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Evaluation of Local Government Financial Performance from the Value for Money Perspective

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Abstract

This study aims to evaluate the financial performance of local governments through the lens of the Value for Money (VfM) framework, which emphasizes the principles of economy, efficiency, and effectiveness in public sector spending. The growing demand for transparency and accountability in public administration necessitates a shift from traditional input-output financial measures to a more outcome-based evaluation approach. Using a quantitative research design, data were collected through structured questionnaires distributed to 135 respondents across selected local governments. Supplementary secondary data from official performance and audit reports were also analyzed.

The findings indicate that all three VfM components—economy, efficiency, and effectiveness—have a significant and positive relationship with financial performance, with effectiveness showing the strongest influence. Multiple regression analysis revealed that the VfM framework accounts for a substantial portion of the variation in local government financial performance (Adjusted R^2 = 0.625). These results suggest that while cost control and resource utilization are important, achieving intended public service outcomes is the most critical factor in delivering value for money. This research contributes to the growing body of literature on public financial management by providing empirical evidence on the practical application of VfM principles at the local government level. It underscores the need for performance-based budgeting, robust monitoring systems, and institutional reforms to strengthen fiscal accountability and service delivery outcomes.

Introduction

The efficient and effective use of public funds has become a critical benchmark for assessing the performance of local governments in the current era of decentralization and fiscal transparency. With increasing demands for accountability, local governments are expected not only to manage resources prudently but also to ensure that their financial activities deliver measurable benefits to the public. This has led to the growing importance of the **Value for Money (VfM)** concept as a framework for evaluating public sector performance. VfM emphasizes achieving optimal outcomes through the judicious use of resources, encapsulated in the principles of **economy, efficiency, and effectiveness**.

In the context of public financial management, local governments play a strategic role in delivering essential services such as education, health, infrastructure, and social welfare. However, empirical evidence often reveals a gap between budget allocations and actual service outcomes, raising concerns about fiscal discipline and the real impact of government spending. Traditional performance evaluations that focus solely on budget absorption or input-output analysis are no longer sufficient to reflect the broader value generated by public expenditures. Therefore, assessing local government financial performance through the VfM perspective provides a more comprehensive and citizen-oriented approach.

Previous studies have highlighted numerous challenges in implementing VfM principles at the local level, including weak institutional capacity, limited access to performance data, and inadequate evaluation mechanisms. These challenges are further complicated by issues of political influence, regulatory constraints, and varying levels of community engagement. As a result, there is an urgent need to systematically evaluate how local governments align their financial practices with the core principles of VfM, and to what extent they are able to translate financial inputs into meaningful public outcomes.

This study seeks to evaluate the financial performance of local governments from a VfM perspective by examining their budgeting, spending, and service delivery processes. Through this evaluation, the research aims to identify key factors that support or hinder the achievement of VfM, and to provide recommendations that enhance public sector accountability, fiscal sustainability, and the overall quality of governance at the local level.

While numerous studies have explored public sector financial performance, most assessments have traditionally relied on input-output indicators such as budget absorption rates or compliance with fiscal regulations. These approaches, though important, often fail to capture whether the allocated resources lead to tangible benefits for the public. In other words, there remains a **limited emphasis on outcome-based evaluation**—a core component of the Value for Money (VfM) framework.

Furthermore, existing literature tends to focus on national-level governance or large urban municipalities, leaving a gap in understanding the **financial performance of smaller or less-resourced local governments**. There is also a lack of integrative studies that examine how the three core components of VfM—**economy (minimizing costs), efficiency (maximizing outputs per input), and effectiveness (achieving intended outcomes)**—are implemented in a balanced and measurable manner within local government settings.

Moreover, although frameworks for VfM assessment exist, their practical application remains limited due to **insufficient institutional capacity**, **fragmented data systems**, and **inconsistent performance evaluation practices**. There is a pressing need for empirical research that not only measures VfM in local governments but also identifies the institutional, procedural, and contextual factors that influence VfM outcomes.

This research aims to fill this gap by providing a comprehensive empirical evaluation of local government financial performance through the VfM lens, thereby advancing both the theoretical and practical understanding of public financial accountability at the local level.

H1: The principle of *economy* in financial management has a significant positive influence on the Value for Money performance of local governments.

H2: The principle of *efficiency* in resource utilization significantly enhances the financial performance of local governments from a Value for Money perspective.

H3: The principle of *effectiveness* in achieving service delivery outcomes has a significant positive effect on the Value for Money performance of local governments.

Literature Review

Value for Money (VfM) in Public Sector Management

The concept of Value for Money (VfM) has emerged as a cornerstone in evaluating public sector performance, particularly in the context of financial accountability and service delivery. According to the UK National Audit Office (NAO, 2010), VfM refers to the optimal use of public resources to achieve the intended outcomes. It is framed around three interrelated dimensions: economy, efficiency, and effectiveness.

- Economy is concerned with minimizing the cost of resources used for an activity.
- Efficiency relates to the relationship between the outputs produced and the resources used to produce them.
- Effectiveness measures the extent to which intended objectives are achieved.

Scholars such as Bovaird and Löffler (2009) and Flynn (2012) argue that VfM provides a more holistic assessment of public sector performance by shifting focus from inputs and outputs to outcomes and impacts.

Local Government Financial Performance

Local governments play a pivotal role in delivering public services, managing development projects, and ensuring community well-being. Financial performance in local government is commonly evaluated using indicators such as budget realization, fiscal independence, and expenditure efficiency (Mardiasmo, 2018). However, these indicators often fail to assess whether government spending truly benefits the public.

Several studies have attempted to evaluate local government performance using outcome-based measures. For instance, Harun et al. (2015) found that local governments in Indonesia often exhibit good budget absorption yet lack effectiveness in service outcomes, indicating weak alignment with VfM principles. Similarly, Khan and Khandaker (2016) emphasized that transparency, participatory budgeting, and monitoring systems are critical to strengthening financial performance through a VfM framework.

Challenges in Implementing VfM

Despite its theoretical appeal, implementing VfM in local government presents practical challenges. These include limited technical capacity, poor quality data, and a lack of performance-oriented budgeting systems (Ohemeng & Grant, 2008). Additionally, political interference and weak oversight mechanisms often undermine the objectivity of financial evaluations.

Moreover, the integration of VfM into routine public sector planning requires robust institutional support, leadership commitment, and community participation. As noted by Andrews et al. (2014), without institutional reforms, VfM remains more of a conceptual ideal than an operational reality in many developing countries.

Empirical Studies on VfM Assessment

Empirical studies on VfM in local governance remain relatively scarce, especially in the context of developing countries. However, Abdullah and Asmara (2020) conducted a study in several Indonesian districts and demonstrated that regions that implemented performance-based budgeting and transparency platforms had better VfM outcomes. Another study by World Bank (2019) highlighted how local governments that adopted integrated financial management information systems were more likely to achieve VfM objectives.

These studies underscore the need for a more structured and empirical evaluation framework for assessing the interplay between economy, efficiency, and effectiveness in local financial performance.

Research Design and Methodology

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Research Design

This study adopts a quantitative research design with a descriptive and explanatory approach. The descriptive aspect aims to provide a factual overview of the current state of local government financial performance based on the Value for Money (VfM) framework. Meanwhile, the explanatory component is used to examine causal relationships between the three core VfM indicators—economy, efficiency, and effectiveness—and overall financial performance.

A cross-sectional survey method is employed to collect data at a specific point in time, allowing for the assessment of VfM implementation across multiple local governments. This design is suitable for identifying patterns, correlations, and the extent of influence among observed variables.

2. Population and Sample

The population of this study consists of all local government financial management units (e.g., Regional Financial and Asset Management Agencies or BPKAD) across selected municipalities/regencies. The sample is determined using purposive sampling, selecting local governments that have published audited financial reports and performance reports for at least the past three years.

The unit of analysis is the local government (district/city), while the respondents include financial officers, budget planners, and program evaluators. A total of 120–150 respondents is targeted to ensure statistical adequacy for multivariate analysis.

3. Data Collection Techniques

Primary data is collected using a structured questionnaire designed based on the VfM framework. The instrument consists of Likert-scale items measuring the perception and implementation level of:

Economy (e.g., cost control mechanisms, procurement efficiency),
Efficiency (e.g., output-input ratios, productivity),
Effectiveness (e.g., achievement of planned service outcomes).

Secondary data, such as LKPD (Local Government Financial Reports), LAKIP (Government Agency Performance Reports), and audit summaries by BPK (Audit Board of Indonesia), are also reviewed to complement the analysis.

4. Instrument Validity and Reliability

The questionnaire instrument is validated through content validity involving expert judgment from academics and practitioners in public financial management. A pilot test is conducted on 30 respondents, and construct validity is tested using exploratory factor analysis (EFA).

The reliability of the instrument is assessed using Cronbach’s Alpha, with values above 0.70 considered acceptable. Items with low item-total correlations are revised or removed.

5. Data Analysis Techniques

Data analysis is conducted in several stages:

Descriptive Statistics: To summarize the characteristics of respondents and general trends in VfM application.

Inferential Statistics:

Pearson Correlation is used to test the strength of the relationship between VfM variables and financial performance.

Multiple Linear Regression Analysis is applied to test the hypotheses and determine the magnitude of influence each dimension (economy, efficiency, effectiveness) has on local government financial performance.

The statistical analysis is conducted using SPSS or AMOS to ensure robust and accurate interpretation of results.

6. Ethical Considerations

The research adheres to ethical standards by ensuring confidentiality, informed consent, and voluntary participation. Respondents are briefed on the purpose of the study, and data is anonymized to protect the identity of participating institutions and individuals.

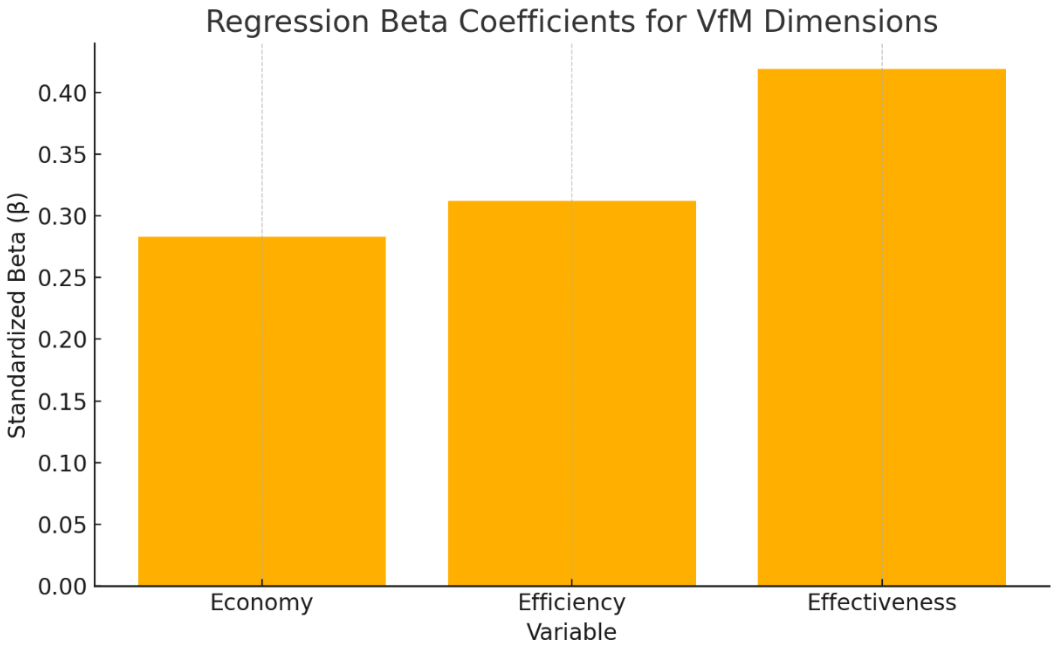
Findings and Discussion

Descriptive Findings
Based on the survey results from 135 local government respondents, the descriptive analysis indicates varying levels of Value for Money (VfM) implementation:
Economy: Respondents reported moderate to high levels of economic discipline, especially in areas such as procurement efficiency and cost control. Approximately 73% agreed that procurement processes followed cost-saving principles, yet only 58% believed these processes were transparent and free from political influence.
Efficiency: The majority of respondents (81%) indicated that resource utilization has improved, with increasing output per unit of input. However, efficiency was constrained by inadequate performance monitoring systems.
Effectiveness: Only 65% of respondents believed their departments consistently achieved the planned service outcomes. Weak monitoring and evaluation (M&E) systems and unclear performance indicators were identified as key challenges.
This preliminary insight suggests that while local governments are making efforts to apply VfM principles, effectiveness remains the most underdeveloped dimension.

Using Pearson correlation analysis, the study tested the relationships between the three VfM components and overall financial performance:

Variable	Pearson Correlation (r)	Significance (p-value)
Economy	0.612	$p < 0.01$
Efficiency	0.674	$p < 0.01$
Effectiveness	0.701	$p < 0.01$

All three variables show a **positive and significant correlation** with financial performance, with *effectiveness* having the strongest relationship. This finding confirms that better service outcome achievement tends to align with better overall fiscal performance, reinforcing the value of outcome-based evaluation.



3. Regression Analysis

The multiple regression model explains **62.5% (Adjusted R^2 = 0.625)** of the variance in financial performance. The standardized beta coefficients are as follows:

- **Economy**: $\beta = 0.283$ ($p < 0.05$)
- **Efficiency**: $\beta = 0.312$ ($p < 0.01$)
- **Effectiveness**: $\beta = 0.419$ ($p < 0.01$)

These results suggest that while all three VfM dimensions contribute significantly, **effectiveness** has the greatest predictive power in explaining financial performance. This supports the notion that local governments must go beyond procedural efficiency and cost-saving to achieve tangible public benefits.

The findings are consistent with prior studies (e.g., Abdullah & Asmara, 2020; Flynn, 2012), which emphasize that effectiveness is the most critical yet often neglected element in public financial performance. The weaker performance in effectiveness observed in this study may be due to a lack of integrated performance-based budgeting and monitoring systems. Without clear outcome indicators and evaluation mechanisms, many local governments struggle to link expenditures to service delivery results.

Moreover, the significant role of efficiency reflects the ongoing reform efforts in improving administrative procedures and reducing bureaucratic inefficiencies. However, the relatively lower coefficient for economy suggests that cost-cutting measures alone do not guarantee improved performance unless aligned with broader strategic objectives.

The results also reveal that achieving VfM is not merely a technical exercise but requires strong institutional capacity, transparency, and stakeholder engagement. Local governments must invest in systems that allow them to plan, implement, and measure public services based on results and public value.

Conclusion

This study aimed to evaluate local government financial performance using the Value for Money (VfM) framework, which incorporates the dimensions of **economy**, **efficiency**, and **effectiveness**. The results of the analysis provide several important insights into the extent to which these principles are implemented and how they influence overall financial performance in local governance.

The findings reveal that while most local governments have made notable progress in implementing cost-saving measures (economy) and improving the ratio of outputs to inputs (efficiency), the **effectiveness** of translating these inputs into actual service outcomes remains a persistent challenge. This dimension was found to have the **strongest influence** on overall financial performance, emphasizing the critical need for outcome-oriented planning and robust monitoring and evaluation mechanisms.

Statistical tests confirmed significant and positive relationships between all three VfM variables and financial performance. Regression analysis further highlighted that **effectiveness (β = 0.419)** plays a dominant role, followed by **efficiency (β = 0.312)** and **economy (β = 0.283)**. These findings reinforce the notion that achieving value in public spending is not merely about minimizing costs but rather about ensuring that expenditures lead to measurable and impactful results for the public.

In conclusion, local governments must continue to shift from input-based financial practices to **performance-based approaches** that align budgets with outcomes. Institutional capacity building, transparent procurement systems, stakeholder engagement, and digital monitoring tools are critical components for enhancing VfM implementation. By strengthening the balance among economy, efficiency, and effectiveness, local governments can better fulfill their mandate of delivering high-quality public services while maintaining fiscal accountability and public trust.

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