The Effect of Head of Region Characteristics on Local Government Financial Performance: The Case of Indonesia

Endang Sri Rahayu1*, Doddy Setiawan1

1 Universitas Sebelas Maret, Surakarta, Indonesia
Email: ending.srira@gmail.com

ABSTRACT

This study investigated the effect of head of region characteristics on local government financial performance. The head of region characteristics consists of age, tenure, education level, gender and affiliation of political parties. The sample of the study consists of 1,100 Local Government Financial Report which has been audited by Supreme Audit Board during of 2011 – 2015 period. Financial performance was measured by using budget absorption and the ratio of regional autonomy. The results of the study found that age of the head of the region has a positive effect on the financial performance of local government, tenure of the regional head has a negative effect, education level of the regional head has no effect, female head of the region has a negative effect, and affiliation of local political parties has a negative effect on the financial performance of local government.

Type of paper: Empirical

Keywords: head of region characteristics, local government, financial performance, political party

1. Introduction

The implementation of regional autonomy brings the consequence of decentralization. Decentralization is the handover of the authority of the government by the central government to the autonomous regions to regulate and administer its government (Law No. 32 of 2004). Moisiu (2014) argues that decentralization of local government is important process to build a democracy of a country. With the decentralization system, local governments are given full authority to regulate and manage all government affairs as well as implement regional development and management of the potential of local resources owned including financial and regional wealth as well as other sources that can contribute to local revenue. Decentralization is a process of political devolution, fiscal, and decision-making from the central government to local governments (Moisiu, 2014).

The delegation of central authority to local governments must be accompanied by the budget allocations required to exercise the authority (Ritonga et al. 2013). Budget transfers from the central government to regional governments include Revenue Sharing Fund (DBH), General Allocation Fund (DAU) and Special Allocation Fund (DAK). Revenue Sharing Funds are sourced from taxes and natural resources. On the other hand, General Allocation Fund is sourced from National Revenue and Expenditure Budget (APBN) allocated to the regions with
the aim of equitable distribution of inter-regional financial capability. The Special Allocation Fund aims to help fund special activities (UU no 23 2014). Transfer mechanisms to regions are based on considerations to reduce the imbalances that may occur between regions (horizontal imbalances) or between the central and regional governments (vertical imbalances). The implication is that the subsidies allocated by the regions to exercise the authority of local government in providing public services to the public will vary.

Implementation of decentralization in Indonesia needs to be supported by reliable human resources and heads of region who are capable and have competence in the implementation of local government. This is because decentralization has brought significant economic, social and political changes, which leads people’s behavior to be critical of local government policies, demands on the performance of local government such as the quality of public services to be more responsive and aligned to the interests of the people, better public facilities and infrastructure, the demand for increased earnings and the creation of good governance based on quality, integrity and competence of local government apparatus.

Referring to the views of the Upper Echelons Theory used by the private sector on the characteristics of corporate leaders such as personality, demographics and functional backgrounds which have a significant influence on the firm’s strategic performance. Individual characteristics such as age, education, and length of service or tenure are linked to the organization’s strategic performance. It can also be applied in the public sector in achieving government performance. With the education level, appropriate educational background, maturity/age, and sufficient work experience will open more to the local executive’s perspective to be able to adapt to the changes and create innovation to achieve optimal government performance (Sutaryo, 2013). The regional head as an executive party plays an important role in carrying out local governance especially in policy making and strategic decisions. Hence it is required for regional heads to possess integrity and adequate competence. Regional heads who have good integrity and competence will influence the performance of the government administration of a region.

Research on the characteristics of the Chief Executive Officer (CEO) as the chairman of the company in the private sector has been done by Balta et al. (2010) revealed that the level of education and executive functional education background affects financial reporting and hierarchical decentralization in strategic decision-making processes. Magoutas et al. (2011) showed in his research that education is one of the most influential factors in increasing the economic potential of the company. The author discussed the role of education and its impact on the company’s financial performance. The results showed that education have a significant effect on the economic performance of manufacturing companies in Greece. This is not in line with research conducted by Gottesman and Morey (2010) which discovered that educational background is not related to the financial performance of the company.

The characteristics of corporate leaders according to the Upper Echelons Theory can also be applied in the public sector as well. For instance, Sebaa et al. (2009) in a study using regional head characteristics proxyd by age, education, tenure, alignment and performance to investigate strategy in Dubai local government level. Results indicated that higher levels of education indicate an increase in government strategic performance, while age and tenure have no effect on improving strategic performance of local governments. Gomes et al. (2013) conducted research on the quality of mayors proxyd against educational background, age, previous administrative experience and city size on the financial performance of Brazilian local
governments. The results showed that the quality of the mayor does not affect the government’s financial performance.

The implementation of Residencies/Cities government with decentralization system requires the competence and integrity of government apparatus especially the head of region as the driving force and be responsible of all governing activities. In the public sector, a regional head must have special characteristics to bring change for the better. For instance, with the ability of a regional head to develop and manage existing resources to promote economic growth. The more increasing economic growth will be, then the level of regional financial autonomy will also increase accordingly. Therefore, the expected welfare of the society can be met. This is also pertained to public service issues such as health, education, public facilities and infrastructure which can be met by the government as a welfare-guarantee to the public. But in fact, it is still often found that the head of the region has not been able to bring significant changes of economic welfare during his tenure.

According to Regulation of Ministry of Finance No. 249 / PMK.02 / 2011 on Performance Measurement and Evaluation of the Implementation Work Plan and Budget Ministry/Institution stated that budget absorption is one of the methods on assessing the financial performance of Ministry / Institution. Under the regulation, local governments are expected to apply in assessing the financial performance of local governments so that the budget provided by local government either capital expenditures or unforeseen expenditures derived from the central government transfer can be absorbed to the maximum to fulfill the public service.

2. **Literature Review**

Referring to the Upper Echelons Theory developed by Hambrick and Mason (1984), a company or organization becomes a reflection of its top managers. The way they compete in the market is mainly influenced by the characteristics of their leaders such as personality, demographics and functional background. In the Upper Echelons Theory, it disclosed that management has significant influence on the strategic direction and it is one of the strategic resources in a company. Based on Upper Echelons Theory expressed by Hambrick and Mason (1984), they concluded that individual characteristics such as age, education, and tenure relate these characteristics to the organization’s strategic performance.

Hambrick and Mason (1984) argue that manager’s age is related to his maturity in making decisions, considering the received information and evaluating them before taking a decision. Older age tends to pay attention to financial and career certainty. Older people tend to avoid change and prefer the status quo. A person’s level of education is defined by open-mindedness and the ability to process complex information (Yusup, 2015). Genders of men and women differ in how they process messages or information (Meyers-Levi and Maheswaran, 1991).

a. **Age of Regional Head Towards Local Government Financial Performance**

Age is one of the main factors that can affect behavior. In the perspective of Upper Echelons Theory, a manager’s age is positively related to the tendency to see more information, evaluate information more accurately, and take longer decisions (Hambrick and Mason, 1984). It is also expressed by Yusup (2015) that older head of region in making decisions tends to be more accurate in collecting and analyzing information and can review the decisions made
while avoiding any involvement with crime. The study of Sebaa et al. (2009) discovered that age has no effect on the strategic orientation that leads to improved performance. This is also revealed by Prayitno (2012) which proved that the age of the head of region does not affect the performance of local government.

Different results revealed by Wiersema and Bantel (1982) that age as one of the demographic characteristics of a top manager determines the perspective in strategic decision-making for the company. The higher the age of a corporate manager the more confidence in decision-making he should support leadership in making changes to corporate strategy. This is in line with research by Prasetyo (2014) which showed the age of the head of the region shows wisdom and maturity of a person leading to wiser making-decisions. Based on the above description, it can be developed the first hypothesis as follows:

**H$_1$**: Age of regional head has positive effect towards local government financial performance.

**b. Tenure of Regional Head Towards Local Government Financial Performance**

The office tenure is the time that a person has lived during leading and occupying a position in an organization. The longer the tenure of the head of the region is lived, then the work experience becomes more and more mature. This will result in the head of the region who hold the position longer will use the ability and proper thinking in taking a decision. The results of the study Sebaa et al. (2009) revealed that the tenure of local government manager in Dubai has a positive effect on strategy and performance. Strategy and performance of local government in providing satisfactory public services for the community, including quality and quantity of output, efficiency and effectiveness. Kidwell et al. (1987) proved that managers with longer work experience have a positive effect on ethical decision-making. This is in line with Wiersema and Bantel’s (1992) research which used an executive’s term to predict the outcome of an organization. Based on the above description, it can be developed the second hypothesis as follows:

**H$_2$**: Tenure of regional head has positive effect towards local government financial performance.

**c. Education Level of Regional Head Towards Local Government Financial Performance**

To improve the financial performance of local government, it requires the competence of the regional head. The competence of regional heads can be gained from experience and education. Through education, one can develop his potential, to realize the personality, intelligence and need skills (Wiersema and Bantel, 1992). Education is one of the most influential factors in improving the economic potential of communities, enterprises and countries (Magaoutas et al. 2011). The research results of Magaoutas et al. (2011) revealed that education has a significant effect on economic performance on manufacturing companies in Greece. The higher the level of education a person goes, the more complex the knowledge and skills and experience they have.

Executives with higher education tend to be better at performing activities because they have better cognitive (Hambrick and Mason, 1984). This is reinforced by research conducted by Sebaa et al. (2009) which suggested that higher education will lead to improved performance. Heads of regions with higher levels of education will be able to improve the financial performance of
local governments. Another case with Gottesman and Morey’s (2010) research which revealed that the achieved educational background and the selectivity from which the Chief Executive Officers (CEO) graduated from is not related to financial performance. Based on the description above, it can be developed the third hypothesis as follows:

H₃: Education level has positive effect towards local government financial performance.

d. Regional Head Gender Towards Local Government Financial Performance

Gender is a state that a person is naturally given from birth. The existence of gender in both men and women societies provide a different perception of how men and women face challenges in solving the problems they encounter. This includes how the regional heads of both men and women affect in making decisions / policies in carrying out their duties. Meyers-Levi and Maheswaran (1991) revealed that compared to males, females typically detail more content in information. In addition, women managers in managing organizations are more flexible and more participatory (Meier et al. 2006). Therefore, the existence of female managers is expected to provide better financial performance.

Previous studies include Collin-Dodd et al. (2004), Meier et al. (2006), Esteve et al. (2012), and Jalbert et al. (2013) revealed that the gender of managers influences how managers manage their organizations. Collin-Dodd et al. (2004) revealed that the motivation of women about career and family have positive results on financial performance. In addition, the results of the Jalbert’s research et al. (2013) showed that women managers tend to have better financial performance than male managers. Based on the above explanation, it can be developed a hypothesis as follows:

H₄: Female head of region has positive affect towards local government financial performance.

e. Political Parties Affiliation Towards Local Government Financial Performance

Chaney et al. (2009) suggested that the quality of income reported by politically affiliated companies is lower when compared to companies with no political links. In addition, it was found that the quality of the information presented by the company with political links does not have the ability to predict future circumstances. The quality of the information herein decreases the ability to compete and responds to market demand for more reliable information. Another study conducted by Leuz and Gee (2006) in Indonesia showed that strong political relationships decrease the company’s ability to compete with foreign companies and reduced long-term performance.

Hanafi (2014) found that political parties play a significant role in the effort to produce candidates for regional leaders with integrity and can carry out the mandate of the people through direct elections. With the support from political parties, it is expected that the regional heads who win in the election will have good integrity and competence so that they can produce better performance and fulfill people’s expectation. This research is proxied by political background with the percentage of political parties bearing the head of the region as supported by the number of DPRD members in each region. Based on the description above, it can be developed hypothesis as follows:
H$_2$: Political party affiliation has positive effect towards local government financial performance.

3. Research Methodology

Population used in this research is the entire local governments (Regency and City) in Indonesia. Sampling technique is using purposive sampling method with the following criteria:


b. Regencies/Cities government that provides complete data and information in the Local Government Financial Report (LKPD) required in the study and have been audited by the Supreme Audit Board of the Republic of Indonesia (BPK RI).

c. Regencies/Cities government that has an active / accessible website and present complete information, including data on the composition of political parties supporting the regional head as well as the number of legislative members of Regional House of Representatives (DPRD).

Research equation for the study is as follow

$$\ln(KKD_{i,t}) = \alpha + \beta_1 \text{Age}_{i,t} + \beta_2 \text{Tenure}_{i,t} + \beta_3 \text{Education Level}_{i,t} + \beta_4 \text{Gender}_{i,t}$$

$$+ \beta_5 \text{Political}_{i,t} + \beta_6 \ln(\text{Population}_{i,t}) + \beta_7 \ln(\text{PAD}_{i,t}) + e$$

(KKD$_{i,t}$: Regional Financial Performance i year t
Age$_{i,t}$: Age of regional head i year t
Tenure$_{i,t}$: Tenure of regional head i year t
Education Level$_{i,t}$: Education level of regional head i year t
Gender$_{i,t}$: Gender of regional head i year t
Political$_{i,t}$: Political party affiliation of regional head i year t
lnPopulation$_{i,t}$: Natural Log of regional population i year t
lnPAD$_{i,t}$: Natural Log of Own-Source Revenue i year t
$\alpha$: Constanta
$\beta_1$ ... $\beta_7$: Regression Coefficient
$e$: Standard error

4. Results

Sample of the study consist of 1,100 local government years during 2011 – 2015 period with the 220 unique local government.

Descriptive statistics in this study is a statistical test in general aimed to see the distribution of data from the variables used in the study. Size used in the research is the minimum value, maximum value, average/mean value and deviation standard. Descriptive statistics of this study are presented in Tables 2 and 3.

Based on table 2, the average value of total expenditure is 88.32903. The average value of capital expenditure amounted to 81.93645. Unexpected expenditure is on average of 32.27082. The value indicates that the overall budget absorption of local government in Indonesia is quite favorable. Regional autonomy is on average value of 0.11 indicating that the level of autonomy
Table 2. Descriptive Statistics

<table>
<thead>
<tr>
<th>Variables</th>
<th>Maximum</th>
<th>Minimum</th>
<th>Mean</th>
<th>Std. Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Expenditure</td>
<td>99.68000</td>
<td>15.15000</td>
<td>88.32903</td>
<td>6.632336</td>
</tr>
<tr>
<td>Capital Expenditure</td>
<td>102.3000</td>
<td>8.990000</td>
<td>81.93645</td>
<td>12.14774</td>
</tr>
<tr>
<td>Unexpected Expenditure</td>
<td>98.85000</td>
<td>0.000000</td>
<td>32.27082</td>
<td>32.59362</td>
</tr>
<tr>
<td>Autonomy Ratio</td>
<td>0.768577</td>
<td>0.010921</td>
<td>0.115306</td>
<td>0.116658</td>
</tr>
<tr>
<td>Age</td>
<td>77.00000</td>
<td>31.00000</td>
<td>53.72894</td>
<td>7.268928</td>
</tr>
<tr>
<td>Tenure</td>
<td>10.00000</td>
<td>0.000000</td>
<td>4.175218</td>
<td>2.668595</td>
</tr>
<tr>
<td>Politic</td>
<td>0.766667</td>
<td>0.000000</td>
<td>0.334396</td>
<td>0.179648</td>
</tr>
<tr>
<td>Population (value in thousand)</td>
<td>3534114.0</td>
<td>16318.00</td>
<td>533572.3</td>
<td>571905.0</td>
</tr>
<tr>
<td>PAD (value in million Rupiahs)</td>
<td>1859695.0</td>
<td>5020.38</td>
<td>144586.2</td>
<td>218971.4</td>
</tr>
</tbody>
</table>

Table 3. Frequency Distribution

<table>
<thead>
<tr>
<th>Variable</th>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education Level</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Senior High School</td>
<td>57</td>
<td>5.1</td>
</tr>
<tr>
<td>Bachelor Degree or higher</td>
<td>1058</td>
<td>94.9</td>
</tr>
<tr>
<td>Gender</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Female</td>
<td>48</td>
<td>4.3</td>
</tr>
<tr>
<td>Male</td>
<td>1067</td>
<td>95.7</td>
</tr>
</tbody>
</table>

in local government in Indonesia is still low. The local government is still dependent on transfer funds from the central government. Further section discusses the regression result.

This study results revealed that age has a positive effect on the financial performance of local governments, especially total spending and unexpected expenditures so that hypothesis (H1) is accepted. The results of this study contradict the research of Sebaa et al. (2009) which shows that age has no effect on the strategic orientation leading to improved performance. The same thing is also found by Prayitno (2012) that the age of the head of the region does not affect local government performance. The results of this study are consistent with Wiersema and Bantel (1982) that found age as one of the demographics of a top manager determines the perspective in strategic decision-making company. The higher the age of a corporate manager, the more confident the decision-making to support leadership in making changes to corporate strategy. Prasetyo (2014) shows that the age of the head of the region shown one’s maturity, thus one is wiser in making decisions.

Tenure has a negative effect on local government financial performance, especially capital expenditures, unexpected expenditures and self-reliance ratios, so the hypothesis (H2) is rejected. The results of this study are not in line with Kidwell et al. (1987) research which proves that managers with longer work experience have a positive effect on ethical decision-making. This is in line with Wiersema and Bantel (1992) research which uses an executive’s term to predict the outcome of an organization.

The level of education has a positive effect on the financial performance of local governments, especially on unexpected expenditures so that the hypothesis (H3) is accepted. The results of this study are consistent with the study of Magaoutas et al. (2011) revealed that education influence much on economic performance on manufacturing companies in Greece. The higher the level of education a person, the more complex the knowledge and skills and experience he/she has. Sebaa et al. (2009) suggest that higher education will lead to improved performance. Heads of regions with higher levels of education will be able to improve the financial performance of local governments.
Table 4. Panel Data Regression Test Results

<table>
<thead>
<tr>
<th>Variables</th>
<th>Total Expenditure</th>
<th>Capital Expenditure</th>
<th>Unexpected Expenditure</th>
<th>Autonomy Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>α constant</td>
<td>116.979</td>
<td>-173.889</td>
<td>-492.999</td>
<td>-2.147</td>
</tr>
<tr>
<td>Age</td>
<td>0.076***</td>
<td>0.223</td>
<td>0.865***</td>
<td>0.000</td>
</tr>
<tr>
<td>Tenure</td>
<td>-0.088**</td>
<td>0.397</td>
<td>-2.439***</td>
<td>-0.002**</td>
</tr>
<tr>
<td>Education level</td>
<td>0.690</td>
<td>-6.753</td>
<td>45.980***</td>
<td>0.007</td>
</tr>
<tr>
<td>Gender</td>
<td>-1.099</td>
<td>-5.072</td>
<td>-30.330***</td>
<td>-0.011</td>
</tr>
<tr>
<td>Politics</td>
<td>-1.589**</td>
<td>-10.715</td>
<td>34.404***</td>
<td>-0.053**</td>
</tr>
<tr>
<td>Population (log)</td>
<td>5.666***</td>
<td>43.472*</td>
<td>-69.042*</td>
<td>0.135*</td>
</tr>
<tr>
<td>PAD (log)</td>
<td>-5.859***</td>
<td>1.232</td>
<td>-15.648***</td>
<td>0.142***</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Testing Model</th>
<th>Random</th>
<th>Fixed</th>
<th>Fixed</th>
<th>Fixed</th>
</tr>
</thead>
<tbody>
<tr>
<td>F-Test</td>
<td>12.455</td>
<td>3.536</td>
<td>3.549</td>
<td>81.343</td>
</tr>
<tr>
<td>Prob.</td>
<td>0.000***</td>
<td>0.000***</td>
<td>0.000***</td>
<td>0.000***</td>
</tr>
<tr>
<td>Adjusted R²</td>
<td>0.069</td>
<td>0.344</td>
<td>0.355</td>
<td>0.943</td>
</tr>
<tr>
<td>Observation (N)</td>
<td>1085</td>
<td>1096</td>
<td>1048</td>
<td>1093</td>
</tr>
</tbody>
</table>

Desc: *, **, *** Significant on 10%, 5%, 1%

Heads of regions gender negatively affect the financial performance of local governments, especially on unexpected expenditures, so the hypothesis (H4) is rejected. This shows that the heads of women and men have no effect on the financial performance of local governments. The results of this study are different from those of Collin-Dodd et al. (2004) which revealed that women’s desire for career and family has a positive result on financial performance. In addition, Jalbert et al. (2013) show that women managers tend to have better financial performance than male managers.

Affiliation of political parties negatively affected the financial performance of local governments, especially on capital expenditure so that the hypothesis (H5) is rejected. The results of this study are not in line with Hanafi’s (2014) research results which revealed that political parties play a significant role in the effort to produce candidates for regional leaders with integrity and can carry out the mandate of the people through direct elections. With the support from political parties, it is expected that the regional heads who win the election to have good integrity and competence so that they can produce better performance and can fulfill the people’s expectation.

5. Conclusion

The result of the study shows the importance of head of region characteristics to explain local government performance. Age has a positive effect on local government financial performance. Conversely, political party affiliation and tenure have negative effect on local government financial performance.

The results of this study have implications for local governments in terms of budget preparation for operating expenditures, capital expenditures and unexpected expenditures should be prepared before the current budget year and consider inputs from various parties as encompassed in Regional Development and Planning Forum. With earlier and better planning, operating expenditures, unexpected expenditure, and capital expenditures can be implemented
so that benefits can be immediately realized by the society. Associated with the level of regional autonomy, local governments should explore more potential of natural resources owned by each region and not always depend on budget transfers from the central government alone. Political parties should be more selective in choosing prospective candidates of regional heads that carried in the regional head election. Criteria of integrity, quality, credibility and leadership must be considered compared to capital money.

References


