

# The Impact of Leverage, Equalization Funds, and Capital Expenditures on the Financial Performance of Regency and City Governments in South Sumatra Province, 2020-2024

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## ABSTRACT

*This study aims to examine and analyze the influence of leverage, equalization funds, and capital expenditures on the financial performance of regency and city governments in South Sumatra Province over the 2020-2024 period. Financial performance was assessed using the local government financial autonomy ratio as the primary measurement indicator. The research population and sample encompass all 17 regencies and cities in South Sumatra Province, observed across a five-year period, resulting in a total of 85 data points. Secondary data were utilized, sourced from Budget Implementation Reports (LRA) and regional balance sheets obtained through the official website of the Directorate General of Fiscal Equalization (DJPK) of the Ministry of Finance of the Republic of Indonesia. The findings reveal that, when examined individually, leverage exerts a negative and significant influence on local government financial performance; equalization funds likewise demonstrate a negative and significant effect on local government financial performance; while capital expenditures produce a positive and significant effect on local government financial performance. When assessed jointly, the three variables simultaneously demonstrate a statistically significant collective influence on the financial performance of regency and city governments in South Sumatra Province throughout the 2020–2024 period.*

## A. INTRODUCTION

As an archipelagic nation, Indonesia has adopted a decentralized governance model in which local governments are entrusted with greater fiscal authority and budgetary responsibilities. This expanded authority, formally established through Law No. 23 of 2014, aims to enhance the quality of public services and promote community welfare at the regional level. The devolution of regional autonomy is expected to drive improvements in efficiency, effectiveness, and public sector accountability (Syaukani HR et al., 2022). Nevertheless, the successful implementation of regional autonomy remains contingent upon the institutional readiness and financial management capabilities of each local government (Doroh et al., 2021).

Regional financial management—encompassing the planning, budgeting, execution, administration, supervision, and accountability of the Regional Budget (APBD)—must adhere to the principles of transparency, accountability, and public participation, as mandated by Government Regulation No. 12 of 2019. Evidence of this accountability is reflected in the preparation of the Local Government Financial Report (LKPD), which must conform to the Government Accounting Standards stipulated in Government Regulation No. 71 of 2010. Within this framework, periodic evaluations of local government financial performance are essential, and the local financial autonomy ratio serves as a key benchmark for assessing financial management outcomes within a given budget cycle (Insani et al., 2023).



A persistent challenge confronting regency and city governments across South Sumatra Province is the low level of fiscal autonomy, coupled with an excessive reliance on central government transfer funds, which significantly constrains their flexibility in determining local development priorities. This situation has escalated into a concern at the provincial level, with the South Sumatra Provincial Government calling on all regencies and cities in December 2024 to intensify efforts in mobilizing locally generated revenue and reducing fiscal dependence on central transfers (Suara Sumsel News, 2024). Furthermore, NEXT Indonesia Center (2026) reported that South Sumatra Province experienced a decline in its fiscal autonomy classification, shifting from the "Self-Reliant" category to "Moving Toward Self-Reliance" during the 2023–2024 period.

This persistently weak financial performance is shaped by a combination of factors, among which leverage, equalization funds, and capital expenditures have been identified as particularly influential (Putri & Priyadi, 2021). In the context of local government, leverage captures the degree to which a government relies on external debt financing to fund its operational and development activities. Equalization funds, on the other hand, reflect the extent of a region's fiscal dependency on transfers from the central government. Capital expenditures, meanwhile, represent government investment in fixed asset acquisition and infrastructure development, both of which are anticipated to catalyze local economic growth and strengthen fiscal capacity over time.

Prior studies have yielded inconsistent findings regarding the effects of these three variables on local government financial performance. With respect to leverage, Aisyah et al. (2026) reported a positive and significant effect, whereas Putri & Priyadi (2021) arrived at the opposite conclusion. Concerning equalization funds, Ramadhanty & Yulsiati (2022) found a positive effect, while Putri & Amanah (2020) identified a negative one. Regarding capital expenditures, Putri & Priyadi (2021) documented a significant positive effect, whereas Natalia & Suprpto (2023) found no significant effect. These contradictory findings underscore the need for further empirical investigation, particularly within the specific context of regencies and cities in South Sumatra Province for the 2020–2024 period.

Motivated by the aforementioned gaps and empirical inconsistencies, this study is designed to empirically investigate the extent to which leverage, equalization funds, and capital expenditures — both individually and collectively — shape the financial performance of regency and city governments throughout South Sumatra Province during the 2020–2024 observation window.

## B. THEORETICAL STUDY

This study is grounded in fiscal federalism theory, as developed by Oates (1999), which examines the optimal allocation of fiscal authority and expenditure responsibilities between central and subnational governments. In the Indonesian context, fiscal decentralization adheres to the principle of money follow function, which calls for harmonization between the delegation of governmental authority (expenditure assignment) and the corresponding allocation of revenue sources (revenue assignment) to local governments (Irmawati & Kawedar, 2025). However, research by Latifa et al. (2025) found that high fiscal dependency on central government transfers—comprising the General Allocation Fund, Special Allocation Fund, and Revenue-Sharing Fund—is indicative of weak fiscal autonomy at the regional level and fails to incentivize local governments to develop their own revenue base.

Elevated leverage indicates a high degree of dependence on external debt financing, while a dominant share of equalization funds in the revenue structure reflects significant reliance on central fiscal transfers. Both conditions point to a diminished capacity for fiscal self-sufficiency. Conversely, well-targeted capital expenditure reflects a proactive effort by local governments to strengthen their economic base and long-term fiscal capacity. This theoretical framework therefore provides a relevant foundation for explaining why leverage, equalization funds, and capital expenditures may influence local government financial performance as measured by the financial autonomy ratio.

Local government financial performance refers to the level of achievement in managing regional finances, encompassing both revenue and expenditure over a single budget period, and can be assessed through ratio-based financial indicators applied to the APBD (Pangestu, 2023). In this study, financial performance is proxied by the local financial autonomy ratio—defined as the ratio of total locally generated revenue (PAD) to the sum of central government transfers, provincial transfers, and loans. This ratio reflects the degree to which a region is fiscally self-reliant and indicates its level of dependence on external financial assistance, particularly from the central government (Wulandari et al., 2023). The criteria used to classify levels of local government financial autonomy are presented in Table:

**Table of Regional Financial Autonomy Criteria**

| Percentage of Autonomy | Financial Performance Capacity | Relationship Pattern |
|------------------------|--------------------------------|----------------------|
| 0-25%                  | Very Low                       | Instructive          |
| 25-50%                 | Low                            | Consultative         |
| 50-75%                 | Moderate                       | Participatory        |
| 75-100%                | High                           | Delegative           |

**Source: Mahmudi (2019)**

Within the framework of local government finance, leverage refers to the extent to which a regional government depends on debt-based financing relative to its total equity, operationalized in this study through the Debt-to-Equity Ratio (DER). When managed prudently, leverage can serve as a complementary financing instrument that enables local governments to sustain operational activities and pursue infrastructure development without being wholly reliant on internally generated revenue (Mahmudi, 2019). Equalization funds, as mandated under Law No. 1 of 2022, represent intergovernmental fiscal transfers disbursed from the national budget (APBN) to regional governments with the primary objective of supporting the implementation of fiscal decentralization across Indonesia; these funds encompass Revenue-Sharing Funds, General Allocation Funds, and Special Allocation Funds. For the purposes of this study, equalization funds are quantified using the dependency ratio, expressed as the proportion of total equalization funds to total regional revenue. In this study, capital expenditures are transformed using the natural logarithm (Ln) of total realized regional capital expenditures to normalize the data distribution.

Drawing on the theoretical framework and prior empirical evidence, the hypotheses proposed in this study are as follows: (H1) leverage has a negative and significant effect on local government financial performance; (H2) equalization funds have a negative and significant effect on local government financial performance; (H3) capital expenditures have a positive and significant effect on local government financial performance; and (H4) leverage, equalization funds, and capital expenditures simultaneously exert a significant effect on the financial performance of regency and city governments in South Sumatra Province for the 2020–2024 period.

### C. RESEARCH METHODS

The research objects comprise all regency and city governments within South Sumatra Province. Accordingly, the sample consists of all 17 regencies and cities in South Sumatra Province observed over a five-year period spanning 2020 to 2024, yielding a total of 85 observation units.

The dependent variable in this study is local government financial performance (Y), operationalized through the local financial autonomy ratio, which represents the proportion of total locally generated revenue (PAD) relative to the combined total of central government transfers, provincial transfers, and regional loans. The independent variables consist of three measures: leverage (X1), quantified using the Debt-to-Equity Ratio (DER), which captures the proportion of total liabilities to total equity; equalization funds (X2), measured through the dependency ratio, representing the share of total equalization funds in total regional revenue;



and capital expenditures (X3), transformed using the natural logarithm (Ln) of total realized local government capital expenditures to normalize the data distribution across regions.

#### D. RESULTS AND DISCUSSION

The normality assumption was verified through the One-Sample Kolmogorov-Smirnov Test, which produced an Asymp. Sig. (2-tailed) value of 0.200, exceeding the 0.05 threshold and confirming that the residuals are normally distributed. Multicollinearity was assessed by examining Tolerance and VIF values; all independent variables recorded Tolerance figures above 0.10 and VIF figures below 10.00, ruling out multicollinearity concerns. The Glejser test was employed to detect heteroscedasticity, and all independent variables returned significance values above 0.05, indicating homoscedastic residuals. Finally, the Durbin-Watson statistic of 1.085 — falling within the acceptable range of -2 to +2 — confirmed the absence of autocorrelation (Ghozali, 2021).

**Table of Descriptive Statistic**

|                                    | N  | Minimum   | Maximum  | Mean       | Std. deviation |
|------------------------------------|----|-----------|----------|------------|----------------|
| X1 Leverage                        | 85 | -11.94758 | 12.24448 | 3.0577613  | 3.29304687     |
| X2 Equalization Fund               | 85 | 54046     | .63934   | .6089073   | .01805566      |
| X3 Capital Expenditures            | 85 | 25.84862  | 27.85488 | 26.7699979 | .49479981      |
| Y Government Financial Performance | 85 | .010578   | .059162  | 0.327929   | 0.089003       |
| Valid N (listwise)                 | 85 |           |          |            |                |

**Source: Processed data output (SPSS 26), 2026**

As shown in the descriptive statistics table, the local government financial performance variable (Y) exhibits a mean of 0.328 or 32.8%, placing most regencies and cities in South Sumatra Province within the consultative autonomy category and highlighting their substantial reliance on central government fiscal transfers. The leverage variable (X1) records a mean of 3.058 with a standard deviation of 3.293, signifying considerable heterogeneity in debt management practices across the sampled regions. The equalization fund variable (X2) averages 0.609 or 60.9% of total regional revenue, affirming that the dominant portion of local government income continues to be sourced from central government transfers rather than locally mobilized revenue. The capital expenditure variable (X3) registers a mean of 26.770 in natural logarithmic form with a standard deviation of 0.495, reflecting a relatively even distribution of capital expenditure allocations across regencies and cities during the study period. Further results of the coefficient of determination test, F-test, and t-test are presented in the following tables.

**Table of Coefficient of Determination Test**

| Model | R                 | R Square | Adjusted R Square | Std. Error of the Estimate | Durbin-Watson |
|-------|-------------------|----------|-------------------|----------------------------|---------------|
| 1     | .634 <sup>a</sup> | .402     | .380              | .070070                    | 1.085         |

**Source: Processed data output (SPSS 26), 2026**

**Simultaneous Test Table (F-Test)**

| Model        | Sum of Square | df | Mean Square | f      | Sig               |
|--------------|---------------|----|-------------|--------|-------------------|
| 1 Regression | .268          | 3  | .089        | 18.176 | .000 <sup>b</sup> |
| Residual     | .398          | 81 | .005        |        |                   |
| Total        | .665          | 84 |             |        |                   |

**Source: Processed data output (SPSS 26), 2026**

**Partial Test Table (T-Test)**

| Model                   | t      | Sig  | Conclusion                                                      |
|-------------------------|--------|------|-----------------------------------------------------------------|
| X1 Leverage             | -3.118 | .003 | H1: has a negative and significant effect (Hypothesis accepted) |
| X2 Equalization Fund    | -4.940 | .000 | H2: has a negative and significant effect (Hypothesis accepted) |
| X3 Capital Expenditures | 2.817  | .006 | H3: has a positive and significant effect (Hypothesis accepted) |

**Source: Processed data output (SPSS 26), 2026**

Based on the results of the coefficient of determination test, the Adjusted R-Square value of 0.380 indicates that the three independent variables collectively explain 38.0% of the variation in local government financial performance, while the remaining 62.0% is attributable to other variables beyond the scope of this study. The results of the simultaneous test (F-test) yielded a calculated F-value of 18.176 with a significance level of  $0.000 < 0.05$ ; therefore, it can be concluded that leverage, equalization funds, and capital expenditures collectively exert a significant effect on local government financial performance, and H4 is accepted. The regression equation obtained is  $Y = 0.459 - 0.008X_1 - 2.228X_2 + 0.047X_3$ .

Findings from the partial significance test (t-test) reveal that leverage (X1) yields a t-statistic of -3.118 at a significance level of 0.003, which falls below the 0.05 threshold, thereby establishing that leverage exerts a statistically significant negative influence on local government financial performance and warranting the acceptance of H1. This outcome implies an inverse relationship between regional leverage and fiscal autonomy. From the perspective of fiscal federalism theory, this condition reflects that local governments have become increasingly reliant on external debt financing rather than optimizing their own locally generated revenue, thereby narrowing their fiscal space and undermining their capacity to independently finance public services (Oates, 1999). These results are consistent with the study by Putri & Priyadi (2021), but are inconsistent with the study by Aisyah et al. (2026). The equalization fund variable (X2) registers a t-statistic of -4.940 at a significance level of 0.000, well below the 0.05 criterion, confirming a negative and statistically significant effect on local government financial performance and leading to the acceptance of H2. This result implies that regions with a higher share of equalization funds in their revenue composition tend to exhibit lower levels of fiscal self-sufficiency. This outcome is theoretically coherent within the fiscal federalism framework, as equalization funds averaging 60.9% of total local governments to mobilize their own revenue sources; consequently, the autonomy ratio as a proxy for financial performance continues to deteriorate (Latifa et al., 2025). These results are consistent with the studies by Putri & Amanah (2020) and Prastiwi & Aji (2020), but are inconsistent with the study by Ramadhanty & Yulsiati (2022).

The capital expenditure variable (X3) produces a t-statistic of 2.817 at a significance level of 0.006, which is below the 0.05 significance threshold, confirming that capital expenditure exerts a positive and statistically significant effect on local government financial performance, thus H3 is accepted. This finding implies that regions with higher realized capital expenditure tend to achieve greater levels of fiscal autonomy. Within the fiscal federalism framework, capital expenditures directed toward infrastructure development and the acquisition of local fixed assets serve as a means of strengthening the regional economic base, gradually stimulating local economic growth, broadening the tax base, and augmenting locally generated revenue (PAD) over the long term, which ultimately contributes to an improvement in the financial autonomy ratio as a proxy for local government financial performance (Oates, 1999). These results are consistent with the study by Putri & Priyadi (2021), but are inconsistent with the study by Natalia & Suprpto (2023).

## E. CONCLUSION AND SUGGESTIONS

### Conclusion



The empirical evidence gathered through this investigation yields the following conclusion. First, leverage exerts a negative and statistically significant effect on local government financial performance in South Sumatra Province for the 2020-2024 period, as substantiated by a t-statistic of -3.118 and a p-value of 0.003. Second, equalization funds demonstrate a negative and statistically significant effect on local government financial performance, corroborated by a t-statistic of -4.940 and a p-value of 0.000. Third, capital expenditure produces a positive and statistically significant effect on local government financial performance, corroborated by a t-statistic of 2.817 and a p-value of 0.006. Finally, when considered jointly, leverage, equalization funds, and capital expenditures collectively exert a statistically significant influence on the financial performance of regency and city governments across South Sumatra Province for the 2020-2024 period, as supported by an F-statistic of 18.176 and a p-value of 0.000, suggesting that higher investment in infrastructure and fixed assets contributes to the expansion of the local revenue base and strengthens fiscal autonomy over time.

### Suggestions

Drawing from the research outcomes, several practical recommendations are offered. Regional administrations across South Sumatra Province are advised to adopt a more cautious approach to liability management, ensuring that leverage levels do not escalate to a point that compromises fiscal autonomy. Concurrently, local governments should actively pursue revenue diversification strategies, including the intensification of local taxation, optimization of regional levies, and productive utilization of locally owned assets, so as to diminish structural reliance on equalization fund transfers. With respect to capital expenditure, regional administrations are encouraged to strengthen planning rigor and supervisory mechanisms to ensure that infrastructure investments yield measurable and sustained contributions to local economic development and fiscal self-reliance. For the academic community, subsequent investigations are encouraged to broaden the variable scope, extend the geographical coverage beyond South Sumatra Province, and lengthen the observation window to enhance the generalizability of findings.

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