas for agency conflicts.

Figure 2: Agency relationships in property investment activities of pension funds and foreign investors in Tanzania



Source: Author's conceptualisation, 2010

Pension funds' property investment activities

A pension fund is basically a fund reserved to pay workers' pensions when they retire from service (Brueggeman and Fisher, 2005). The term pension fund is also normally used to refer to the organisations responsible for the management of the funds. It is

clear from this definition, that pension funds are therefore mere depositories of their members' money. Literally, members of pension funds can be compared to shareholders of public limited liability companies. Administrators of pension funds have a fiduciary responsibility to the insured persons and are expected to act prudently in carrying out their investment duties (Tamagno, 2000).

Pension funds are known worldwide for holding substantial proportions of real estate assets in their investment portfolios. For instance, in the USA, since the 1950s allocation to property has been kept in the range of 0% to 17% (Worzala and Bajtelsmit, 1993). The situation has been more or less similar in the UK over the same period of time, although prior to the 1980s some isolated cases of UK pension funds recorded up to over 20% investment property holdings (IPF, 1993). More recently, average real estate investment holdings by pension funds in the USA, UK, Germany, Netherlands and Australia are 3.4%, 6%, 12%, 10% and 11% respectively (PREA, 2006). Limited literature exists on property allocations by pension funds in Africa. Newell et al (2002) report that about 8% of the portfolios of insurance companies and pension funds in South Africa comprise of real estate assets. Pension funds in Tanzania allocate between 20% and 40% to real estate assets (Mpogole, 2006; Kongela, 2005; Geho, 2001).

Pension funds in the context of this study are corporate institutions responsible for collection, management and payment of money mainly meant for pension and other related benefits. The major sources of funds for the pension funds are monthly members' contributions and investment income. In Tanzania, all major pension funds are state-sponsored and each one was established by an Act of the Parliament. Membership to pension funds is mandatory for all people with formal employment. Each member must contribute 20% of his or her monthly wage. The burden of the contribution is shared between the employee and the employer, either by each one contributing 10% or by the employer contributing 15% and the employee 5%. Some employers pay the whole 20% for their employees. Employers, like employees, are therefore also main stakeholders of pension funds. Owing to the importance of pension funds to the nation's social security system, the government closely monitors their operations.

Each pension fund has a Board of Trustees which is in many ways similar to a Board of Directors in a limited liability company. Members of the Boards of Trustees represent the key stakeholders i.e. employees, employers, the government and the Management of the respective pension fund. The chairpersons of the Boards of Trustees are appointed by the President of the United Republic of Tanzania, and other members are appointed by the minister of the ministry under which the respective pension fund operates. The management team of each pension fund is headed by a Director General, who is also appointed by the President of the United Republic of Tanzania. Other senior members of the Management are appointed by the respective Boards of Trustees. Just like the Board of Trustees, the management of a pension fund operates more or less like that of a limited liability company. The management executes all day-to-day activities of the pension fund, including investment activities.

Pension funds are among the largest institutional investors in Tanzania. Unlike in the past, when pension funds were forced to invest most of their investible funds in government securities, they now can diversify their investment portfolios across a broader spectrum of investment vehicles. This follows the enactment of Public Corporations Act No. 2 of 1992, which among others enhanced flexibility in the investment activities of parastatal organisations. As a consequence, real estate has become one of the popular investment vehicles held by pension funds. Pension funds invest in both direct and indirect property investment vehicles. The indirect property investment common amongst pension funds in Tanzania include private equity companies, loans to property developers, hire-purchase housing for members, and government bonds financing institutional property and infrastructure development. Over the last decade, their average portfolio allocation to direct property alone has been above 20% (Kusiluka, 2009). Pension funds in Tanzania are widely commended for their role in the face uplifting of many large urban centres with their modern and expensive properties.

More than 80% of the pension funds' investible funds which are not invested in real estate are invested in government securities and public equities and debt

instruments. Due to this fact, coupled with the inactiveness of capital markets and Dar es Salaam Stock Exchange (DSE) in terms of daily trading volumes, and thus less volatility of securities (Fumbuka, 2008; Kibola, 2008), pension fund managers have not been so much preoccupied with the money invested in equity and debt instruments. Instead, they are more involved with investment in real estate. Apart from the Boards and Managements of pension funds, many more other people (agents) are involved in the investment decision making process. Such other people include property managers, lawyers, investment analysts and other consultants. As such, pension funds' property investment activities have gradually attracted the attention of researchers (e.g. Geho, 2001; Mwamoto, 2003; Geho, 2004; Kongela, 2005; Mpogole, 2006).

The network of relationships created in the property investment activities of the pension funds is of the principal-agent nature. Besides, the close involvement of the government in the affairs of pension funds adds another dimension of agency conflicts. Closeness of the government in the management of pension funds has led to a wide misconstruction that pension funds are state-owned organisations. As widely reported in corporate governance literature (Gupta, 2005, Liu and Sun, 2005; Shen and Lin, 2009), state ownership or even partial state ownership and corporate performance are negatively correlated. The main argument is that corporate governance practice within state owned corporations is not effective, because even non-performing top managers are kept (Shen and Lin, 2009).

Multiplicity of agents in the property investment activities of pension funds coupled with the involvement of the government in key decisions increase exposure to agency problems. Incidents of laxity of people assuming the role of principals in the monitoring of agents are apparent in all levels of agency relationship, from the boards of trustees to property managers. As Donnelly and Mulcahy (2008) underscore, in the absence of a proper mechanism to control the actions of agents and credible performance benchmarks, corporate managements can easily produce less credible performance reports or conceal the real economic performance of the firm from its owners. Administrators of pension funds in Tanzania have often been criticised for

questionable property investment decisions, despite the good performance reports released by the managements (Mpogole, 2006; Kusiluka, 2008; Matotola, 2009).

The focus of the investigation in this study is on the main agency relationships existing in the property investment activities. These include those between members and government, members and Boards of Trustees, government and Boards of Trustees, Boards of Trustees and Management, Management and other contracting parties including in-house property investment experts and external property investment consultants.

Foreign investors' property investment activities

Apart from pension funds, private investors are also increasingly entering the property market in Tanzania. Owing to the capital intensiveness of property investment and shortage of local sources of funds the property market still has few participants from local private investors (Kusiluka, 2009). Large private property investments are largely owned by foreign investors. Besides, majority of properties owned by local investors are owner-managed or involve agents whose roles are very limited and intervention by owners in the agents' duties is very common. Besides, most of property investments owned by local investors take the form of family businesses. Separation of ownership and management in such family businesses is minimal, which minimises chances of agency conflicts. To the contrary, property investments owned by foreign investors use a great deal of agents for various activities ranging from market studies to property management.

Agency relations are very common in international investment (Greif, 2006; Cohen, 1969). Like the pre-modern merchants, international real estate investors also use abroad agents starting from the investment decision making stage to investment management. One of main reasons for using agents is that international real estate investors need someone who is well versed with the local market. A typical case of agency relationships is given by Rottke (2004) who demonstrates the nature of agency problem arising out of actions of private equity opportunity funds investing in foreign markets. These emerging institutions are popular investment vehicles for institutional and large private investors. Having less expertise in the respective

foreign markets, the opportunity funds prefer using local transaction partners; thereby creating a two-level principal-agent relationship i.e. the one between original investors and managers of the opportunity fund, and the other one between opportunity funds managers and local transaction partners.

As noted by Williamson (1985), incompleteness in (ownership) contracts means that there are non–contractible elements due to difficulties in contemplating in advance all possible future contingencies and measuring performance under each contingency. Hart (1988) refers to this cause of incomplete contract as bounded rationality. Although agency theory provides tools to help principals deal with agency costs, such tools are not always, or rather universally, effective. As pointed out by Junker (2005), agency problem grows with the size of the company or number of shareholders. Along the same lines of argument, it can be added that the extent of agency problem differs between local and foreign investors. Unlike local investors, foreign investors' powers to create institutions to minimise agency costs in foreign countries may be limited. The situation worsens when less developed investment markets are involved. Institutions to address concerns of foreign investors are less developed in developing market and much less developed in African countries (Abdulai, 2006; Asiedu, 2002; Feder and Feeny, 1991). Shrouded with property rights problems, such investment markets pose many problems in implementing contracts.

Despite assertions that globalisation has removed institutional barriers to international investors, still many regions including Africa are yet to realise substantial benefits of globalisation. As noted by Hamilton and Webster (2009), although gobalisation has increased the flow of both Foreign Indirect Investment (FII) and Foreign Direct Investment (FDI), this flow has mainly been within and between a few economic blocks namely, Western Europe, USA, Canada, and Japan. To attract more foreign investment, less developed countries have embarked on institutional reform programmes aimed at improving investment environment for private investors. For instance, to attract foreign investment, many less developed countries have established investment agencies, mainly to provide investors with information and assist them set up investment activities in the respective countries (Ebohon et al,

2002). Tanzania Investment Centre (TIC) is the agency (agent) catering for this service in Tanzania.

Owing to the complexity of land ownership procedures for foreigners, foreign property investors normally find themselves in need of services of some government agencies, especially the Tanzania Investment Centre (TIC). As such, the foreign investors somehow have to accept the advice given by TIC and use it while making their investment decisions. Ironically, TIC was established to fulfil its own interests, which may not always be in line with those of investors. With its main objective being to attract investors, TIC may not always act in the best interest of the investors. Some foreign investors also prefer owning investments jointly with local partners. In most cases local partners also perform some agency roles such as making decisions on behalf of their foreign partners, taking active role in investment management, attending emergency cases etc.

TIC and all other agents engaged by foreign investors, such as consultants for market studies, feasibility studies, construction, marketing, selling, and property management, expose investors to agency problems. For the purpose of this study only some principal-agent relationships are considered. These include those between investors and government agencies, investors and local market consultants, investors and managers, investors and local partners, managers and in-house property investment and management experts, managers and a multiple of external property investment and management experts such as property management and sales agents and other property consultants.

6.0 Summary of the research issue

Broadly, this study is an application of institutional theory to the analysis of real estate investment activity taking place in a setting characterised by weak formal institutions. The study particularly employs agency theory to explain sub-optimal property investment decisions. As noted by the neo-institutionalists that some undesirable institutions are created and perpetuated in the society by people with power to serve their own interests, it is similarly posited in this study that people acting as agents may use their powers (of information) to pursue their own interests

at the expense of their principals' resources. In line with the institutional theory it is further posited that, in the absence of, or with weak, formal institutions, informal institutions play a decisive role in controlling agency relationships. The present study therefore examines whether informal institutions are effective in mitigating agency conflicts in a setting where formal institutions are still at their embryonic stage of development.

7.0 Methodology

7.1 Research strategy

This study employs a mixed research strategy, although its inclination is more towards a quantitative component. Mixed methods research is an approach to inquiry that combines or associates both qualitative and quantitative forms of research (Creswel, 2009). The weaknesses of each of the mono strategy research have widely been used advocate for a mixed methods strategy (Bergman, 2008; Creswel, 2009; Creswel, 2007; Johnson and Turner, 2003). Nonetheless, there is still a war between the purists of a qualitative research strategy and those of a quantitative research strategy (Alastalo, 2008; Bryman, 2008; Brannen, 2008). One of the striking arguments of contention is that the two methods cannot be combined because they arise from different paradigms (Smith and Heshusius, 1986; Kuhn, 1970; Burrell and Morgan, 1979). Despite the war between the purists of each of the two research strategies, practice show that studies employing both qualitative and quantitative methods are very common to find.

The mixed methods design is increasingly considered to be a hybrid design which takes the best of qualitative and quantitative methods and combines them (Bergman, 2008; Tashakkori and Teddlie, 2008; Bryman, 2008). The philosophical orientation most often associated with mixed methods research is pragmatism (Teddlie and Tashakori, 2009). Mixed methods research strategy encourages thinking 'outside the boxes' of mono research strategies, which have been the source of paradigmatic war between researchers for many years (Brannen, 2008). DeCuir-Gunby (2008) identifies five purposes of mixed research, which are: triangulation, complementarity, development, initiation, and expansion. Three scenarios are common with studies

employing a mixed research strategy i.e. quantitative component dominating and preceding the qualitative or qualitative component dominating and preceding the quantitative or qualitative component preceding the quantitative (Brannen, 2008; Creswel, 2008; Creswel, 2009).

Adoption of a mixed methods strategy in this study is necessitated by paucity of research in the subject matter being investigated, particularly in the institutional setting obtaining in Tanzania and other similar countries. Although various aspects of agency theory have been widely studied over the recent past, very little has been done to cover the social settings with weak formal institutions. Besides, relatively little attention has been directed to real estate investment activities. Qualitative research strategy is widely recommended as a forerunner to quantitative research for areas of research which have not been previously investigated (Nganga et al, 2003). Accordingly, the qualitative component of this study is meant to be a mapping exercise carried to inform the research design and serve as a prologue to a quantitative phase.

Superiority of the quantitative component is commensurate with the central purpose of this study and the central research question. Quantitative research is generally said to be directed at theory verification, while qualitative study research has typically been more concerned with theory generation (Punch, 2008). Although in this study the qualitative component is aimed at being a forerunner to the quantitative component, the results of the quantitative research will be compared with the preliminary results obtained from the qualitative analysis to enhance the conclusions of the study.

7.2 Data collection

7.2.1 Qualitative data

The qualitative methods used to set the foundation of this study are focus group interviews, in-depth interviews, and a review of documentary evidence. Focus group interviews will be used to elicit data from members of pension funds. The optimum number of participants in a focus group may vary, but many authors recommend

groups of between 6-12 participants (Smithson, 2008; Marshall and Rossman, 2006; Cozby, 2007; Krueger and Casey, 2000). For this study, five focus group interview sessions each consisting of 6 participants will be conducted. All sessions will be moderated by the author. The participants will be drawn out of members of various pension funds amongst postgraduate students and staff members at Ardhi University in Tanzania.

The in-depth interviews with key informants amongst members of boards of trustees and senior managements of pension funds, foreign property investment firms, property management firms, and other institutions will be conducted. Interviews with respondents serving as principals were meant to elicit information on the extent and nature of agency conflicts and the mechanisms used to mitigate them. The interviews will also seek to capture the main practical problems which are encountered by the respondents in a bid to address agency problems given the market environment characterised by infant formal market and corporate governance institutions, shortage of experts, absence of property investment performance benchmarks etc.

On the other hand, interviews with respondents serving as agents will focus on the role of formal and informal institutions in checking agents' behaviour and actions. The interviews will further seek to establish agents' specific roles in property investment activities, their motivation to work for their principals, the degree of discretion they have in investment decisions, the degree of satisfaction with the type of incentives provided to them. For property management agents, interviews in particular will seek to find out whether agents interests are aligned with those of their principals. The questions centre on the main items of property management contracts i.e. contract term, possibilities for contract renewal, basis of fee, letting fees and, sale of property and the fate of the agent when the property is sold during the contract term. Answers to such questions are important in assessing the alignment of agents' interests with those of the principal. For sales agents, the interviews will seek to find out how the fee is determined, how advertising is controlled, and how agency contracts deal with property cross-listing cases.

Interviews will also be conducted with key informants in property and general business investment activities in Tanzania. Respondents in this category will include property consultants and researchers, and officials from government departments charged with the administration of pension funds, capital markets supervision and regulation, and private investment promotion agencies. Additionally, a review of documentary evidence will supplement interviews. Documents to be reviewed include various agency contracts including property management agency contracts, property brokerage contracts, and other property consultants' contracts. Various statutes directly or indirectly affecting property investment activities will also be reviewed. Some of the main statutes to be reviewed include all Acts of Parliament providing for the establishment of the pension funds covered in this study, Tanzania Investment Act of 1997, Capital Markets and Securities Act of 1994, Public Corporations Act of 1993, and Land Act of 1999.

7.2.2 Quantitative data

Survey is the main strategy of enquiry adopted for the quantitative component. As Creswel (2009) points out, survey research provides a quantitative or numeric description of trends, attitudes or opinions of a population by studying a sample of the population. The survey will be cross-sectional, in that data will be collected at one point in time i.e. June 2010 to August 2010. Since this study tests a theory and attempts to expound the limitations of applying a theory in some social settings, it is clear that the findings of this study will be relevant for all settings which share similarities with a setting obtaining in Tanzania. The quantitative component of this study will therefore form a strong basis for generalisation of the results.

Primary data collection will be carried out using self-administered questionnaires. The strength of this method is that the interviewer is able to convince reluctant respondents, motivate respondent and provide additional instructions or explanation when needed (de Leeuw, 2008). This method was chosen to ensure high response rate and to minimise cases of missing data. The questionnaires have been pre-tested to a few potential respondents from all the categories to eliminate any ambiguities in the questions. There are two sets of questionnaires, one served to a sample of respondents identified to serve as principals and another served to a sample of

people identified to serve as agents. The questionnaires have been served to a total of 150 respondents.

Cognizant of the importance of statistical sampling, this study notwithstanding the research environment whose people are not used to dealing with researchers drew its sample using statistical methods. Owing to difficulties in establishing the exact population size of the various groups of respondents, a multistage sampling design has been adopted. Multistage sampling design is normally used when the population size cannot be determined (Cozby, 2007; McBurney, 1998). The different categories of people serving as principals or agents form the clusters. Then, random samples will be drawn for each cluster. The sample size for each cluster will be determined by the author's intuitive estimation of the population of the cluster in question.

Secondary data will be gleaned from various grey literature sources such as publications and reports issued by the Bank of Tanzania (BoT), National Bureau of Statistics (NBS), Tanzania Investment Centre (TIC) and other government publications and reports. Relevant research reports, newspapers and newsletters will also used as a source of secondary data. Data on property investment performance will be directly requested from the owners and managers of the properties in question.

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