

Factors Influencing Financial Health of Local Government's Unit in Gandaki Province of Nepal

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Abstract - Studies on local government's financial health are focused on developing tools for detecting and avoiding potential financial problems of the municipalities of Gandaki province of Nepal. This research seeks to examine the factors that influence the financial health of municipalities in the Gandaki province of Nepal. Using primary data from a structured questionnaire sample of 196 respondents, this research tries to explore the factors that influence Local Government (LG's) financial health. Different factors, namely, structural factors, economic capacity, governance factors, external factors and financial performance by following the relevant literature on local government financial health. Cronbach's alpha is more than 0.70 for all the factors except structural factor, that is, 0.68 which reveals that the instrument provides enough reliability for measuring the proposed issues. The mean financial performance is found high in domain quality of service offered with a mean of 3.86 and SD 0.710, followed by the cost of public service (3.82±0.902). The correlation matrix between the factors reveals that there is a strong positive correlation between the external factor and governance factors ($p < 0.001$), followed by 0.627 for governance factor and financial performance ($p < 0.001$). However, there is a low degree of positive correlation between other sets of factors. Multiple regression model shows that only the government factor is found to be significant ($p < 0.05$) with financial performance. The remaining factors are not significantly related to the financial performance of the LG's. The overall fit of the model is also significant ($F = 4.14$, $df = 4$ and $p < 0.05$). The collinearity statistics also indicate the absence of multicollinearity among the set of independent variables. In addition, the adjusted R square is also high (.584) indicating the high degree of influence on financial performance.

Index Terms - Municipalities, financial condition, structural factors, resource mobilization, economic capacity, governance factors and financial health

INTRODUCTION

Financial health is the ability of an entity to continue to achieve its operating objectives and fulfil its mission over the long term through its revenue potentiality. It is the ability to generate sufficient income to meet operating payments, debt commitments and, where applicable, to allow growth while maintaining service levels. Financial health has been presented officially as crucial to the success of the restructuring of the state. The existing practice of only continuous transfer from federal grants as revenue in municipalities and their dependency on such grants leads

them to limit on formulating and enactment of new tax laws and own sources of revenue, administrative and political body of municipal struggling on sound financial health, the situation can escape from the vicious development need in municipalities. Financial health is the financial capability of a local government to fulfil its obligations, anticipate unexpected events and execute its financial rights efficiently and effectively (Jones & Walker, 2007). A better financial management system is inalienable to the local government to exist in the dynamic political environment, as finance is usually considered to be the overriding factor in determining the health of local government (Kanyane, 2011). Major resistance to measuring and evaluating financial health cannot be defined directly. However, sufficient efforts have been contributed by different scholars to define the conceptual construct, "the financial health of local government." Verity of research papers makes several contributions regarding its confusion than clarification. Simultaneously the different terminologies have been used for that measure like financial condition, fiscal distress, financial position, financial status, fiscal stability etc. Moreover, the term financial was replaced by fiscal, however, each of those studies defines uniquely the operational existence of such terminologies by covering the single aspect of financial health (Ramsey, 2013).

Especially, public services like health, education, building infrastructure, waste management and other administrative service need to deliver by municipalities with appropriate management of financial resources, so the financial health of a local government is important. By the legislative provision, municipalities need to be sound financially and have a significant impact on the political, social and economic conditions within the federal system (Carmeli, 2006). A local government can deliver its services if and only if it is in a good financial condition and a good financial condition assures the sustainability of local government in delivering services at an appropriate quality to their residents.

The financial health of local governments may vary. Such variation creates the need for local government stakeholders; provincial and central governments, central and provincial parliaments, municipal councils and communities to have an effective instrument to monitor the soundness of a wide range of local governments in managing finance and checking financial health. However, difficulties exist in evaluating the financial health of local government due to the unavailability of an effective assessment model and lack of uniformity in financial health checkup instruments and indicators (Chaney

et al., 2002; Kloha, et al., 2005; Wang et al., 2007). Moreover, there is no sufficient empirical evidence regarding the factors that affect the financial health of the municipalities. Prior studies in the area in the context of underdeveloped economies like Nepal are very scanty.

Nepal has transformed from a unitary system of government to a federal system after the promulgation of the current constitution on September 20, 2015. Currently, it has passed through the stage of state restructuring towards the federal set up of three layers of government (a) federal, (b) provincial, and (c) local. It has adopted a policy to promote decentralization and improve accountability and outreach of public service delivery by granting more authority and resources to local governments (Rao, 2016). The governments of all these layers have been bestowed with powers to carry out various functions in their respective areas. They have been authorized to mobilize revenues to undertake their responsibilities. One of the most important factors in the ability of LGs to effectively operate lies in their financial capacity. LGs deal on a combination of direct revenue sharing, inter-governmental transfers (Federal and/or Provincial), revenues from their sources (e.g., tax and non-tax revenue), and in specific cases private finance (e.g., bonds, private sources for infrastructure lending). To better execution of fiscal federalism, municipalities are found successful it should be carefully sequenced with a true devolution of authority through legislative mechanism and discretion to local officials and able to enhance own revenue (Bahl, 2009).

However, Nepalese municipalities have yet to receive grants under the fourfold grant regime established by the Constitution (conditional grants, complementary grants or special grants, and equalization grants) (Hachhethu, 2017). The *Constitution* assigns 22 areas of rights to the LGs and substantial expenditure responsibilities to the sub-national level in its schedule 8 of the constitution. Among these bestowed under their jurisdiction, LGs assume responsibility for: the management of the local services; local level development plans and projects; basic and secondary education; basic health and sanitation; local roads; town police; water supply and small hydropower projects; and disaster management (Hachhethu, 2017). As of new constitutional provision, revenue assignments reveal that the major sources of revenue are custom duty, value-added tax (VAT), excise duty, corporate income tax, and personal income tax. These sources of revenue comprise around 80% of total tax revenue are under the rights of the federal government. Around 90% of total tax revenue would be under the jurisdiction of the federal government (Prasad, 2015). However, the Provision of VAT and excise duty divisible 70, 15 and 15 per cent to the federal, provincial and local government respectively is made by the inter-governmental fiscal transfer Act.

Overview of allocation pattern of public expenditure vertically examined over five key ministries (Education, Health, Agriculture, Urban Development, and Federal Affairs and Local Development), analyzed almost 20 per cent public expenditure placed to local government level under the three-tier governance structure in Nepal. In the public service and economic affairs of the nation involvement of local government need to be minimal in percentage. Moreover, a huge burden of national spending on education, community

affairs, housing and a significant portion of expenditure requirements on health would take place from the local level (Boes, 2016). However, in the fiscal year, 2013/14 share of local government's expenditure on total expenses found only eight per cent (Prasad, 2015). Hence, research in the area of improving the financial health of the Nepalese municipalities is crucial. Therefore, the focus of the study was, on the financial health of local governments in the Gandaki province of Nepal.

The research findings will contribute significantly to researchers, consultants, regulators, and LGs' executives who wish to study, add value, or promote good fiscal balance practices. Similarly, policymakers who wish to formulate policies in effective operation of LGs could consider the financial health practices in place and examine their impact on LGs' effective service delivery. This research would help deepen understanding of financial health on policy decisions and regulations. Financial regulators in developing economies can consider the areas of governance that are most crucial to add economic value to stockholders cost-effective service, reduce uncertainties in public service and promote empowered LGs. The results of this study would also help executives of LGs who seek effective governance reform to focus on mechanisms that enhance service value. Researchers can build on this research work to expand knowledge and build a financial health model. Further, the study would contribute to global literature on financial health by exploring linkages between fiscal balance and LGs performance in a small and underdeveloped economy like Nepal. Furthermore, the research findings will contribute to the successful implementation of fiscal federalism in Nepal and aid in making the local governments financially sound and fiscally sustainable.

The study has tried to especially identify the factors affecting the financial health of local government units in Gandaki province of Nepal. Considering this fact, the study focused the consistent estimation of the relationship between governance structure, financial position, socio-economic factors of the local government units with their financial performance. Thus, the study concentrated to examine the factors that influence the financial performance of local government units in Gandaki province of Nepal.

DEVELOPMENT OF HYPOTHESES

I. *Structural Factor and Financial Performance*

Several studies argued that the population size, dependency rate, literacy rate, quality of life, socioeconomic status of citizens and immigration are important dimensions of structural factors; among them, the population density and quality of life have reverse relation to the financial condition of a public sector entity. Accordingly, this variable would have an inverse impact on public spending (Choi et al., 2010; Cuadrado-Ballesteros et al., 2014). Moreover, the studies reveal that there exists a statistically significant relationship between structural factors and financial condition (Benito et al., 2010; Rodríguez-Bolívar et al., 2016). In the context of a developing economy like Nepal, it was found that multiple policy implications are essential for erecting the appropriate intergovernmental fiscal architecture in the days ahead. Fiscal

federalism by considering such factors with more taxing power to local government is worthwhile in improving the municipal performance. In the context of Nepal, the municipal structure supporting decentralized power regarding revenue collection alone could not contribute much to improving the overall municipal performance. Single revenue right is not sufficient to improve municipal performance and balanced structural factors are crucial for the enhancement effect of municipalities (Khanal, 2016). Based on these facts the first hypothesis of this study is:

Hypothesis 1: Structural factor has a statistically significant relationship with the financial performance of municipalities.

II. Economic Factors and Financial Performance

Many factors can influence the economic environment of local government. It includes the availability of resources, sources of revenue generation, capacity to meet commitments, cost of providing services, capability to recover costs, financial efficiency, achieved budget balance, level of employment, the status of infrastructure development and growth of business and industry. Budget results (surplus/deficit) would have a great influence on financial performance as well as its sustainability (Rodríguez-Bolívar et al., 2016; EU, 2012). Similarly, Ghimire (2019) concludes that direct and indirect tax revenues are strongly related to municipal performance. Additionally, the ratio of municipal own source to total revenue is related to municipal performance (Jorge, Cerqueira, & Furtado, 2022; Hawxwell et al., 2021). Hence, these studies show a positive relationship between economic factors and the financial performance of the local government. In contrast, Guillaumon et al. (2011a) find the insignificant relationship between the budget result and financial transparency. Similarly, out of the constructs of economic factors gross domestic product (GDP) is considered as the main factor that would affect financial health, because of its direct relationship with tax revenues, public debt and more generally financial performance (Easterly & Rebelo, 1993; Andreula et al., 2009). Growth of business and industry has the main relation on the enhancement of employment rate and the local GDP and it has been considered as a driver for financial performance (Rodríguez-Bolívar et al. 2016). Financial performance is the basic instrument of better public service of local government and it requires effective resource management capacity by making elected officials more responsible and accountable toward generalized public service (Brusca & Montesinos, 2006; Halachmi, 2005). Several indicators have been developed in this regard in developed economies, however, it is in the way of development in the context of developing economies. This indicates it is necessary to introduce performance evaluation scenarios related to the economic environment of the local government unit and then it will be comparable as well as benchmarking values will be significant also (Zafra-Gómez, López-Hernández & Hernández-Bastida, 2009). Those literature guided to set the second hypothesis of this study as:

Hypothesis 2: Economic factor has a statistically significant relationship with the financial performance of municipalities.

III. Governance Factors and Financial Performance

Municipal governance includes several constructs like good governance, local government management capacity, transparency, budgeting and accounting procedures, municipal human resource capacity, political interference,

anti-corruption practices and measures, public participation in municipal governance and role of municipal leadership. Municipal strategy and planning, organization and structure, finance and procurement, policies (regulations and incentives), data governance, inclusive urban development are the key factors to enhance the knowledge and awareness, political commitment, organization, perceived cost-benefit financing, socio-environmental justice and use of the resource (Henderson, Escobar & Revell, 2021). Essential elements for sound governance are identified as a representative system of local democracy: issues such as fair conduct of elections and formal representation of parties are critical; Community accountability and participation: including that the local government is responsive, open and transparent in its operation; Ethical conduct; Good planning processes in place: including a focus on sustainability and long-term planning; Competent administrations: with competent and capable elected and appointed officials; Sound financial management: founded on principles promoting efficiency, effectiveness, equality; and Developmental and sustainable service delivery: to all and particularly the poor and disadvantaged, however, there is no evidence of universally single best model for efficient local government (City Insight, 2020). Kiamba (2008) find a significant impact of good governance and governing factors on financial performance. In the context of Nepal, Chaudhary (2019) reveal that municipal units are facing issues ranging from insufficient law, employees, and infrastructure for mobilization of economic resources which is affecting financial performance. Thus, based on prior empirical literature it can be hypothesized that:

Hypothesis 3: The governance factor has a statistically significant relationship with the financial performance of municipalities.

IV. External Factors and Financial Performance

External factors include the relationship with the central and provincial government, central government policies, federal grants and municipal independence. Kimaba (2008) concludes that the financial performance of local governments is influenced by their political composition, how internal audits are conducted, and managerial approaches used by the chief administrative officers. The level of cooperation, coordination and support from the federal and provincial government has a direct impact on the fiscal condition. Fiscal transfers perform a significant role in financing the expenditure needs of municipalities. In Nepal, the provision of three tiers of power-sharing mechanisms among government units was based on coexistence, cooperation and coordination (Acharya, 2021). But according to Kelly (2019), only the progress in political decentralization may not be sufficient in the absence of institutionalization of efficient, equitable and accountable fiscal decentralization. However, Chaudhary (2019) states that the linkage between local government units and the province is poor due to insufficient laws. Based on this fact the fourth hypothesis is developed as:

Hypothesis 4: External factor has a statistically significant relationship with the financial performance of municipalities.

RESEARCH METHODOLOGY

The study employs a quantitative approach using a cross-sectional survey method to collect expert opinions on

indicators of financial health and their relative importance for assessing the financial soundness of municipalities in the Gandaki province of Nepal. Additionally, it also collects their views on measures to be undertaken to improve it. The design is appropriate as there is no established financial health measure in Nepal as it has recently implemented fiscal federalism. The survey was aimed at identifying the relative importance of indicators of financial health and measures to be undertaken to enhance the financial sustainability of the local government units in Nepal. The study units comprise of respondents having expertise in the field consisting of university teachers of the relevant area, officials of LG units, trainers at Urban Development Training Centre (UDTC), and officials of INGO/NGO's working in the field within Gandaki Province of Nepal. The participants of the questionnaire survey have selected purposively. The sample size for the opinion survey was determined using central limit theorem $\{n= z^2 \times p \times (1-p)/e^2\}$ with a margin of error of seven per cent and a confidence level of 95 per cent which resulted in a sample size of 196. The margin of error of seven per cent have been taken into consideration because of a limited number of such categories of respondents within the province.

The study period followed immediately after the implementation of fiscal federalism in Nepal in 2017 after completion of the elected local bodies. The study has employed a pilot survey with 20 per cent of the planned sample and analyzed the results to refine the construct and variables of financial health for Nepalese municipalities and development of final survey instrument in addition to reviewing the existing empirical work. A semi-structured self-administered questionnaire was used to collect primary data. The research instrument consisted of five-point Likert scale questions to collect information and opinion on the importance of various factors required to achieve financial sustainability of the local government units.

Both bivariate and multivariate analyses were used for analyzing data. The bivariate analysis involved cross-tabulation by using Statistical Package for Social Science (SPSS) version 20 and summated scale with equal weight is used to assess explanatory variables has been employed for the factor items. Correlation analysis is used to assess the association between the independent and dependent variables. Similarly, multivariate analysis was undertaken using OLS multiple regression model for analyzing the factors influencing the financial health of the municipalities. The following regression model specification was used for the analysis of the effect of municipal governance structural factors, economic factors, governance factors, and external factors on financial performance:

$$LGFP_i = \alpha_0 + \beta_1 SF_i + \beta_2 ECF_i + \beta_3 GF_i + \beta_4 EF_i + \varepsilon$$

Where, *LGFP* = Local government's financial performance; α = intercept term; β_1 to β_4 = regression coefficients; *SF* = Structure factors; *ECF* = Economic factors; *GF* = Governance factors; and *EF* = External Factors. *SF*, *EF*, *GF* and *EF* represent vector of variables measuring the dimensions and ε is the error term.

Various measures were undertaken to ensure the reliability and validity of measurement instruments, data collection, and analysis methodology employed. The dependent and independent variables used in the study were selected based on their use in prior empirical studies. The OLS multiple

regression model diagnostic tests results and prior empirical work. The models were examined for multi-collinearity, autocorrelation, heteroscedasticity, normality and linearity to establish the robustness of estimations. The reliability of constructs used in the questionnaire survey was accessed via internal consistency reliability measure Cronbach's Alpha. Additionally, pre-testing of the questionnaire and expert opinion were undertaken.

RESULTS AND DISCUSSION

Table 1 presents the item-wise mean scores and standard deviation of factors affecting municipal performance used in the study, viz., structural factors, economic factors, governance factors and external factors. It also exhibits the value of the internal consistency measure, Cronbach's alpha to ascertain construct reliability. The Likert scale used ranges from anchors 1 = Least important to 5 = Most important.

Table 1: *Descriptive Analysis*

| Constructs and Variables | | <i>M</i> | <i>SD</i> |
|--|---------------------------------------|----------|-----------|
| Structural Factors (SF) | | | |
| (i) | Population size | 3.87 | 0.766 |
| (ii) | Dependency rate | 3.80 | 0.748 |
| (iii) | Literacy rate of citizens | 3.98 | 0.744 |
| (iv) | Quality of life of citizens | 3.95 | 0.739 |
| (v) | Socio-economic status of citizens | 3.83 | 0.765 |
| (vi) | Immigration | 3.94 | 0.792 |
| | Cronbach's alpha | | 0.754 |
| Economic Factors (ECF) | | | |
| (i) | Availability of resources | 3.79 | 0.812 |
| (ii) | Source of revenue generation | 3.73 | 0.752 |
| (iii) | Capacity to meet its commitments | 3.76 | 0.803 |
| (iv) | Cost of providing services | 3.80 | 0.814 |
| (v) | Capability to recover costs | 3.70 | 0.787 |
| (vi) | Financial efficiency | 3.78 | 0.798 |
| (vii) | Achieve budget balance | 3.64 | 0.776 |
| (viii) | Level of employment | 3.75 | 0.767 |
| (ix) | Status of infrastructural development | 3.74 | 0.820 |
| (x) | Growth of business and industry | 3.80 | 0.877 |
| | Cronbach's alpha | | 0.707 |
| Municipal Governance Factors (GF) | | | |
| (i) | Good governance | 3.82 | 0.819 |
| (ii) | Transparency | 3.71 | 0.871 |
| (iii) | Local government management | 3.60 | 0.788 |
| (iv) | Budgeting and accounting procedures | 3.69 | 0.770 |
| (v) | Municipal human resource capability | 3.67 | 0.763 |
| (vi) | Political interference | 3.73 | 0.780 |

| | | | |
|---|--|------|-------|
| (vii) | Anti-corruption practices and measures | 3.68 | 0.800 |
| (viii) | Public participation in municipal governance | 3.69 | 0.778 |
| (ix) | Role of municipal leadership | 3.78 | 0.809 |
| | Cronbach's alpha | | 0.716 |
| External Factors (EF) | | | |
| (i) | Relationship with central government | 3.60 | 0.801 |
| (ii) | Central government policies | 3.68 | 0.747 |
| (iii) | Federal grants | 3.64 | 0.721 |
| (iv) | Municipal independence | 3.71 | 0.799 |
| | Cronbach's alpha | | 0.783 |
| Local Government's Financial Performance (LGFP) | | | |
| (i) | Revenue base | 3.73 | 0.867 |
| (ii) | Quality of service offered | 3.73 | 0.697 |
| (iii) | Access to external financing | 3.72 | 0.821 |
| (iv) | Cost of public services | 3.82 | 0.802 |
| (v) | Financial self-sufficiency | 3.77 | 0.806 |
| | Cronbach's alpha | | 0.843 |

The internal consistency among construct items has been established as depicted by the value of Cronbach's alpha which is greater than 0.70 for each factor. The alpha value obtained from the analysis, it reveals the scale used to measure the constructs are reliable. Instruments to measure municipal governance structural factors are population size; dependency rate; literacy of citizens; quality of life of citizens; socio-economic status of the citizen; and immigration (Choi et al., 2010). All the items associated with the construct structural factor are found to be important ($M > 3.80$, $SD > 0.74$). Literacy rate of citizens is revealed as relatively important structural variable ($M = 3.98$, $SD = 0.74$) followed by quality of life of citizens ($M = 3.95$, $SD = 0.73$). Additionally, among the structural factors' population size with a mean score of 3.80 ($SD = 0.76$) has been found to have relatively less importance.

Similarly, the economic factor is measured through items - availability of resources, source of revenue generation, capacity to meet its commitments, cost of providing services, capability to recover costs; financial efficiency; achieve budget balance; level of employment; status of infrastructure development; and growth of business and industry (Brusca, Manes Rossi & Aversano, 2015). Among the economic factors, cost of providing services ($M = 3.80$, $SD = 0.81$) and growth of business and industry ($M = 3.80$, $SD = 0.87$) which have equal mean scores are found to be relatively important economic factors for municipal units in Nepal. The next important economic factor is revealed to be the availability of resources with a mean of 3.79 ($SD = 0.82$) followed by financial efficiency having a mean score of 3.78 ($SD = 0.79$). However, among the scale items source of revenue generation ($M = 3.73$, $SD = 0.75$) is found to have the lowest mean score.

Similarly, municipal governance factor includes good governance; Transparency; local government management;

budgeting and accounting procedures; human resource capacity; political interference; anti-corruption practice and measures; public participation in municipal governance; and the role of municipal leadership (Rodríguez-Bolivar et al., 2016). The results depict that good governance ($M = 3.82$, $SD = 0.81$), role of municipal leadership ($M = 3.78$, $SD = 0.80$) and political interference ($M = 3.73$, $SD = 0.78$) are important dimensions of municipal economic factor in Nepal. On the other hand, local government management with a mean score of 3.60 ($SD = 0.78$) is found to have relatively less importance. However, all the item mean scores are greater than three which reveal that all scale items are important economic factors.

The items of external factor construct include the relationship with central government; central government's policies; federal grants; and municipal independence (Vicente et al., 2013). The results reveal that municipal independence ($M = 3.71$, $SD = 0.79$) is the most important external factor followed by central government policies ($M = 3.68$, $SD = 0.74$). On the contrary, federal grants with a mean score of 3.64 ($SD = 0.72$) is found to have the lowest mean score among the external variables.

Finally, constructs of municipal financial performance include revenue base; quality of service offered; access to external financing; cost of public services; and financial self-sufficiency (Marshall & Douglas, 1997). The important underlying dimensions of financial performance are revealed to be cost of public services ($M = 3.82$, $SD = 0.80$), financial self-sufficiency ($M = 3.77$, $SD = 0.80$) and revenue base ($M = 3.73$, $SD = 0.86$) in order of relative significance respectively. In contrast, access to external financing with a mean score of 3.72 ($SD = 0.82$) is found to be the least important indicator of financial performance.

Finally, the mean construct wise score computed by taking equally-weighted average scores of construct items for structural factor, economic factor, governance factor, external factor and financial performance is found to be 3.89, 3.74, 3.70, 3.65 and 3.75 respectively. The finding depicts that structural factor is perceived to have relative importance over other factors while external factor is found to have the least importance. Overall, the mean score of the explanatory sub-constructs of financial performance is found to be 3.74 which depicts that all the constructs are perceived to be important dimensions associated with the financial soundness of municipal units in Nepal.

Table 2 presents the bivariate correlation matrix of construct wise mean scores computed by taking a composite average of construct items of structural factor, economic factor, governance factor and external factor with construct score of financial performance. The primary interest of concern is correlation coefficients of construct level scores of structural, economic, governance, and external factor with local governance financial performance. Additionally, the correlation coefficients also indicate the fulfilment of the linearity assumption of explanatory variables with financial performance to be used in subsequent multiple regression analysis. Furthermore, the correlation among explanatory variables reveals the possibility of meeting the multicollinearity assumption.

Table 2: Correlation Matrix

| | M | SD | SF | ECF | GF | EF | LG FP |
|----------|----------|-----------|----------------|-----------------|-----------------|-----------------|----------|
| SF | 3.8 9 | 0.75 9 | 1.00 | | | | |
| ECF | 3.7 4 | 0.80 1 | .078 (.280) | 1.00 | | | |
| GF | 3.7 0 | 0.79 8 | .138 (.053) | .141* (.049) | 1.00 | | |
| EF | 3.6 5 | 0.76 7 | .026 (.720) | .273* (.000) | .330* (.000) | 1.00 | |
| LGF P | 3.7 5 | 0.70 9 | .108 (.131) | .900* (.000) | .157* (.028) | .248* (.000) | 1.0 0 |

(Source: Field Survey, 2021)

Note: * $p < .05$, ** $p < .01$, *** $p < .001$. The values in the parentheses are p-values.

The values of correlation coefficient; $r(194) = 0.90$, $p < 0.001$ reveal that economic factor has strong positive correlation

Table 5: Factors Affecting Financial Performance of Municipalities: Output of Multiple Regression Model

| Model | Beta Coefficients | | T | Collinearity Statistics | |
|----------------------------|-------------------|------------|--------|-------------------------|-------|
| | B | Std. Error | | Tolerance | VIF |
| (Constant) | -1.481 (0.136) | .989 | -1.497 | | |
| SF | .028 (0.271) | .025 | 1.105 | 0.976 | 1.024 |
| ECF | .511** (0.000) | .019 | 27.413 | 0.919 | 1.089 |
| GF | .017 (0.406) | .020 | .833 | 0.872 | 1.146 |
| EF | -.007 (0.844) | .034 | -.197 | 0.838 | 1.193 |
| R-Squared = 0.813 | | | | | |
| Adjusted R-Squared = 0.809 | | | | | |
| F = 207.26*** | | | | | |

*, **, *** means the statistics is significant at 10%, 5%, & 1% level of significance respectively. The values in parentheses are p-values.

The results reveal that the explanatory variables explained a significant proportion of variance in dependent variable financial performance, $R^2 = 0.81$, $F(4, 191) = 42.00$, $p < 0.001$. The values of Variance Inflation Factor (VIF) associated with individual beta coefficients ($VIF < 5$) indicate the absence of heteroscedasticity problem in the multiple regression model employed. The findings of the multiple regression model

with financial performance. External factor has significant and positive mediocre correlation $r(194) = 0.25$, $p < 0.001$. Additionally, governance factor is found to have correlation coefficient $r(194) = 0.15$, $p = 0.02$ with financial performance. In contrast, structural factor has insignificant correlation coefficient with financial performance.

Table 5 presents the output of the multiple regression model employed to analyze the factors influencing the financial performance of municipalities in Gandaki province of Nepal. Based on prior empirical review, the antecedents of financial performance are structural, economic, governance and external factors. Table 5 presents the output of the multiple regression model employed to analyze the factors affecting the financial performance of municipal units in Nepal. The results reveal that only the beta coefficient associated with economic factors is significant at the conventional level of significance, $\beta = -0.51$, $t(191) = 27.41$, $p < 0.001$. It depicts that the financial performance of municipal units is positively related to economic factors. The beta coefficients associated with other explanatory variables are found to be statistically insignificant which reveals that the null hypothesis of no significant relationship with financial performance is not rejected. It means the structural, governance and external factors do not affect the financial performance of the municipal units.

support only the hypothesis that economic factor has a statistically significant relationship with financial performance. Other alternate hypotheses of the significant relationship of structural, governance and external factors with financial performance can not be accepted at the conventional level of significance.

The existing studies regarding the financial health of local government states among structural factors population size

inversely influenced (Guillamon et al., 2011b; Choi et al., 2010; Rodriguez-Bolivar et al., 2016) and consider as a risk factor for financial health. On the contrary with those studies, the current study sees the opportunity to enhance its revenue and favourable impact through broadening the tax base. Dependency rate generally found a negative impact on financial performance (Kholá et al., 2005; Rodriguez-Bolivar et al., 2009b) but found statistically significant with the financial health of municipalities (Zefra-Gomez et al., 2009b) and examined critically as a construct of a structural factor because of prominent role toward expenditure base for cost of providing services. Literacy rate of the citizen improving service quality of the municipal through maintaining transparency and enhancing better set of behaviour, also seeking for reliable information (Rodriguez-Bolivar, 2016) and citizen's quality of life having a positive impact on the financial health of municipalities (Cuadrado-Ballesteros et al., 2014) have found a similar set of condition Nepalese context through this study. Through immigration adverse impact on financial health found by existing empirical studies due to an increase in social spending requirements. Despite this fact, Rodriguez-Bolivar (2016) found a significant impact on financial health might be the impact of building infrastructure requirements concentrates on specific locations and reducing the capital expenditure requirements in geographically varying topography like Nepal.

In a similar manner of *economic factors* include the availability of resources, sources of revenue generation, capacity to meet commitments and cost of providing services in favor of well financial performance of the municipal unit globally (Cuadrado-Ballesteros et al., 2014) the same scenario is found in this study also. Capability to recover costs, financial efficiency and achieved budget balance is directly associated with the budget results. Due to such budget result surplus/ deficit may occur and influence its financial health (EU, 2012). A positive relationship is found with the financial performance of these elements (Rodriguez-Bolivar, 2016) and show a statistically insignificant relationship with fiscal health (Guillamon et al., 2011a). But in the Nepalese context, it is found significant. This situation might be the result of newer practices toward fiscal federalism by the municipalities. Level of employment, the status of infrastructure development and growth of business and industry are used in previous studies to measure the fiscal distress in the condition of economic crisis and enumerated the unemployment implies both reductions of sources of revenue and increased social expenditure (Zefra-Gomez et al., 2009a; Benito et al., 2010; Brusca et al., 2015; Rodriguez-Bolivar et al., 2016). Each of these studies supported sufficiently the situation happening in this study also.

Governance is another prominent issue toward enhancing financial performance with good governance. The creation of a sound financial position is possible through good governance, maintaining transparency with sound budgeting and accounting practices without political interference. Local government management capacity and municipal human resource capacity enhanced efficient and effective revenue mobilization to achieve the government's objectives (Bolivar, 2016). The ability to execute financial rights efficiently and effectively is shown by an increase in a local government's revenues. anti-corruption practices and measures, public participation in municipal governance and the role of municipal leadership move forward the condition of financial

independence and enhance the local governments capacity (Jones & Walker, 2007). Ritonga (2014) argues that the ability to meet financial obligations is shown by the capability of a local government creates through economic discipline and good governance practice as a similar result of this study.

In addition to structural, economic and governance factors, *external factors* emphasize the role of variables such as capital and personnel expenditures as well as financial independence of the local government while those influence the financial performance of municipalities (Brusca et al. 2015). It deals with the relationship with the central and provincial government, central government policies, federal grants and municipal independence. Finally, previous studies have also considered the external factors that express the effect on financial distress and sustainability of political decisions assumed during the pre-election year, the election years and the post-election year. Sound financial health of a local government is possible when a local government's efforts concentrate on executing its financial rights (i.e., collecting revenue) efficiently and effectively and can meet all financial obligations to its stakeholders to achieve municipal's objectives (Bolivar, 2016).

CONCLUSION

The primary purpose of the study is to identify the factors that affect the financial performance of local government units of Gandaki province in Nepal. The results of the study reveal that economic and external factors are major variables that are positively associated with the financial performance of municipalities. Among the antecedents of financial performance of municipal units; quality of life, growth of industries and business, cost of providing services, good governance, municipal leadership, municipal independence, and central government policies are found to be important. Economic factors are found to have a major influential relationship with financial performance. The significant dimensions of financial performance of municipal units; capacity to decrease the cost of public services, financial self-sufficiency and quality of services offered are found to be influenced by the economic capacity of municipal units in terms of broadening the tax base, efficacy in cost of services offered, resource availability, financial efficiency, capacity to meet commitments, employment level and ability to recover costs. Despite valuable contributions in the newer field of fiscal federalism in Nepal, the study took into consideration structural, economic, governance and external factors established through the developed economy. However, in a developing economy, those factors might not be sufficient factors to analyze the financial performance of municipalities. This study concentrated only on the municipalities of Gandaki province of Nepal rest of the six provinces excluded from the study. This might influence the municipal financial performance differently. Theoretically, financial soundness is measured based on revenue, expenditure and debts but in the Nepalese context debt base is not found in practice and is excluded from the analysis. Through the Local Government Operation Act 2017, the federal government tried to empower local government to broadening the revenue base and intended to strengthen economic factors even though local governments' practice of formulating Acts and imposing taxes toward generating their source of revenue is not found usual and feel difficulty in the issue. So, the federal government

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should provide specific guidelines and strengthen them in addition to the revenue sharing scheme. Future researchers can broaden the study area to cover the entire geography of Nepal and employ structural equation modelling to gain better insights into the factors affecting the financial performance of the local governments of Nepal.

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