

## Does Wealth Levels, Reliance and Leverage Influence Financial Performance?

Neni NURHAYATI<sup>1\*</sup>, Rosa FITRIANA<sup>2</sup>, Anna ISROWIYAH<sup>3</sup>, Fatmawati ZAHROH<sup>4</sup>, Inneke Putri WIDYANI<sup>5</sup>

<sup>1</sup>Faculty of Economics and Business, Universitas Kuningan, Indonesia, Email: neninamina@gmail.com

<sup>2</sup>Universitas Bale Bandung, Email: rosa.fitriana1979@gmail.com

<sup>3</sup>Politeknik Negeri, Malang, Indonesia, Email: annaisrowiyah@gmail.com

<sup>4</sup>UIN Maulana Malik Ibrahim Malang, Email: fatmawati.zahroh.fe@uin-malang.ac.id

<sup>5</sup>Universitas Terbuka, Email: inneke@ecampus.ut.ac.id

\* Corresponding Author

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### Abstract

*This study aims to determine whether the level of wealth, dependence, and leverage affects financial performance. The research was conducted covering the variable level of regional wealth including local revenue, the variable level of regional dependence with the center covering general allocation funds, leverage variables including debt to equity, while the variable regional financial performance includes efficiency ratios. The research was conducted with a quantitative approach. The research sample was collected using a saturated sampling technique approach. The research sample was conducted in 4 districts, namely, Kuningan, Majalengka, Indramayu, and Cirebon, from data on the level of regional wealth in the form of general allocation funds and income for each region in 2014-2018 with 20 observations. The analysis test is performed by panel data analysis using the OLS (Ordinary Least Square) method through the eviews approach. The results of the study indicate that the level of regional assets has a positive and significant effect on regional financial performance, the variable level of regional dependence on the central government has a negative and significant effect on regional financial performance, the leverage variable does not have a significant effect on regional financial performance.*

**Keywords:** Regional Wealth Levels, Reliance, Leverage, Financial Performance

### Introduction

Government apparatus is an important component in the management of government activities that require qualified, competent, effective, and efficient experts in carrying out their duties and functions as well as professionalism. Government officials are required to be able to provide optimal services to the community and to become reliable human resources in carrying out their duties as government officials who must be able to carry out a mental revolution that demands a commitment to serve the community in order to create good governance. (Rahmawati et al., 2021). The creation of good government governance can be seen from how local governments are performing. The performance of local governments, which is the main factor in measuring the success of local government achievements, is financial performance. Regional government financial performance is the level of achievement of a work result in regional finance, which includes regional revenues and expenditures by using a financial system that is stipulated through a policy or statutory provision for one period budget. One of the instruments for measuring regional financial performance is by analyzing financial ratios against the established Regional Revenue and Expenditure Budget, and one of them is by measuring the ratio of regional financial

efficiency.

Given people's self-interest motive, government official managers tend to pursue their own interests rather than the interests of citizens (Megginson, 2017; Megginson & Netter, 2001; Shleifer & Vishny, 1997). Further, the agency problem is signified as there is no clear financial objectives guiding their decisions and a weak performance-compensation link in privatized firms (Liu, Wang, Zhang, & Zhang, 2012; Sheshinski & López-Calva, 2003). The agency problems may result in inefficiency in the business operations of the privatized firms' and consequently there will be low return on capital invested in SOEs and/or privatized firms. Based on the data obtained by the researcher, it was found that the average Regional Financial Performance of District Government in Region III Cirebon during the last five years from the 2015-2019 budget period for Kuningan Regency had an average of 105.42%, Cirebon Regency had an average of 97.23 %, Majalengka Regency has an average of 100.27%, and Indramayu Regency has an average of 101.40%. If you look at the data, the district government in Region III Cirebon has an efficiency ratio of only 101.08% on average, meaning that the district's capacity is inefficient. Because the average value obtained for each district is still above 100%. Meanwhile, suppose it is seen from the criteria of the efficiency ratio. If it is below 80%, the ability of the regional financial performance is said to be efficient. But in

reality, the end rate is still above 80%. It can be concluded that the efficiency ratio for five years in the district government in Region III Cirebon is still inefficient. The increase in the efficiency ratio of District Government Revenue in Region III Cirebon shows that the performance of regional revenue has decreased due to the large expenditure spent to increase its income. Organizational demands to acquire, develop and maintain quality human resources are increasingly urgent in accordance with the dynamics of the ever-changing environment. So that employee work competence is a work process that provides understanding and ability to employees in carrying out activities so that what is expected by the organization can be adequately achieved in order to improve performance. There is a demand for every organization, especially for public organizations, to be able to make changes or reforms in the bureaucracy as a form of government commitment to providing the best possible service to the community.

Accountability in a narrow sense can be understood as a responsibility that refers to who the organization (or individual workers) is responsible for and for what the organization (individual workers) is responsible for (Bustaman et al., 2018), in a broad sense, accountability can be understood as the obligation of the trustee (agent) to provide accountability, present, report, and disclose all activities and activities that are the principal's responsibility who has the right and authority to ask for this accountability (Karmawan, 2017; Rahayu et al., 2015; Williams, 2015). Accountability means accountability by creating supervision through the distribution of power in various government agencies to reduce power buildup while creating conditions for mutual supervision (Kosec & Wantchekon, 2018). The conceptual framework of public accountability can be built based on four components: a performance measurement system, a financial reporting system, the implementation of public sector audits, and a well-functioning public accountability channel (Ellwood & Newberry, 2007; Saputra et al., 2021)

Previous studies that used regional wealth variables to assess their impact on financial performance were (Retnowati, 2016; Pratama et al., 2015; Minarsih, 2015; Kusumawardani, 2012). Their research results prove that regional wealth has a positive effect on financial performance. However, it is different from the research by Armaja et al. (2015), which states that regional wealth has a negative effect on the financial performance of local governments. This research is in line with research conducted by Basar (2019). Then, previous studies that used a variable level of regional reliance on the central government were (Alviani 2018; Zonia, et al. 2017), which stated that the level of regional reliance on the central government did not effect on the financial performance of local governments. However, it is different from the research conducted by (Wiguna 2015; Lestari 2019; Suryaningsih 2016) that the level of regional reliance on the central government affects the financial performance of local governments. Research conducted by Ayuningsih (2016) and Sari (2016) states that Leverage does not affect local governments' financial performance. However, it is different from research conducted by Patrick (2007) and Sumarjo (2010) concerning the Effect of Government Characteristics on Financial Performance which concluded that Leverage has a positive effect on the financial performance of local governments. With the increasing Leverage of the local government, the supervision carried out by creditors will be tighter. Based on this explanation, it can be said that the results of previous studies related to this study show inconsistent results. Based on the background of the research described above, the researchers are interested in exploring: Does the level of regional wealth, the level of regional dependence on the central government, and Leverage affect the Financial Performance of the Regional Government? How does the

Regional Wealth Level affect the Regional Government's Financial Performance? How is the influence of the level of dependence of the region on the center on the financial performance of the regional government? Finally, how does Leverage affect Local Government Financial Performance?

## Literature Review

### Stewardship Theory

Grand theory in this study uses Stewardship Theory. The theory of stewardship explains that management situations are not motivated by individual goals but rather aimed at their main outcome goals for the organization's benefit (Donaldson, 1989 & Davis, 1991). The government is the steward responsible for managing the resources and the people as the principal owner of the resources. There is an agreement that exists between the government (steward) and the people (principal) based on trust, collectively according to organizational goals. According to Putro (2013), stewardship theory assumes a strong relationship between organizational success and owner satisfaction. The government will make maximum efforts in running the government to achieve the government's goals, namely improving the welfare of the people. If the government can achieve this goal, the people as owners will be satisfied with the government's performance. The government will protect and maximize the wealth of the organization with its performance, so that the organization's goals will be maximally achieved.

Stewardship theory is also related to the theme of government authority. Stewardship theory for this research implies that it can explain the existence of local government as an institution that can be trusted to accommodate the aspirations of the community, can provide good services to the public, and can be accountable for the finances entrusted to it, so that economic goals are met, and the welfare of the community can be maximally achieved. To carry out these responsibilities, stewards (managers and internal auditors) direct all their abilities and expertise in making internal control effective in order to produce quality financial information reports (Wahida, 2015).

### Agency theory

Agency theory is the relationship between agent and principal, where the agent is responsible for the principal's performance. In this case, the government can be said to be the agent while the people are the principal. The community as the principal provides the mandate and authority for the government in managing and running the government. Jensen & Meckling (1976) describe agency relations as a contract under one or more principals that involve agents to perform some services for them by delegating decision-making authority to agents. The government as an agent has the responsibility and obligation in its performance to the principal as the party that gives the mandate. Meanwhile, the people as the principal to the agent and as the principal have the right to hold the agent accountable. Financial reports and disclosure of information to the public are a form of monitoring tool to increase the principal's trust in the agent and as the accountability between the agent and the principal. In the concept of providing information via the internet to the public, it can be used as a tool to reduce agency conflicts.

Financial attitudes reflect individual values regarding various aspects of financial savings. According to Khanifah et al. (2017) states that personal financial behaviour comes from financial attitudes, individuals who are not wise to respond to financial problems tend to have poor financial management. By being wise in managing finances, it can reflect having good financial management as well. Financial attitudes lead to individual

thinking, individual valuation and individual decisions related to financial management practices both for themselves and their organizations or business entities. Research conducted by Arshad et al. (2015) shows that financial attitude has a significant positive effect on personal financial management, meaning that an increase in financial attitude will cause an increase in personal financial management (Atmadja et al., 2021). Performance measurement is defined as a financial or non-financial system of work carried out or the results achieved from an activity, a process, or an organizational unit.

Agency theory is also related to the theme of government authority. Regional government financial performance is the level of achievement of a work result in regional finance, which includes regional revenues and expenditures using a financial system that is determined through a policy or statutory provision during one budget period. Regional government financial performance is the level of achievement of a work result in regional finance, which includes regional revenues and expenditures using a financial system that is determined through a policy or statutory provision during one budget period. One way to analyze the performance of local governments in managing their regional finances is to analyze the financial ratios of the Regional Revenue and Expenditure Budget that has been determined and implemented (Halim, 2004). The purpose of measuring a measurable local government financial performance can encourage achievement for local governments because this will certainly provide feedback to improve continuously and achieve goals in the future, one of the tools for analyzing local government performance. In managing regional finances is to analyze the performance of the regional government in managing their regional finances by analyzing financial ratios against the Regional Expenditure Budget that has been determined and implemented

### **Relationship between wealth level and financial performance**

In the process of budget formulation and amendment, two perspectives emerged indicating the application of agency theory, namely the relationship between the people and the legislature and the legislature with the executive. In the agency relationship between the legislature and the executive, the executive is the agent, and the legislature is the principal (Halim and Abdullah, 2006). Concerning the central government, the legislature is an agent that defends the principal's interests; however, there are no clear mechanism and control fiber arrangements in the delegation of executive authority to the legislature. It is what often causes budget distortions prepared by the legislature so that the budget tends to prioritize the self-interest of the legislative parties.

Government Law Number 8 of 2006 concerning Financial Reporting and Performance of Government Agencies states that performance is an output or result of an activity or program that is to be or has been achieved in connection with the use of a budget with measured quantity and quality. Concerning Regional Financial Performance, according to a study conducted by Agustina (2013), in the journal Regional Financial Performance is the level of achievement of a job in the regional financial sector, including income and expenditure using financial indicators determined through policies or statutory provisions. Invitations during the budget period.

Regional wealth describes the level of prosperity of an area. Regional wealth can be seen from the amount of Regional Original Revenue. Large Revenues will make the regions no longer depend on transfer funds from the center and begin to become independent in regional administrative activities. An increase in PAD will increase regional financial performance. The higher the regional wealth, the better the financial

performance of the regional government.

H1: The wealth level has associated with the financial performance

### **Relationship Dependence on the Central Government on financial performance**

The level of regional reliance shows how much regional reliance on the central government in financing development (Reskohadiprojo, 2001; Wibisosno & Yuliana 2012). According to (Nordawan and Ayuningtias, 2010. General allocation funds is a fund that aims to equalize financial capacity between regions in order to reduce imbalances in financial capacity between regions through the application of a formula that considers regional needs and potentials. General allocation funds are used to finance government administration so that services to the community can be carried out. The government will monitor the implementation of the general allocation funds allocation to motivate local governments to perform better. Thus, the higher the reliance of local governments on the central government, it is hoped that the better local government services to the community so that local government performance will also increase (Mustikarini & Fitriyani, 2012).

The greater reliance of local governments on financial assistance from the central government will cause regional governments to be reluctant to optimize the exploration of their PAD potential. The regional government considers that the revenue assistance from the central government is sufficient to finance the administration of its government so that local governments do not need to improve their performance anymore in exploring the potential of their original regional revenue. Thus, the higher the reliance on the central government, the lower the performance of local governments. Supported by the results of previous research by (Gideon 2013; Damayanti 2011), the level of regional reliance on the center negatively affects government financial performance.

Prudence in financial management is associated with a healthy financial attitude and positive financial behavior because it facilitates a person to spend cautiously, understand the financial choice, and have self-control over his or her financial situation, particularly in decisions over savings, credit management, or any day-today financial transactions (Aydin & Akben, 2019; Bakar & Bakar, 2020). Financial attitude is an understanding that helps individuals to be rational and increasing confidence in financial management. The existence of human resource competence and financial attitude in cooperative financial management also requires coordination between cooperative financial management parties so that synchronization and good and appropriate cooperation arrangements for using finance in cooperatives are needed (Atmadja et al., 2021).

H2: The Reliance on the Central Government has a Negative association with the financial performance

### **Leverage relationship to financial performance**

According to the trade-off theory proposed by Kraus and Litzenberger (1973), a firm will have to trade off the costs and benefits of debt. The benefits of debt primarily originate from tax shields (Modigliani & Miller, 1963) whereas the costs of debt are mainly driven by bankruptcy costs (in other words, financial distress costs) associated with firm's increasing financial risk as a result of interest payment. Financial leverage is measured by long term liabilities to common equity ratio (Hoang & VO, 2020). Leverage In public sector accounting, Leverage is the ratio used to measure how much a region depends on creditors in financing its regional assets. Regions with a high degree of Leverage

# GENERAL MANAGEMENT

mean that they are heavily dependent on external borrowing to finance their assets. In local governments, it is important to calculate the leverage ratio for creditors and potential creditors in making credit decisions. Creditors will use this ratio to measure the ability of local governments to pay their debts (Sumarjo, 2010; Sari 2016). Leverage is the ratio between debt and equity. The greater the Leverage owned by an entity, the entity will have a poor performance. It indicates that the entity cannot finance its own operations, so it requires funds from external parties. Supported by the results of previous research by Sumarjo (2010), examined the effect of Leverage on local government financial performance. The results of his research prove that Leverage has an effect on the financial performance of local governments.

H3: Leverage has associated with the financial performance

## Methodology

In this research, the method used is the descriptive method and statistical verification. In conducting this research, the writer uses the descriptive method and verification method with a quantitative approach. The number of observations in this study was 20 samples which were tested with SPSS.. data analysis using eviews method, to determine the relationship between research variables. The dependent variable in this research is the performance of local governments. Performance is a description of the achievement of implementing an activity in achieving the goals, vision, and mission of an organization (Bastian, 2006). Measurement of local government financial

performance can be measured by assessing the efficiency of realizing the allocation made by the government to a budget. The efficiency ratio is a ratio that describes the ratio between output and input or realized expenditure with the allocations budgeted by local governments. An Independent variable is a variable that affects the dependent variable either positively or negatively. In this case, the independent variable consists of the level of regional wealth (X1), the central government reliance (X2), and Leverage (X3).

## Results and Discussion

The population in this study were all data on the Budget Realization Report of the Regency Government in Region III Cirebon for the 2015-2019 budget year, consisting of Kuningan Regency, Majalengka Regency, Indramayu Regency, and Cirebon Regency, namely four districts, then a sample of 20 data was found. Based on the test results, probability or p-value is  $0.308845 > \alpha$  or  $0.308845 > 0.05$ , then  $H_0$  is accepted. It means that in this study, the normality test was fulfilled. Based on the results of the multicollinearity test, the correlation between the independent variables was  $-0.391183 < 0.8$ , so in this study, there was no multicollinearity. Based on the results of the Heteroscedasticity test, the p-value obs \* R-squared was  $0.9987 > \alpha$  or  $0.9987 > (0.05)$ , then  $H_0$  was accepted. It means that in this study, there is no heteroscedasticity. Based on the autocorrelation test, the p-value R-squared was  $0.9170 > \alpha$  or  $0.9170 > (0.05)$ . It means that in this study, there was no autocorrelation.

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2160.995	5727.810	6.377281	0.0009
TKD	427.1942	161.4457	2.646055	0.0176
TKDTPP	-6980.009	8698.922	-1.802399	0.0441
L	19676.11	37715.77	0.521694	0.6090

Table 1. Partial Test Results (t test)

Based on table 1, testing the Level of Regional Wealth on Regional Financial Performance produces an t-count statistical value of 2.646055, for the t-table value where the significance used is 5% or  $\alpha$  of 0.05 and degrees of freedom (df) =  $nk-1 = 20-3-1 = 16$ , then the t table is 1.74588 because  $t_{count} > t_{table}$

( $2.646055 > 1.74588$ ) and a significant level (p-value) = 0.0176  $< 0.05$  then  $H_a$  is accepted and  $H_0$  is rejected, which means that the level of regional wealth partially has a positive and significant effect on regional financial performance.

Dependent Variable				
Method: Pooled Least Squares				
Date: 26/17/21 Time: 21:35				
Sample: 2014 2018				
Included observations: 5				
Cross-sections included: 4				
Total pool (balanced) observations: 20				
Variable	Coefficient	Std. Error	t-statistic	Probability
C	2160.995	5727.810	6.377281	0.0009
TKD?	427.1942	161.4457	2.646055	0.0176
TKDTPP?	-6980.009	8698.922	-1.802399	0.0441
L?	19676.11	37715.77	0.521694	0.6090
Fixed Effects (Cross)				
_KABKNG—C	1652.720			
_KABCRB—C	-45.66494			
_KABIDR—C	-512.3914			
_KABMJL—C	-1094.663			
Effects Specification				
Cross-section fixed (dummy variables)				
R-Squared	0.746009	Mean dependent var	202.1620	
Adjusted R-Squared	0.597847	S.D. dependent var	16.03411	

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S.E of Regression	10.16811	Akaike info criterion	7.765565
Sum Squared Resid	1240.687	Schwarz criterion	8.163858
Log likelihood	-69.65565	Hannan-Quinn criter.	7.843316
F-Statistic	5.035101	Durbin-Watson stat	2.012289
Prob (F-Statistic)	0.007267		

Table 2. The estimation results of the Fixed Effect model

Based on the results of the F test / simultaneous test in table 2, it can be seen that Fcount is 5.035101 with a significance level of 0.007267 and  $df_1 = 4-1 = 3$  and  $df_2 = 20-3-1 = 16$ , the value of Ftable using the level  $\alpha = 0.05$  or 5% is 3.63 so that  $F_{count} > F_{table}$  ( $5.035101 > 3.63$ ) then  $H_0$  is rejected and  $H_a$  is accepted. The rejection of  $H_0$  is indicated by a significance value of  $0.007267 < 0.05$ , so it can be concluded that the level of regional wealth, the level of regional dependence on the central government, and Leverage simultaneously affect regional financial performance.

## The Effect of the Wealth Level on the Financial Performance

In testing the hypothesis that has been done, it shows that the level of regional wealth has an effect on regional financial performance, this is evidenced by  $t_{count} > t_{table}$  ( $2.646055 > 1.74588$ ) so that  $H_0$  is rejected and  $H_a$  is accepted, which means that the level of regional wealth has a positive and significant effect on regional financial performance. Regional wealth describes the level of prosperity of an area. Regional wealth can be seen from the amount of Regional Original Revenue (PAD). Large PAD will make the regions no longer depend on transfer funds from the center and begin to become independent in regional administrative activities. An increase in PAD will increase regional financial performance. The higher the regional wealth, the better the local government's financial performance. The results of this study support the results of previous studies conducted by (Retnowati, 2016), (Pratama et al., 2015), (Minarsih, 2015), and (Kusumawardani, 2012).

## The Effect of the Central Government Reliance on the Financial Performance

In testing the hypothesis that has been done, it shows that the level of Central Government Reliance has an effect on regional financial performance, this is evidenced by  $-t_{count} > t_{table}$  ( $-1.802399 > 1.74588$ ) and a significant level ( $p$ -value) =  $0.0441 < 0.05$  then  $H_a$  is accepted and  $H_0$  is rejected. The greater Central Government Reliance on financial assistance from the central government will cause regional governments to be reluctant to optimize the exploration of their PAD potential. The regional government considers that the revenue assistance from the central government is sufficient to finance the administration of its government so that local governments do not need to improve their performance anymore in exploring the potential of their original regional revenue. Thus, the higher the reliance on the central government, the lower the performance of local governments. The results of this study support the results of previous research conducted by Basar (2019)

## The Effect of Leverage on the Financial Performance

In testing the hypothesis, it shows that Leverage has no significant effect on regional financial performance; this is evidenced by  $t_{count} < t_{table}$  ( $0.521694 < 1.74588$ ) and a significant level ( $p$ -value) =  $0.6090 > 0.05$  then  $H_0$  is accepted, and  $H_a$  is rejected. Leverage is the ratio between debt and equity. The greater the Leverage owned by an entity, the entity

will have a poor performance. It indicates that the entity cannot finance its own operations, so it requires funds from external parties. Leverage has no effect on regional financial performance. It can be explained that when Leverage shows debt financing to equity. Meanwhile, according to Bastian (2005), funding in the public sector is Regional Original Income, Balanced Funds, Regional Loans, and other legal income. Funding will be used for local government operational activities and the Balancing Fund because these two things do not have a high risk, there is no interest expense, and there are no demands for repayment. Ayuningsih (2016) and Sari (2016).

## The Influence of the Wealth Levels, the Central Government Reliance and Leverage on Regional Financial Performance

Based on the results of the analysis on the statistical F test that has been carried out, the results of this study state that  $F_{count} > F_{table}$ , which means that  $H_0$  is rejected and  $H_a$  is accepted, in other words, the level of regional wealth, the level of regional dependence on the central government and Leverage affect regional financial performance. From the results of this study, by measuring using the Level Wealth Level, Central Government Reliance, and Leverage, some results can significantly affect 59.78% while other variables outside the model influence the rest.

## Conclusion

Based on this research that has been done, the following conclusions are obtained: Wealth Level, Central Government Reliance, and Leverage simultaneously have a significant effect on Regional Financial Performance of Region III Cirebon in 2015-2019. Then, The level of regional assets has a positive and significant effect on regional financial performance. The higher the regional wealth, the better the local government's financial performance, and if the level of wealth decreases, the regional financial performance will decrease. The Central Government Reliance has a negative and significant effect on Regional Financial Performance. The higher the reliance on the central government, the lower the regional financial performance, and if the reliance on the central government is getting lower, the regional financial performance will be even higher. The Last, Leverage does not have a significant effect on regional financial performance. The greater the Leverage has a bad financial performance, and the lower the Leverage, the better the financial performance.

This research is contributed for the Regional Government, and it is recommended that they continue to improve and further enhance the financial performance of their regions through the potential and capabilities of the regions so that they can produce more optimal financial performance. It is recommended that regional governments increase their regional wealth again and make the region's own revenue as one that has a major contribution to finance the region's needs. Local governments are advised to manage their own regional resources to reduce the level of dependence on the central government. This research also contributes in theoretical terms. It is shown that

Wealth Level, Central Government Reliance, and Leverage impact local government financial performance, and are proven to provide new views in stewardship theory and agency theory. In terms of practice, this research also contributes to a view that: to improve the performance of local governments, and it is necessary to pay attention to Wealth Level, Central Government Reliance, and Leverage so that improvements are more synergistic and sustainable. For further research suggestion, it is recommended to add variables and observation period not only five years, but also to obtain more comprehensive results. And it can expand the research population so that we get even more maximum results.

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