

## **The Influence of Regional Government Size, Local Original Revenue, and Balancing Funds on the Financial Performance of Regency/City Regional Governments in North Sumatra Province for the 2020-2023 Period**

**Siti Fatimah**

[Infolarispa4@gmail.com](mailto:Infolarispa4@gmail.com)

**Muhammad Rizal**

[muhammadrizall@unimed.ac.id](mailto:muhammadrizall@unimed.ac.id)

Universitas Negeri Medan

### **ABSTRACT**

This study is motivated by the suboptimal management of regional assets and locally generated revenue (PAD), as well as the high dependence of local governments on transfer funds from the central government, which has led to a decline in the financial performance of local governments in North Sumatra Province. This study aims to analyze the effect of local government size, PAD, and balancing funds on the financial performance of local governments using agency theory as the analytical framework. The population of this study includes 33 regencies/cities in North Sumatra Province during the 2020–2023 period, with a saturated sampling technique applied. The data used in this study was collected by documentation. Data were analyzed using multiple linear regression analysis. The results indicate that local government size and PAD have a positive effect on the financial performance of local governments, while balancing funds have no significant effect. These findings support agency theory, which suggests that differences in interests between the central government (principal) and local governments (agents) influence financial performance. Dependence on transfer funds creates potential inefficiency and reduces the motivation of local governments to improve fiscal independence. Conversely, higher PAD and larger organizational scale strengthen accountability and the effectiveness of regional financial management.

**Keywords: Local Government Financial Performance, Local Government Size, Locally Generated Revenue, Balancing Funds, Agency Theory.**

## **BACKGROUND**

North Sumatra Province is one of the regions that has implemented regional autonomy. Its legal basis evolved from Law Number 44 of 1999 and the principles of autonomy in Law Number 22 of 1999, which were later refined through Law Number 32 of 2004 concerning Regional Government. This concept of regional autonomy gives each region the freedom to formulate local regulations, as well as to develop, manage, and implement its internal financial policies (Sujarweni, 2015). As a form of decentralization, regional autonomy delegates authority from the central government to regions so they can manage their affairs independently. With this authority, local governments are expected to be able to improve welfare and the quality of public services in a democratic, fair, equitable, and sustainable manner.

The current implementation of regional autonomy is based on Law Number 23 of 2014 concerning Regional Government and Law Number 33 of 2004 concerning Fiscal Balance between the Central Government and Regional Governments. This autonomy policy emerged due to the central government's limited ability to oversee development across all regions. Therefore, regional autonomy is crucial for realizing good governance. In the context of state financial management, the government continues to encourage increased transparency and accountability. Government Regulation Number 105 of 2000, Article 4, specifically emphasizes that regional financial management must be carried out in an orderly manner, in accordance with laws and regulations, efficiently, effectively, transparently, and responsibly, while always observing the principles of justice and propriety.

In the context of regional autonomy, financial management capability is a fundamental measure of successful implementation (Roy Kelly, 2020). One crucial indicator of this capability is the level of regional budget absorption. Optimal budget absorption indicates the effectiveness of local governments in converting financial resources into wealth and services that can be enjoyed by the public (Safpremi, 2022). Conversely, minimal budget absorption can reflect performance inefficiencies, potentially leading to unhealthy budget surpluses or deficits. Excessive surpluses can indicate delays in productive spending, while deficits covered by debt risk triggering a regional financial crisis if not managed prudently.

Mardiasmo (2002) stated that granting regional autonomy is expected to provide regions with greater flexibility in regional development through efforts that, to the greatest extent possible, increase active community participation. Granting regional autonomy is expected to increase the efficiency, effectiveness, and accountability of the public sector in Indonesia. Regions are required to seek alternative sources of development funding

without compromising the expectation of continued assistance and sharing from the central government and to use public funds in accordance with community priorities and aspirations.

Therefore, decentralization requires each regional government to carefully manage its Regional Revenue and Expenditure Budget (APBD). APBD management must align with national development strategies and local potential, ensuring sustainable resource distribution. Independence in regional financial management aims to ensure development can be implemented without complete dependence on central government funding allocations. Therefore, accurate financial reporting and effective financial management are essential as performance measurement instruments and a form of transparency to the public. This financial performance measurement serves as a reflection of the evaluation of regional achievements in carrying out the mandate of autonomy, and therefore must be conducted periodically.

Specifically, local government financial performance reflects the extent to which fiscal management has been achieved. This encompasses the effectiveness of regional revenue and expenditure, as regulated by the financial system, as well as applicable policies and laws and regulations, within a budget period. Within this timeframe, local governments are expected to achieve optimal performance in accordance with the planned and approved budget. Measuring this financial performance is vital to the public interest, serving as an evaluation tool to assess the gap between plans and actual performance, and as a basis for continuous improvement. Local government financial performance contributes to annual regional revenue growth, as evidenced by the government's ability to tap into its potential. Improving government financial performance will impact public welfare, as the region's greater ability to tap into its potential is used not only to finance the governance system and regional development but also to optimally improve public services. As the party responsible for managing regional finances, local governments are crucial in minimizing the decline in annual regional revenue growth by increasing their ability to generate financial resources.

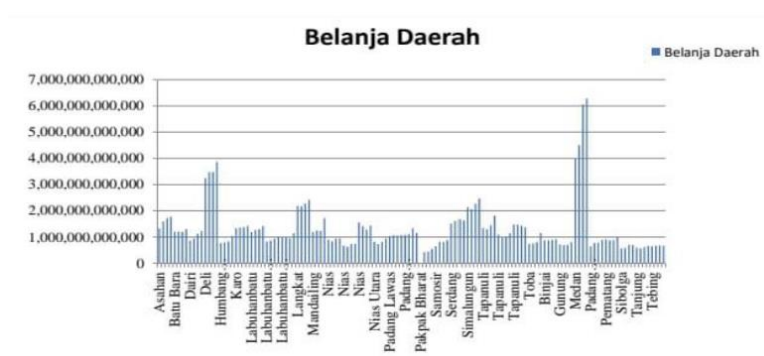
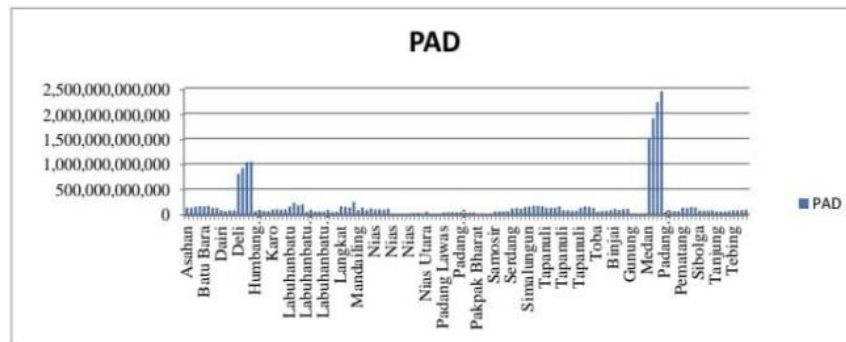


Figure 1. Regional Expenditure Graph of Regencies/Cities in North Sumatra Province for the 2020-2023



**Figure 2.** Graph of Regional Original Income (PAD) of Regencies/Cities in North Sumatra Province for the 2020-2023 Period



**Figure 3.** Graph of District/City DP in North Sumatra Province for the 2020-2023 Period

Based on the graph presented, it can be concluded that local revenue (PAD) in regencies/cities in North Sumatra is insufficient to cover their respective regional expenditures. This indicates that PAD is still not a reliable and stable source of revenue for local governments. Although local governments receive transfer funds from the central government, almost all regencies/cities in North Sumatra are still unable to cover their respective regional expenditures.

Transfer funds from the central government should be able to help improve regional financial capacity, but in reality, many regions still experience budget deficits.

One example is data from the Directorate General of Public Works and Public Housing (DJPK), which shows that Deli Serdang Regency's Regional Original Revenue (PAD) in 2021 amounted to Rp926,137,759,153, but its regional expenditure reached Rp2,451,655,133,476. Despite receiving transfer funds from the central government amounting to Rp3,473,760,778,916, Deli Serdang Regency still experienced a budget deficit of Rp95,967,886,287. This condition indicates that Deli Serdang Regency still faces difficulties in managing regional finances. Relatively low Regional Original Revenue (PAD)

and high regional expenditure make it difficult for Deli Serdang Regency to achieve budget balance.

In contrast, Medan City's 2021 PAD reached Rp1,906,512,189,047, which is relatively higher than that of Deli Serdang Regency. Medan City's regional expenditure reached Rp4,499,145,144,312, but with central government transfers of Rp2,977,574,253,244, Medan City did not experience a budget deficit in 2021. This indicates that Medan City still relies heavily on central government transfers to finance most regional activities and projects.

## RESEARCH METHODS

This research was conducted in regencies/cities in North Sumatra Province by accessing the official website of the Directorate General of Fiscal Balance (DJPK) through its official page [www.djpk.kemenkeu.go.id](http://www.djpk.kemenkeu.go.id), along with the financial statistics of the North Sumatra government for 2020-2023 obtained from the BPS Sumut catalog [bps.go.id](http://bps.go.id). The population in this study was 25 regencies and 8 cities in North Sumatra Province, totaling 132 samples. The sampling technique used in this study was saturated sampling or census, which is a sampling technique where all members of the population are used as samples.

The dependent variable in this study is the financial performance of the district/city governments in North Sumatra Province. The independent variables include The size of the regional government, local revenue, and balancing funds. Data analysis techniques include descriptive statistical analysis, classical assumption testing, and multiple linear regression analysis using SPSS software.

## RESULTS AND DISCUSSION

### Descriptive Statistical Analysis

Descriptive statistical analysis is a statistical analysis used to summarize and present data into information that is easier to understand and interpret. Descriptive statistics provide an overview of the data used in the research through minimum, maximum, average, and standard deviation values.

**Table 1.** Descriptive Statistical Analysis Test Results

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Standard Deviation
Regional Government Financial Performance	132	25.02	31.24	28.4740	.73946

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Size of Local Government	132	23.36	28.52	25.2530	.98749
Locally-generated revenue	132	26.70	28.81	27.5269	.44797
Balancing Fund	132	.70	1.19	.9838	.08165
Valid N (listwise)	132				

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Source: SPPS Data Processing, 2025

Based on the results of the descriptive statistical analysis test with 132 samples, it can be explained that:

1. The Regional Government Financial Performance obtained a mean value of 28.47 with a minimum value of 25.02 in Toba Regency in 2021 with a value of 0.702107318. The maximum value of 31.24 was found in North Padang Lawas Regency in 2022 with a value of 1.186504828 with a standard deviation of 0.73946.
2. The size of the Regional Government obtained a mean value of 25.2554 with a minimum value of 23.26 in Gunung Sitoli City in 2023 with a value of 25.02374227. The maximum value of 28.52 was found in Medan City in 2023 with a value of 31.24075393 with a standard deviation of 0.98749.
3. Regional Original Income obtained a mean value of 27.4752 with a minimum value of 26.70 in West Nias Regency in 2022 with a value of 23.26136193. The maximum value of 28.81 was found in Medan City in 2023 with a value of 28.52415897 with a standard deviation of 0.44797.
4. The Balancing Fund obtained a mean value of 0.9786 with a minimum value of 0.70 in Pakpak Bharat Regency in 2020 with a value of 26.70245547. The maximum value of 1.19 was found in Medan City in 2023 with a value of 28.81304202 with a standard deviation of 0.08165.

### **Multiple Linear Regression Analysis**

Multiple linear regression analysis is a statistical method that researchers can use to determine the relationship between one dependent variable and two or more independent variables. This analysis is conducted with the aim of predicting or explaining the influence of several factors on an outcome.

**Table 2.** Test Results Multiple Linear Regression Analysis

Coefficients <sup>a</sup>		Unstandardized Coefficients	
		B	Std. Error
1	(Constant)	.896	.038
	Size of Local Government	-.007	.002
	Locally-generated revenue	.011	.001
	Balancing Fund	.001	.002

a. Dependent Variable: Government Financial Performance

Source: SPSS Data Processing, 2025

Based on the results of the multiple linear regression analysis test, the following regression equation can be formulated:

$$KKPD = 0.896 - 0.007 UPD + 0.011 PAD + 0.001 DP$$

The results of the equation obtained above can be interpreted as follows:

1. The constant (absolute value of Y) is 0.896, which means that if the variables of regional government size, regional original income and balancing funds are zero, then the value of regional government financial performance is 0.896.
2. The size of the local government has a negative coefficient value (-0.007), indicating that a 1 unit increase in the size of the local government will reduce the financial performance of the local government by -0.007.
3. Regional original income has a positive coefficient value (0.011) indicating that a 1 unit increase in regional original income will increase the financial performance of the regional government by 0.011.
4. The balancing fund has a positive coefficient value (0.001) indicating that a 1 unit increase in the balancing fund will increase the financial performance of the regional government by 0.001.

### Analysis of the Coefficient of Determination (R<sup>2</sup>)

The coefficient of determination (R<sup>2</sup>) is used to measure the ability of a research model to explain variations in the dependent variable. This can be seen through the R Square value.

**Table 3.** Test Results Coefficient of Determination (R<sup>2</sup>)

Model Summary				
Model	R	R Square	Adjusted R Square	Standard Error of the Estimate
1	.763a	.582	.571	.00480

a. Predictors: (Constant), Balancing Fund, Local Original Income, Size Local government  
 b. Dependent Variable: Regional Government Financial Performance

Source: SPSS Data Processing, 2025

Based on the results of the determination coefficient (R<sup>2</sup>) test in table 4.9 above, the R-Square value obtained is 0.582. This means that approximately 58.2% of the variation in the dependent variable can be explained by the independent variables included in the model, namely the size of the regional government, local revenue, and balancing funds. The remainder (41.8%) is explained by other factors not included in the model used.

### Simultaneous Test (F Test)

The F-test is used to examine the influence of independent variables on the dependent variable simultaneously or jointly. The F-test provides an overview of the overall accuracy of the regression model. If the significance value is <0.05, then the independent variables simultaneously have a significant effect on the dependent variable. Therefore, it can be concluded that the regression model created is quite good at explaining variation in the data.

**Table 4.** Simultaneous Test Results (F)

ANOVA						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.004	3	.001	.53,336	.000b
	Residual	.003	115	.000		
	Total	.006	118			

a. Predictors: (Constant), Balancing Fund, Local Original Income, Size Local government

b. Dependent Variable: Regional Government Financial Performance

Source: SPSS Data Processing, 2025

Based on the results of the simultaneous test (F) in table 4.10 above, it shows the F count value of 53.336 with a significant value of 0.000 which is smaller than 0.05. To see the F table, the calculation can be done  $df_1 = k-1$ ,  $df_2 = nk$ , so that the F table value is 2.68, so it can be seen that the F count  $53.336 > F$  table 2.68, which means that the independent variables can influence the dependent variable together significantly. So it can be concluded that H<sub>4</sub> is accepted.

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### Test Partial (t-test)

The t-test is used to partially test the effect of an independent variable on a dependent variable. The basis for the t-test is based on the calculated t-value and the t-table value, with a significance value less than 0.05, indicating that the independent variable has a partial significant effect on the dependent variable.

**Table 5.** Partial Test Results (t)

Model		Coefficients <sup>a</sup>	
		t	Sig.
1	(Constant)	23,537	.000
	Size of Local Government	-3,402	.001
	Locally-generated revenue	11,718	.000
	Balancing Fund	.466	.642

a. Dependent Variable: Regional Government Financial Performance

Source: SPPS Data Processing, 2025

Based on the results of the partial test (t) in table 4.11 above and comparing it with the t-table value ( $df = nk$ ,  $df = 119 - 4 = 115$ ) at  $\alpha = 0.05$ , the t-table value obtained is 1.658 which can be explained as follows:

1. The t-test results for the first hypothesis (H1) on the size of the local government obtained a significance value of 0.001 with a t-count value of -3.402. The significance value of  $0.001 < 0.05$  and  $t\text{-count } -3.402 < t\text{-table } 1.658$  so that H1 is accepted. Therefore, it can be concluded that the variable of the size of the local government has an effect on the financial performance of the local government of the Regency/City in North Sumatra for the period 2020-2023.
2. The t-test results for the second hypothesis (H2) on local revenue obtained a significant value of 0.000 with a t-count of 11.718. The significant value of  $0.000 < 0.05$  and  $t\text{-count of } 11.718 > t\text{-table } 1.658$  so that H2 is accepted. Therefore, it can be concluded that the local revenue variable has an effect on the financial performance of the Regency/City regional government in North Sumatra for the period 2020-2023.
3. The t-test results for the third hypothesis (H3) on balancing funds obtained a significance value of 0.642 with a t-count of 0.466. The significance value of  $0.642 > 0.05$  and  $t\text{-count of } 0.466 > t\text{-table } 1.658$  so that H3 is rejected. Therefore, it can be concluded that the balancing fund variable does not affect the financial performance of the Regency/City regional government in North Sumatra for the period 2020-2023.

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## **1. The Influence of Regional Government Size on Regional Government Financial Performance**

Based on the research results obtained, the size of the local government influences the financial performance of local governments. This can be seen from the test results in Table 4.11, where the size of the local government has a significance value of  $0.001 < 0.05$  and  $t \text{ count } -3.402 < t \text{ table } 1.658$ , so H1 is accepted. Therefore, it can be concluded that the variable of the size of the local government influences the financial performance of the local government of the Regency/City in North Sumatra for the period 2020-2023.

The size of a local government, as measured by total assets, reflects the extent of a region's resources to carry out public services and development. A larger local government reflects greater regional economic potential. Local governments with substantial assets have more options in allocating their resources to productive activities. They can diversify revenues, develop regional business units, and manage strategic assets that can contribute to improved financial performance. This provides greater flexibility in financial management and allows local governments to invest in various programs and activities that can improve their financial performance.

In relation to agency theory, the community, as principal, has entrusted the management of regional assets to the local government, as agent. The large amount of assets owned by local governments creates greater pressure and responsibility to manage these resources effectively and efficiently, in accordance with the expectations of the community, as principal. Larger local governments have better capacity to manage resources and provide public services.

This aligns with the principles of agency theory, which emphasizes the importance of efficiency in resource management to improve local government financial performance. Thus, larger local governments can improve their financial performance because they have better capacity to manage resources and provide effective and efficient public services. Agency theory also emphasizes the importance of transparency and accountability in regional asset management, allowing the public, as principals, to monitor the performance of local governments as agents.

The results of this study are in line with research conducted by Henny et al. (2023), Linda Kusumaningtyas (2023), and Iqbal Tigana Ridho (2021), which stated that the size of the regional government influences the financial performance of the regional government. The results of this study contradict the research of Sari Rusmita (2019) entitled "The Effect of Government Size, Regional Expenditure, the Level of Dependence on the Center, Prosperity of the Local Government, Leverage on the Financial Performance of Local Government District/City Areas in West Kalimantan," where the

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research conducted showed that the size of the regional government has no influence on the financial performance of the regional government because the assets owned by the region are not utilized effectively to improve the performance of the regional government. The difference in research is likely due to differences in research locations and research periods.

## **2. The Influence of Regional Original Income on the Financial Performance of Regional Governments**

Based on the research results obtained, local revenue has an effect on the financial performance of local governments. This can be seen from the test results in table 4.11 where local revenue has a significant value of  $0.000 < 0.05$  and  $t \text{ count } 11.718 > t \text{ table } 1.658$  so that H2 is accepted. Therefore, it can be concluded that the local revenue variable has an effect on the financial performance of local governments of regencies/cities in North Sumatra for the period 2020-2023.

With substantial regional original revenue, regions can invest in various programs and activities that can improve community welfare and enhance their financial performance. This provides greater flexibility in regional financial management, allowing regions to more effectively allocate their resources to achieve regional development goals. A substantial regional original revenue also allows regions to reduce their dependence on transfer funds from the central government and increase their financial independence. Therefore, increasing regional original revenue can be an effective strategy for regions to improve their financial performance and achieve regional development goals.

In the context of agency theory, the relationship between local governments (agents) and the community (principals) can be seen in the management of Regional Original Revenue (PAD). In this agency theory, local governments, as agents, have an incentive to manage regional original revenue effectively and efficiently, as this can improve their financial performance and increase public trust.

However, local governments may also have incentives to use local revenue for personal or group interests, necessitating monitoring and control mechanisms to ensure that local revenue is used in the public interest. The results of this study align with research conducted by Afia et al. (2021), Febriyanti (2022), and Sulo et al. (2023), which showed that local revenue influences local government financial performance.

## **2. The Influence of Regional Original Income on the Financial Performance of Regional Governments**

Based on the research results obtained, the balancing fund has no effect on the financial performance of local governments. This can be seen from the test results in Table 4.11, where the balancing fund has a significance value of  $0.642 > 0.05$  and a

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calculated  $t$  of  $0.466 < t_{table} 1.658$ , so  $H_3$  is rejected. Therefore, it can be concluded that the balancing fund variable does not affect the financial performance of local governments in regencies/cities in North Sumatra for the period 2020-2023.

Balancing funds, which are transfers of funds from the central government to regional governments as part of fiscal decentralization, should improve regional government financial performance. However, when research shows that balancing funds have no impact on regional government financial performance, this indicates problems in the management and utilization of these funds.

This can be caused by several factors, including the high dependence of local governments on balancing funds. When local governments rely too heavily on balancing funds, they tend to be less motivated to develop regional potential and increase local revenue. As a result, local governments lack sufficient incentives to independently improve their financial performance.

In agency theory, the central government, as the principal, grants authority and resources to regional governments, as agents, to manage balancing funds. However, regional governments, as agents, may not use balancing funds in accordance with the objectives set by the central government. This can occur because regional governments have different interests and priorities than the central government. As a result, balancing funds are used for activities that are less productive or inconsistent with the objectives for which they were provided. As a result, balancing funds are ineffective in improving regional government financial performance. Regional governments need to improve their ability to manage balancing funds to achieve the objectives set by the central government and improve their financial performance. In this context, agency theory emphasizes the importance of oversight and control by the central government to ensure that regional governments use balancing funds in accordance with their stated objectives.

The results of this study are in line with research conducted by Ni Ketut Ayu Anggreni et al. (2019), Ester Trivona Nauw & Budi Riharjo (2021), and Addini & Sri (2025), which showed that balancing funds had no effect on the financial performance of local governments.

However, this differs from Salsabila Pramestya Putri's (2023) research, which showed that balancing funds influence local government financial performance. This study found that greater allocations of balancing funds would improve local government financial performance. The discrepancy in these results may be due to differences in location and research period.

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### **3. The Influence of Regional Government Size, Regional Original Income and Balancing Funds on Regional Government Financial Performance**

Based on the research results obtained, the size of the local government, local revenue and balancing funds simultaneously influence the financial performance of the local government. This can be seen from the results of the simultaneous test (F test) in table 4.10 which has a significant value of  $0.000 < 0.05$  and has an R Square value of 0.582. Thus, it can be concluded that the fourth hypothesis H4, namely the size of the local government, local revenue and balancing funds simultaneously influence the financial performance of the local government, is accepted. The R Square value obtained is 0.582, which means that approximately 58.2% of the variation in the dependent variable (local government financial performance) can be explained by the independent variables included in the model, namely the size of the local government, local revenue and balancing funds. The remainder ( $100\% - 58.2\% = 41.8\%$ ) is explained by other factors not included in the model used.

The size of a local government reflects the extent of its resources to carry out public service functions. The larger the local government, the greater its ability to manage its resources. Meanwhile, local revenue reflects the region's ability to generate revenue independently. The higher the local revenue, the greater the region's flexibility in allocating its resources. Balancing funds are transfers from the central government that provide additional financial resources to regions. Balancing funds can assist regions in financing development and public services. The interaction between these three factors is dynamic and mutually influential.

In agency theory, local governments, as agents, have a responsibility to manage community resources effectively and efficiently. The interaction between local government size, local revenue, and balancing funds can help increase transparency and accountability in regional financial management.

The large size of local governments allows for the development of better information systems, thereby increasing transparency in financial management. High local revenue encourages local governments to manage their finances effectively and efficiently. Meanwhile, balancing funds create the need for more comprehensive reporting, thereby helping to reduce information asymmetry between local governments and the public. Thus, the synergy between local government size, local revenue, and balancing funds can help improve local government financial performance and increase public trust in local government.

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## CONCLUSION

Based on the research results and discussion, the following conclusions can be drawn from this research:

1. The size of a local government influences its financial performance. This aligns with agency theory, which states that local governments, as agents, are responsible for managing resources for the benefit of the community as principal. Local government size impacts asset management and utilization capacity, which in turn impacts financial performance.
2. Locally generated revenue also influences the financial performance of local governments. Locally generated revenue is a financial resource that reflects regional fiscal independence, thus playing a role in supporting development and public service delivery. Agency theory emphasizes the need for local governments, acting as agents, to manage this revenue accountably for the benefit of their principals.
3. Balancing funds do not impact local government financial performance. However, dependence on these funds can impact resource management and local government motivation. Within the framework of agency theory, the management of these central funds requires oversight to ensure that their use aligns with the agency's objectives and responsibilities.
4. Simultaneously, these three variables influence local government financial performance. This interaction reflects the dynamics of local financial management, where transparency and accountability are crucial for maintaining public trust and improving performance.

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