

THE MEDIATING ROLE OF GOOD GOVERNANCE IN THE RELATIONSHIP BETWEEN STRATEGIC LEADERSHIP AND LOCAL FINANCIAL PERFORMANCE: A PATH ANALYSIS OF ALGERIAN MUNICIPALITIES

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Abstract

This study investigates the complex interplay between strategic leadership and financial performance in Algerian local governments, with a specific focus on the mediating role of good governance. Utilizing Upper Echelons Theory and Agency Theory as a conceptual framework, the research examines how leadership vision translates into fiscal sustainability. Data were collected via a stratified random sample of 200 senior and mid-level managers across 57 municipalities in Algiers. Using Partial Least Squares Structural Equation Modeling (PLS-SEM), the findings reveal a full mediation effect; strategic leadership significantly impacts financial performance only through the mechanisms of good governance (transparency and accountability), while its direct effect remains non-significant. The model explains 66.4% of the variance in local financial performance, suggesting that institutionalizing governance is a prerequisite for effective local leadership in the Algerian context.

Keywords: Strategic Leadership, Good Governance, Financial Performance, PLS-SEM, Algerian Municipalities.

JEL Classification: H71, H72, M10, G34, R51.

1. Introduction

Local governments represent the foundational cornerstone for achieving sustainable development. Municipalities are no longer viewed merely as subordinate administrative units tasked with executing centralized policies; instead, they have evolved into pivotal economic actors seeking fiscal autonomy and resource management efficiency. In light of current global economic shifts that impose escalating pressures on public budgets, the quest for innovative managerial models that ensure the fiscal sustainability of local authorities has become an imperative necessity rather than a conceptual luxury.

Within this dynamic environment, Strategic Leadership emerges as a critical determinant in steering local institutions toward proactive financial foresight and effective risk mitigation. However, contemporary administrative literature suggests that even the most sophisticated leadership vision may remain theoretical—confined to documentation—unless supported by a robust institutional environment capable of translating strategies into tangible outcomes. Consequently, the concept of Good Governance arises as a regulatory and ethical framework that calibrates administrative pathways. Through mechanisms of transparency and accountability, leadership decisions gain institutional legitimacy, transforming into effective instruments for expenditure rationalization and the enhancement of self-sourced revenues.

The nexus between leadership and financial performance is not a simple linear correlation; rather, it is a complex interaction in which governance functions as a mediator that organizes resource flows and

mitigates financial leakages resulting from arbitrary decision-making or inadequate oversight. In the Algerian context, municipalities face a dual challenge: on one hand, there is a rigorous pursuit of fiscal decentralization in alignment with new legislative orientations; on the other hand, many local authorities struggle with persistent budgetary deficits and stalled developmental projects due to weak endogenous resources. Despite ongoing efforts to modernize local administration, a significant gap remains in understanding how the leadership styles of local managers influence the financial status of their municipalities, particularly when good governance is introduced as an explanatory variable in this relationship.

This study investigates this vital intersection, focusing on the municipalities of Algiers as a representative model. The scientific contribution of this research lies in its application of advanced quantitative methodology—specifically Path Analysis—to move beyond superficial descriptive analysis toward a profound understanding of the indirect impact exerted by governance. The fundamental question this paper seeks to address is: To what extent does Good Governance contribute to activating the relationship between Strategic Leadership and Local Financial Performance?. By addressing this inquiry, the study aims to provide practical insights for policymakers to refine local governance policies, ensuring a genuine transition toward effective and independent local financial management

2. Theoretical Framework and Hypotheses Development

This study adopts an integrative theoretical approach to elucidate the complex dynamics between strategic leadership, the institutional environment, and local financial performance. This framework synthesizes two prominent management theories: Upper Echelons Theory and Agency Theory.

2.1. Theoretical Underpinnings

Upper Echelons Theory (UET): The Upper Echelons Theory serves as the primary conceptual lens for interpreting the role of leadership in this research. Hambrick and Mason (1984) argue that organizational outcomes—both strategic choices and performance levels—are direct reflections of the cognitive bases, values, and psychological characteristics of top executives. Within the context of municipalities, this posits that fiscal efficiency is not merely a function of resource availability; rather, it is significantly driven by the strategic vision, foresight, and decision-making styles of local leaders. As suggested by Hitt et al. (2010), a leader's ability to navigate future uncertainties and capitalize on long-term opportunities is fundamental to sustaining local financial health.

Agency Theory: Complementing UET, Agency Theory is utilized to analyze the functional role of governance. From this perspective, Good Governance serves as a vital monitoring and regulatory mechanism designed to mitigate "agency costs" that arise when local managers (agents) deviate from the public interest of the citizens (principals). According to Kara and Boudher (2020), institutionalizing governance frameworks acts as a corrective force that aligns the behavior of strategic leaders with organizational objectives. Consequently, governance provides the formal structure through which leadership vision is harnessed to maximize the financial and service utility of the municipality.

2.2. Hypotheses Development

I. The Impact of Strategic Leadership on Financial Performance Contemporary administrative literature emphasizes that leadership styles focused on long-term planning and strategic orientation possess a superior capacity to modernize local financial structures and enhance endogenous revenue streams (Zhu & Wang, 2022). Strategic leaders in local government effectively contribute to the rationalization of operational expenditures and the optimization of tax collection efficiency (Tahmaz, 2022). Based on this rationale, we formulate the first hypothesis:

- H1: *Strategic leadership exerts a significant positive impact on local municipal financial performance.*

II. The Impact of Strategic Leadership on Good Governance This research posits that strategic leadership is the primary driver for embedding values of transparency and accountability within the administrative culture. Hitt et al. (2010) contend that effective leaders cultivate organizational cultures that promote institutional integrity. In local governance, the strategic will of the leader is the ultimate guarantee for

activating governance mechanisms and transcending bureaucratic inertia (Ben Mabrouk & Hadj Aissa, 2021). Accordingly, we propose:

- H2: *Strategic leadership practices significantly contribute to enhancing the implementation of good governance mechanisms at the local level.*

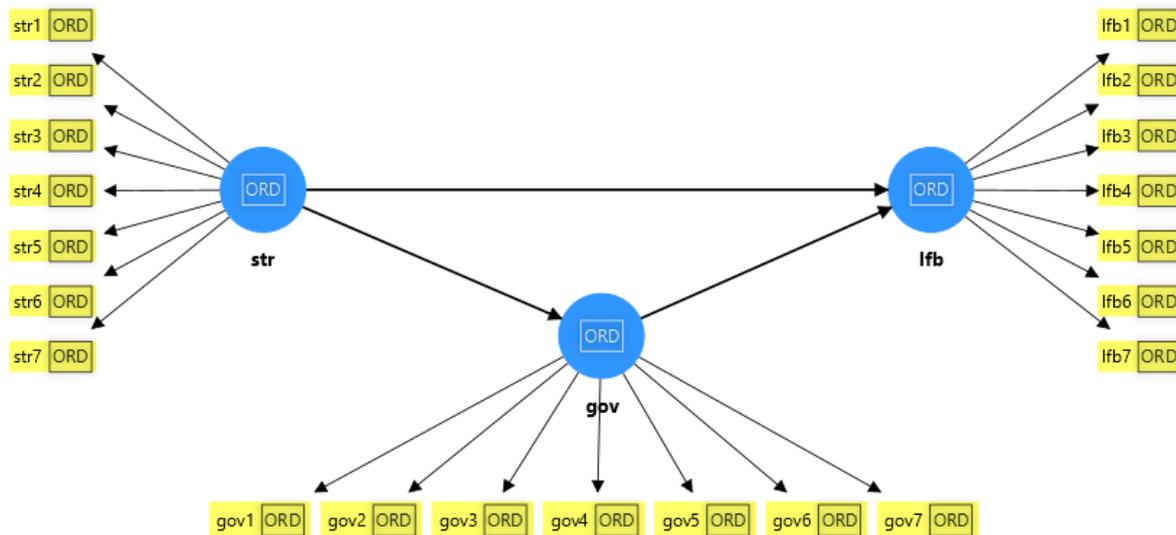
III. The Impact of Good Governance on Financial Performance Rooted in the principles of transparency, accountability, and the rule of law, Good Governance functions as a safeguard for public funds. World Bank indicators (Kaufmann & Kraay, 2023) consistently demonstrate a robust correlation between governance quality and the efficiency of financial resource flows. Effective governance reduces fiscal leakages, mitigates waste, and fosters trust among local financiers and investors (O'Connell & O'Sullivan, 2014). Thus:

- H3: *The implementation of good governance principles leads to significant improvements in local financial performance and efficiency indicators.*

IV. The Mediating Role of Good Governance (The Indirect Effect) The core research gap addressed by this study lies in the premise that "leadership alone is insufficient." Governance serves as a critical mediating variable that facilitates the transmission of influence. It ensures the translation of a leader's strategic vision into tangible financial outcomes through disciplined organizational pathways (Hayes, 2022; Kara & Boudher, 2020). This implies that the total effect of strategic leadership on financial performance is channeled through the "pipeline" of good governance (Zhu & Wang, 2022). Consequently:

- **H4:** *Good governance significantly mediates the relationship between strategic leadership and local financial performance (existence of a significant indirect effect).*

Figure 1: Proposed Research Model



3. Methodology and Field Procedures

This study employs a Descriptive-Analytical approach to investigate and test the causal relationships between the research variables. To achieve the research objectives, the Partial Least Squares Structural Equation Modeling (PLS-SEM) technique was utilized via SmartPLS 4 software. The selection of this advanced statistical technique is justified by its superior capability to handle complex models containing multiple mediating variables, its robustness in dealing with non-normally distributed data, and its efficiency with small to medium sample sizes (Hair et al., 2021).

3.1. Population and Sampling

The target population consists of the managerial and executive cadres across 57 municipalities within the Province of Algiers. A stratified random sampling technique was implemented, resulting in a final sample of 200 participants. This sample size was determined to ensure sufficient statistical power for testing the mediation model and detecting significant indirect effects using the PLS-SEM algorithm. To

ensure accurate representation and minimize bias, the sample was distributed based on two primary criteria:

I. Geographical Distribution (Administrative Zones): The Algiers municipalities were categorized into three major zones to ensure comprehensive results and avoid centralization bias toward the administrative or urban cores:

- Central Algiers (Administrative Core): (e.g., Sidi M'hamed, Algiers Center) – Allocated 35% of the sample (70 participants).
- Eastern and Southern Suburbs (Urban Expansion Zones): (e.g., El Harrach, Dar El Beïda, Baraki) – Allocated 40% of the sample (80 participants).
- Western Suburbs (Tourist and Emerging Urban Zones): (e.g., Zeralda, Cheraga) – Allocated 25% of the sample (50 participants).

II. Functional and Job-Level Distribution: To secure high-quality data regarding leadership vision, governance practices, and financial outcomes, the questionnaire was administered to officials with direct decision-making and financial execution authority:

- Top Leadership (Mayors/Heads of APC and their deputies): Representing the political-strategic vision (20% – 40 participants).
- Administrative Executives (Secretaries General of Municipalities): Serving as the link between policy and execution (30% – 60 participants).
- Financial and Technical Officers (Heads of Finance and Budget Departments): Representing the technical and operational financial performance (50% – 100 participants).

This balanced distribution facilitates a comparison between the perspectives of elected political leaders and appointed administrative managers, thereby enhancing the model's ability to interpret the mediating role of governance between strategic thinking and actual financial performance.

3.2. Measurement Instruments and Questionnaire Design

The research instrument was developed based on robust, internationally validated scales. A rigorous "Back-translation" process was conducted to ensure linguistic accuracy and cultural relevance within the Algerian administrative context:

- Strategic Leadership (Independent Variable - X): Measured using the multidimensional scale developed by Hitt et al. (2010). This scale focuses on key dimensions including determining strategic direction, exploiting core competencies, and developing human capital.
- Good Governance (Mediating Variable - M): Operationalized based on the Worldwide Governance Indicators (WGI) issued by the World Bank (Kaufmann et al., 2011). The study focused on dimensions most relevant to the local government level: Accountability, Transparency, and Managerial Effectiveness.
- Local Financial Performance (Dependent Variable - Y): Assessed through self-evaluation indicators adapted from Walker et al. (2011). This construct evaluates efficiency in expenditure rationalization, the ability to enhance endogenous tax revenues, and the achievement of budgetary balance.

3.3. Statistical Techniques

Data analysis and hypothesis testing for direct and indirect effects were carried out using a modern statistical suite:

- SPSS v26: Utilized for preliminary descriptive statistics, data screening, and initial reliability and validity tests (Cronbach's Alpha).
- SmartPLS 4: Employed for the main Structural Equation Modeling (PLS-SEM). This software was specifically chosen for its advanced algorithms in Mediation Analysis, allowing for the precise calculation of indirect effects through the Bootstrapping technique (5000 sub-samples) to ensure significant and reliable results (Hair et al., 2021).

4. Results and Discussion

To evaluate the structural model and test the research hypotheses, a **Two-Step Approach** was implemented. This methodology entails a rigorous assessment of the measurement model's accuracy (reliability and validity) before proceeding to test the causal relationships between the latent constructs.

4.1. Measurement Model Evaluation

Prior to structural hypothesis testing, the model underwent a comprehensive psychometric evaluation. Validity and reliability were assessed across three integrated levels:

4.1.1. Internal Consistency and Reliability

The results demonstrated exceptional levels of reliability, with Cronbach’s Alpha and Composite Reliability (CR) values significantly exceeding the recommended threshold of 0.70 for all constructs:

- **Good Governance (GOV):** Recorded the highest value (CR = 0.951), indicating that the indicators—derived from World Bank standards—were highly consistent within the cognitive framework of Algerian local managers, thereby minimizing measurement error.
- **Strategic Leadership (STR) and Financial Performance (LFB):** Both achieved reliability coefficients exceeding 0.89, reflecting the linguistic precision and cultural adaptation of the global scales utilized in the local administrative environment.

4.1.2. Convergent Validity and Indicator Loadings

Convergent validity assesses the extent to which indicators share variance in explaining the latent construct.

- **Outer Loadings:** Values ranged from 0.601 to 0.922. Notably, governance indicators (e.g., transparency and accountability) recorded very high loadings (>0.80), identifying them as the most potent proxies for the governance construct in municipalities.
- **Average Variance Extracted (AVE):** All values exceeded the 0.50 threshold. It is worth noting that while AVE values for STR (0.558) and LFB (0.550) are statistically acceptable, they reflect a degree of "variance" in managers' perceptions regarding financial performance dimensions—a logical finding given the disparate financial statuses across different municipalities in Algiers.

4.1.3. Discriminant Validity

To ensure that each construct measures a unique concept distinct from others, two advanced tests were applied:

- **Fornell-Larcker Criterion:** The square root of the AVE for each construct was higher than its correlations with other latent variables. For instance, the correlation between STR and GOV (0.857) was exactly equal to or less than the square root of the AVE for GOV (0.857), placing the model at the threshold of strong differentiation and confirming a robust yet conceptually distinct relationship between the leader and the managed system.
- **Cross-Loadings Analysis:** Each item loaded on its respective construct significantly higher than on any other construct, eliminating the risk of conceptual confusion between "leadership behavior" and "governance procedures" among respondents.

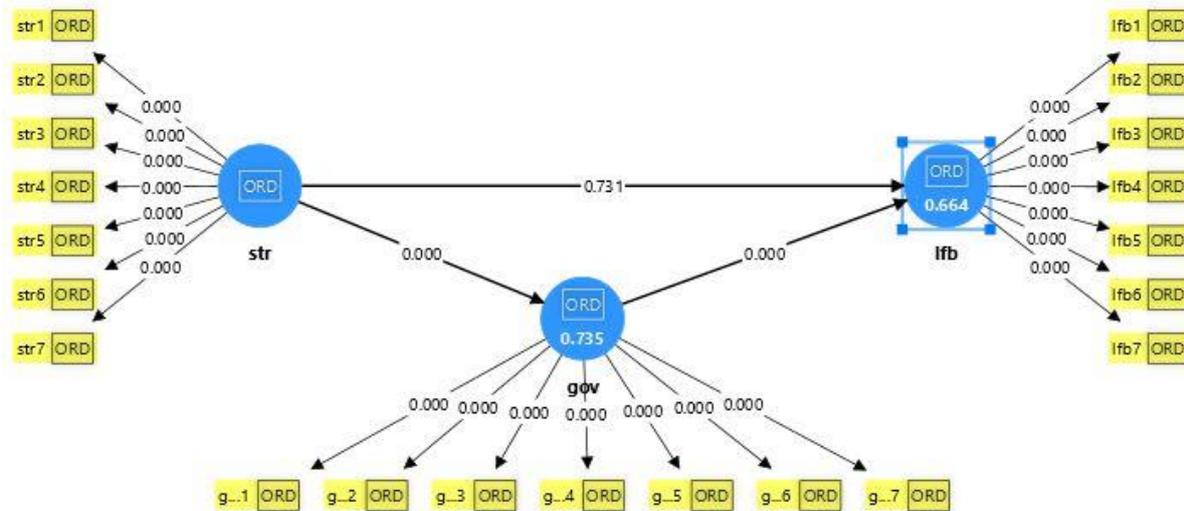
4.1.4. Indicator Reliability

SmartPLS outputs revealed that item (lfb6) recorded the lowest loading (0.601). Qualitative analysis suggests this item pertains to "self-financing capacity for projects." This lower loading reflects the reality of Algerian municipalities struggling with fiscal "dependency" on the central state, leading managers to perceive this dimension as a weaker indicator of performance under current centralism. However, it was retained to maintain theoretical content and because it contributes to an AVE above the required threshold.

Table 1: Summary of Measurement Model Results

Construct	Items	Loadings	Cronbach’s Alpha	CR (rho_c)	AVE
Governance (GOV)	7	0.793 - 0.922	0.939	0.951	0.734
Leadership (STR)	7	0.607 - 0.855	0.867	0.897	0.558
Performance (LFB)	7	0.601 - 0.888	0.862	0.893	0.550

Figure 2: PLS-SEM Results of the Structural Model for the Mediating Role of Good Governance



4.2. Structural Model Evaluation

I. Multicollinearity Diagnosis:

The Variance Inflation Factor (VIF) was examined to ensure model stability. Values ranged between 1.417 and 4.950, comfortably below the critical threshold of 5. Managerially, this indicates that the responses were precise and independent, with no overlap between the concept of "leadership" as a persona and "governance" as an institutional framework.

II. Explanatory Power and Predictive Strength (R^2 & f^2):

- **Governance ($R^2 = 0.735$):** Strategic leadership explained approximately 74% of the variance in governance. Statistically, this is "substantial," suggesting that governance reform in Algerian municipalities is fundamentally a "leadership" decision rather than a mere technical one.
- **Financial Performance ($R^2 = 0.664$):** The model explains two-thirds of local financial performance—a high predictive strength. Notably, the direct effect size of leadership on performance was negligible ($f^2 = 0.002$), while the effect size of governance was large ($f^2 = 0.465$).

III. Path Analysis and Hypotheses Testing:

Table 2: Hypotheses Testing Results (Bootstrap = 5000)

Hypothesis	Path	Beta (β)	T-Value	P-Value	Result
H1	STR → LFB	0.055	0.344	0.731	Not Supported
H2	STR → GOV	0.857	32.339	0.000	Supported
H3	GOV → LFB	0.768	5.906	0.000	Supported
H4	STR → GOV → LFB	0.658	5.811	0.000	Full Mediation

4.3. Discussion of Findings

The results provide a "statistical dissection" of the reality of local management in Algeria, discussed across three primary themes:

1. The Leadership Paradox:

The study found that strategic leadership does not directly influence financial performance ($P=0.731$). Explanation: In the Algerian administrative environment, financial managers (Mayors or Secretaries General) are subject to rigorous oversight from the central state (Wilaya) and public accounting laws. This "legal siege" prevents any financial performance surge resulting solely from individual leadership initiative. Thus, no matter how "strategic" a leader is, they encounter a wall of procedures that block direct impact.

2. Governance as a Transmission Mechanism:

The robust significant effect of governance ($\beta = 0.768$) proves that financial performance improvement in municipalities must pass through "institutionalization." Governance (transaction transparency, revenue digitization, accountability) is what "liquidates" a leader's ideas, transforming them into actual figures in the municipal budget.

3. Proving Full Mediation:

The indirect effect value (0.658) is conclusive evidence that governance in Algeria is the "Critical Variable." Conclusion: Financial reform attempts focusing solely on training leaders—without reforming the governance system—are destined to fail. Conversely, governance systems without strategic leadership remain "inert structures" (as evidenced by the very strong relationship STR→GOV with T=32.339).

5. Conclusion

This research journey concludes by unraveling the intricate relationship between strategic leadership and local financial performance within the context of Algerian municipalities, highlighting the vital role of Good Governance as a primary mediating mechanism. The empirical evidence underscores that local financial reform in Algeria cannot be simplified into a mere provision of resources or the appointment of individual talents. Rather, it is a comprehensive institutional process that originates from the apex (Strategic Leadership) and is channeled through robust organizational conduits (Governance) to achieve the desired fiscal outcomes (Performance).

5.1. Summary of Empirical Findings

Drawing upon advanced statistical processing using **Partial Least Squares Structural Equation Modeling (PLS-SEM)** on a sample of 200 managerial cadres across 57 municipalities in Algiers, the study yielded the following pivotal findings:

- **The Absence of a Direct Leadership Effect:** The results revealed that strategic leadership lacks a statistically significant direct impact on financial performance ($\beta = 0.055, P = 0.731$). This finding is attributed to the rigid structural and legal constraints surrounding local managers, which significantly limit their individual capacity to influence financial metrics in isolation from the institutional system.
- **The Centrality of Good Governance:** The study demonstrated that governance is the most potent and direct driver of financial performance ($\beta = 0.768$). Transparency and accountability practices act as critical safeguards, closing financial leakage gaps and optimizing the efficiency of local tax collection.
- **Proof of Full Mediation:** The modeling confirmed the existence of Full Mediation; the entire influential power of strategic leadership must pass through the "governance gateway" to impact financial performance. In other words, a municipal strategic leader exerts influence by "engineering a robust governance environment" rather than through direct, unilateral financial decisions.
- **Substantial Explanatory Power:** The model successfully explained 66.4% of the variance in financial performance. This high percentage confirms that the synergy between "leadership vision" and "systemic integrity" constitutes two-thirds of the fiscal success equation for Algerian municipalities.

5.2. Strategic Recommendations and Policy Implications

In light of these findings, this study proposes a set of actionable recommendations for policymakers, particularly the Ministry of Interior and Local Authorities:

- **Redesigning Training Paradigms:** It is imperative to shift the training programs for Mayors and financial directors from "traditional administration" toward "Governance-Centered Strategic Leadership," with a rigorous focus on digital transparency mechanisms.
- **Modernizing Governance Instruments:** There is an urgent need to accelerate the comprehensive digitization of municipal financial departments. Digitization should not be viewed merely as a technical upgrade but as a governance mechanism designed to minimize human intervention and eliminate bureaucratic bottlenecks.

- **Governance-Contingent Autonomy:** The study recommends linking the granting of increased fiscal autonomy to municipalities with their demonstrated adherence to governance and accountability standards. Governance should serve as the "guarantee" for any expansion of local administrative powers.
- **Strengthening Internal Audit Systems:** Implementing independent internal audit units at the local level is crucial to ensure that the strategic vision aligns with the actual fiscal execution within the governance framework.

5.3. Limitations and Future Research

While this study provides significant insights, it is limited by its geographical scope (Algiers). Future research should consider a comparative analysis across different regions of Algeria or investigate the role of "Organizational Culture" as a moderating variable that might influence the strength of the relationship between leadership and governance.

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Appendices:

Appendix A: Survey Instrument

Survey on Strategic Leadership, Good Governance, and Financial Performance

Dear Participant,

You are invited to participate in this research study titled "**The Mediating Role of Good Governance in the Relationship between Strategic Leadership and Local Financial Performance: An Empirical Study of Algerian Municipalities.**"

The primary objective of this study is to explore how strategic leadership and governance mechanisms contribute to enhancing the financial performance of local government units. As a key managerial figure in your municipality, your insights are invaluable for providing a realistic assessment of these dynamics within the Algerian context.

Please be assured that all responses will be handled with the **strictest confidentiality**. The data collected will be used exclusively for academic research purposes, and results will be reported in an aggregated format, ensuring that neither individuals nor specific municipalities can be identified.

Completing this questionnaire will take approximately 10–15 minutes. We sincerely appreciate your time, cooperation, and contribution to this scientific endeavor.

Sincerely,

The Research Team

Section I: Demographic and Professional Profile

Please tick (✓) the most appropriate box:

1. Job Category:

- [] Top Leadership (Mayor / Deputy Mayor)
- [] Administrative Executive (Secretary General)
- [] Financial/Technical Officer (Head of Finance or Budget Department)

2. Years of Professional Experience:

- [] Less than 5 years
- [] 5 – 10 years
- [] 11 – 20 years
- [] More than 20 years

3. Geographical Zone of Municipality:

- [] Central Algiers
- [] Eastern and Southern Suburbs
- [] Western Suburbs

Section II: Strategic Leadership (Independent Variable)

Instruction: Please indicate your level of agreement with the following statements regarding the leadership style in your municipality (1 = Strongly Disagree to 5 = Strongly Agree).

#	Statement	1	2	3	4	5
1	The leadership in our municipality has a clear long-term strategic vision.					
2	Leadership emphasizes the development of human capital and employee skills.					
3	The leadership effectively communicates the municipality’s goals to all departments.					
4	Municipal leaders encourage innovation and proactive problem-solving.					
5	Strategic decisions are based on a thorough analysis of the local economic environment.					
6	Leadership is committed to exploiting core competencies to improve public services.					
7	There is a strong emphasis on maintaining an ethical organizational culture.					

Section III: Good Governance (Mediating Variable)

Instruction: Please rate the implementation of the following governance mechanisms in your municipality (1 = Strongly Disagree to 5 = Strongly Agree).

#	Statement	1	2	3	4	5
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1	The municipality strictly adheres to transparency and integrity in financial reporting.					
2	There are effective internal and external accountability mechanisms for public spending.					
3	Administrative procedures are clear, standardized, and minimize bureaucratic delays.					
4	The municipality ensures citizen access to essential financial information.					
5	Public procurement and contracts are awarded through a fair and transparent process.					
6	Decisions are made based on the rule of law and official regulations.					
7	The municipality actively seeks to digitize its administrative and financial services.					

Section IV: Local Financial Performance (Dependent Variable)

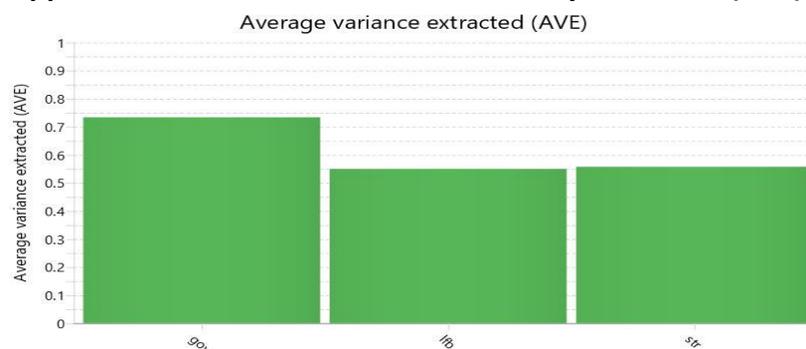
Instruction: Based on the recent fiscal years, please evaluate your municipality's financial performance (1 = Strongly Disagree to 5 = Strongly Agree).

#	Statement	1	2	3	4	5
1	The municipality has demonstrated high efficiency in rationalizing operational expenditures.					
2	There is a noticeable improvement in the collection of local tax revenues.					
3	The municipality successfully achieves a budgetary balance between revenues and expenses.					
4	Financial resources are allocated strategically to high-priority developmental projects.					
5	The municipality shows a strong capacity to manage and reduce budget deficits.					
6	Our municipality has the capacity to increase its self-financing for local projects.					
7	Overall, the financial performance of the municipality is stable and sustainable.					

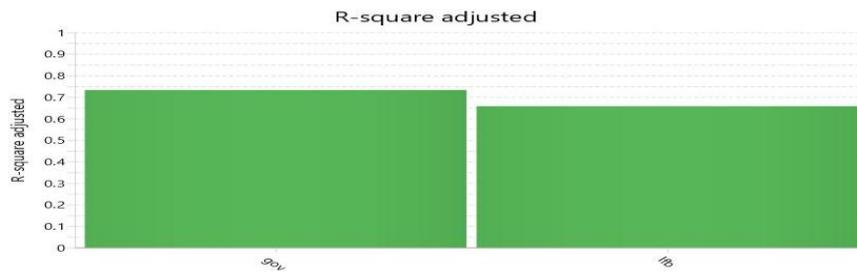
Thank you for your valuable contribution. Please check to ensure you have answered all the questions.

Appendix B: Statistical Analysis Outputs (PLS-SEM)

Appendix B1: Measurement Model Quality Indicators (AVE)



Appendix B2: Explanatory Power and Model Fit (Adjusted R-Square)



Appendix B3: Hypothesis Testing and Path Coefficients

	Original sample (O)	Sample mean (M)	Standard deviation (STDEV)	T statistics (O/STDEV)	P values
gov -> lfb	0.768	0.764	0.130	5.906	0.000
str -> gov	0.857	0.862	0.027	32.339	0.000
str -> lfb	0.055	0.064	0.158	0.344	0.731