

# Islamic Charitable Donations as an Instrument Policy for Poverty Reduction: Is it Effective for Indonesia?

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## Abstract

*The aim of this research is to examine factors that determine poverty reduction in Indonesia by way of undertaking business units of Islamic Charitable Donation as intervening variable. Data were randomly obtained from 244 business units of Islamic Charitable Donation managed by Pesantren Gontor (The largest Islamic Charitable Donation Institution in Indonesia) by employing Structural Equation Model (SEM) of Smart PLS 4 for analysis purposes. The study revealed that business units from the use of Islamic Charitable Donation (source of funds, profitability, Business Capital, Product Innovation, market need) showed a significant impact on Human Resources Development and poverty reduction. The finding of this study will be a benchmark for regulators to utilize Islamic Charitable Donation as an instrument of policy to reduce poverty in Indonesia. Adopting Islamic Charitable Donations as an instrument policy to reduce poverty is a formidable effort of regulators to ensure it is an effective tool. In addition, Islamic Charitable Donation is part of Islamic social funds that inseparable part of policy recommendation that led to maximizing other Islamic social funds to reduce poverty.*

**Keywords:** Structural Equation Model, Islamic Charitable Donation, Poverty Reduction, Instrument Policy

## Introduction

Indonesia has a vast number of potential Islamic charity funds known as Islamic Charitable Donation. According to the CAF World Giving Index 2018, Indonesia has surpassed the United States as the world's most charitable country. This shows that this country strongly desires to contribute and share with others. According to the Indonesian Islamic Charitable Donation Board data, the amount of potential Islamic Charitable Donation assets every year approaches \$139 billion, with Islamic Charitable Donation's land area accounted for 420,000 hectares (Bintoro & Aji, 2020).

According to the Directorate of Zakat and Islamic Charitable Donation Empowerment Ministry of Religious Affairs, donated land in Indonesia across 34 provinces was 52,829.55 hectares in 2021. However, Islamic Charitable Donation land development in Indonesia underwent substantial growth between 1980 and 2017. In 1980, the size of Islamic Charitable Donation land was 63 million square meters; by 2017, and increased to 440 million square meters with an economic value of \$ 25.746 billion. Additionally, cash Islamic Charitable Donation in Indonesia has an excellent potential more than \$180 trillion annually, but only around 0.2 per cent, or roughly IDR391 billion in 2020, has been realized.

Despite its enormous potential, Islamic Charitable Donation's actual impact is still far from expectation to reduce poverty. This demonstrates that the Islamic Charitable Donation endowment has yet to realize its full potential. As a result, there is a significant gap between the actual potential and its impact. The Central Statistics Agency data revealed 24.79 million impoverished people in Indonesia in 2019. The rural poor outnumbered the urban poor by 13.20 per cent and 7.26 per cent respectively (Arham et al., 2020). This demonstrates that

poverty is still major concern in Indonesia and raises the optimism that there is a way to overcome it. One way to reduce poverty is by the establishment of endowment Islamic Charitable Donation. In general, Islamic Charitable Donation in Indonesia has not been utilized to aid for the purpose of economic empowerment (Winarsih et al., 2019). Pesantren Gontor as the largest Charitable Donation institution in Indonesia, on the other hand, has many business units from the use of charitable donation to uplift and empower the economic wellbeing for the people particularly in rural area.

Pesantren Gontor has built Islamic boarding schools by investing and managing Islamic Charitable Donation assets through modern management-based business units. In 1958, Pesantren Gontor possessed approximately 18.59 hectares of land; by 2009, the land asset had grown to approximately 825,184 hectares. Endowments, donations, business, and purchases produced an increase in land assets. Additionally, Pesantren Gontor owns around 50 company units invested as Islamic Charitable Donation assets (Triyawan. A. et al., 2022). This Pesantren has spent over 20 of its Islamic Charitable Donation holdings in productive business units (Huda & Santoso, 2020; Syamsuri et al., 2020). Pesantren manages the institutions' assets, most of which are Islamic Charitable Donation endowments. As a result, Pesantren is developed and managed into an institution who is capable of assisting society's socioeconomic development through community development programs (Medias & Pratiwi, 2019).

### Literature Review

Several studies have highlighted the Islamic Charitable Donation model that is used in many countries. Ascarya et al. (2022) attempt to formulate several simple, productive Islamic Charitable Donation models and select the best Islamic Charitable Donation model suitable for Indonesian Islamic Charitable Donation institutions. He discovered that productive Islamic Charitable Donation models in Indonesia in the form of cash donation as the best model to empower all socio-economic variables, well-being compliance and moral/ethics. However, productive Islamic Charitable Donation models are lacking behind many shortcomings to be completed in the midst of dynamic model of poverty and community empowerment that might be applied to Indonesia.

Meanwhile, Haneef et al. (2014) developed an integrated Islamic Charitable Donation-based Islamic microfinance paradigm for poverty reduction in Bangladesh. The integrated Islamic Charitable Donation-based Islamic microfinance strategy was built based on literature and intellectual discussions. The difficulty of microfinance institutions needs to be improved by the high cost, excessive interest rate and inadequate human resource quality of the beneficiaries. Islamic microfinance organizations have been formed to solve these financial, ethical and human capital shortcomings suffered by conventional financial institutions. In this study, Haneef et al. (2014) mentioned that the integrated Islamic Charitable Donation-based.

Islamic microfinance approach is demonstrated through six constructs: Islamic Charitable Donation resources, Islamic microfinance, takaful, project financing, human resource development, and poverty reduction. Additionally, Structural Equation Modelling was used to examine the relationship between the constructs. There are significant connections between Islamic microfinance and takaful, Islamic Charitable Donation resources and human resource development, Islamic microfinance and human resource development, and Islamic

Charitable Donation resources and project financing. Additionally, the findings indicates that integrating these components lead to possible poverty reduction.

Mohd Thas Thaker et al. (2016) offered a viable alternative form of finance for micro-firms in Malaysia, dubbed the integrated cash Islamic Charitable Donation microenterprises investment model for the sake of poverty reduction. This paper affirmed that, micro firms account for Malaysian SMEs. On the other hand, micro firms need help in obtaining external financing from both private and public sources to maximize in poverty reduction program. They are a high- risk segment of the market. As a result, strict loan criteria have been imposed on them, including collateral requirement, sufficient support documentation, and a track record of a successful business. Unfortunately, most of them could not meet these criteria and therefore need help with finance. Thus, the integrated cash-Islamic Charitable Donation microenterprise investment model was developed to solve microenterprises' financial constraints and accelerate their development and contribution to national income. Experts have indicated that Islamic Charitable Donation usage could be viable for promoting microenterprises and uplift poverty (Shaikh., 2017; Alpay & Haneef, 2015). Raimi (2014) employs a faith-based paradigm to combine corporate social responsibility, the Islamic Charitable Donation system, and the zakat system as a strategy for poverty reduction. This strategy is quite helpful in reducing poverty. Kachkar (2017) devised a Islamic Charitable Donation model that can be utilized to assist impoverished refugees and poverty. The cash Islamic Charitable Donation refugee microfinance fund is established to lend microfinance to prospective refugee micro- entrepreneurs. To address the absence of collateral required for microfinance, a cash Islamic Charitable Donation refugee microfinance fund has been established with a Islamic insurance unit (cooperation) via which refugees can guarantee one another. Additionally, the approach has been built to address the issue of institutional sustainability for the microfinance institution. As a result, a reserve fund has been incorporated into the concept.

The Hamdard Foundation is another example of Islamic Charitable Donation development. Hayat & Naeem (2014) observed that Hamdard Islamic Charitable Donation operates across India and Bangladesh, a unique indication of the organization's essence. The management of Hamdard has put aside 85 per cent of its profits for the needy, health development, education, and other humanitarian projects to reduce poverty.

### **Research Method**

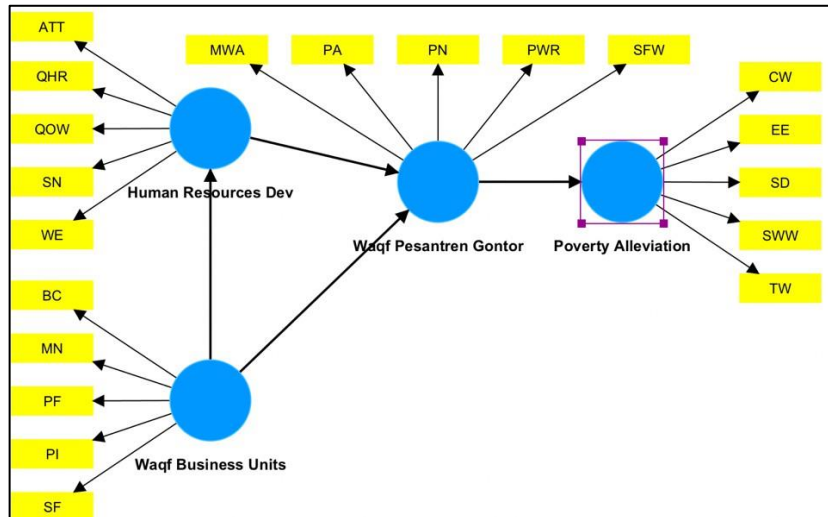
This study undertakes both primary and secondary data sources. Primary data were collected from respondents by way of circulating questionnaire to business units, while secondary data were obtained from books and scientific publications. Using Smart PLS 4.0 software, the Partial Least Square (PLS) approach is employed to analyze the data. The model employs variables with measurable indicators as follow:

1. Human Resources, the indicators used are attitude/good manner, qualified human resources, skill needed, work experience and quality of work.
2. Islamic Charitable Donation Business Units, the indicators used are source of funds, profitability, business capital, product innovation, and market need.
3. Islamic Charitable Donation Islamic Boarding School Gontor, the indicators used are potential of assets, professional manager of charitable donation, productive Islamic

charitable donation regulation, supporting factor of Islamic charitable donation, and management of Islamic charitable donation assets.

4. Poverty Reduction, the indicators used are welfare and economic empowerment.

The concept of the model is described as follows:



Source: Research Finding

Figure 1. Theoretical Framework of Poverty Reduction

The hypothesis of this study are as follow:

1. Hypothesis 1: Islamic Charitable Donation Business Units have a significant influence on the Human Resources Development.
2. Hypothesis 2: Human Resources Development have a significant influence on Islamic Charitable Donation Pesantren Gontor.
3. Hypothesis 3: Islamic Charitable Donation business units have a significant influence on Islamic Charitable Donation Pesantren Gontor.
4. Hypothesis 4: Islamic Charitable Donation managed by Pesantren Gontor have a significant influence on Poverty reduction.

Reasons for using partial least squares structural equation modelling

Several reasons for using PLS-SEM have been well examined in the methodological literature (Hair et al., 2014). The two most commonly cited justifications for employing PLS-SEM in research were a limited sample size and non-normal data distribution. Another reason discussed was the simultaneous estimate of various inter-dependent relationships between variables and the use of latent concept measurement. To examine the hypothesis, this research utilized Smart PLS 4.0 which is a complete of SEM tool. This software developed by Christian Ringle and his team at the University of Hamburg in Germany.

## Results and Discussion

### Realibility and Validity Test

#### 1. Cronbach's Alpha

Cronbach's alpha is utilized in the process of doing reliability study for the scales. In most cases, the dependability coefficient of Cronbach's alpha falls somewhere in

the range of 0 to 1. According to Hair et al. (2013), a good scale has a value that is greater than or equal to 0.80, an acceptable scale has a value of 0.70, and a scale used for exploratory purposes has a value of 0.60. Results of Cronbach’s alpha indicate that Variable of Human Resourch development (0.858), variable of Islamic Charitable Donation Business Units (0.828), variable of Islamic Charitable Donation Pesantren Gontor (0.902), variable Poverty reduction (0.908). Thus, these indicators satisfied the required.

2. Composite Reliability

Composite reliability is favored over Cronbach's alpha as a convergent validity test in a reflective model. Because cronbach's alpha may overestimate or underestimate scale dependability, it may be favored as a measure of reliability. Estimated composite reliability ranges from 0 to 1, with 1 representing complete reliability. Composite reliabilities should be equal to or greater than 0.6 for exploratory models (Chin, 1998; Hock et al., 2010); equal to or greater than 0.70 is considered adequate for confirmatory models (Henseler et al., 2015); and equal to or greater than 0.80 is considered good for confirmatory studies (Daskalakis and Mantas, 2008).

Table 1. Results of Composite Reliability

Variables	Composite Reliability	Cronch’s Alpha	Explanation
Human Resources Development (X1)	0.899	0.858	Reliable
Islamic Charitable Donation Business Units (X2)	0.843	0.828	Reliable
Islamic Charitable Donation Pesantren Gontor (X3)	0.906	0.902	Reliable
Poverty Reduction (Y1)	0.919	0.908	Reliable

Source: Research Finding

Results shows that the composite reliability value of Variable of Human Resourch development (0.899), variable of Islamic Charitable Donation Business Units (0.843), variable of Islamic Charitable Donation Pesantren Gontor (0.906), variable Poverty reduction (0.919) prove that all reflective paradigms exhibit higher levels of internal consistency reliability.

3. Average Variance Extracted

Average Variance Extracted (AVE) can be utilized as a convergent and divergent validity test. In a reflective model, AVE reflects the average communality of each latent factor. In a suitable model, the AVE should be more than 0.5 (Chin, 1998; Hock and Ringle, 2006) and greater than the cross-loadings, which means that factors should account for at least half of the variance of their respective indicators. If AVE is less than 0.50, the standard error exceeds the explained variance.

Fit Structural Equation Model

1. PLS algorithm; and
2. Bootstrapping

Figures 2 and 3 depict the structural models for this research, where R2 denotes the

value of any endogenous and predicted latent variable. R2 is 0.862 for dependent variable, i.e. poverty reduction. It indicates that the three independent variables (Islamic Charitable Donation of Pesantren Gontor) adequately account for 86.2% of the variance in Poverty reduction.

Table 2. Convergent Validity Test

Variables	Indicators	Outer Loading	AVE	Explanation
Human Resources Development (X1)	H1	0.795	0.636	Valid
	H2	0.738		Valid
	H3	0.729		Valid
	H4	0.837		Valid
	H5	0.878		Valid
Islamic Charitable Donation Business Units (X2)	B1	0.784	0.586	Valid
	B2	0.769		Valid
	B3	0.712		Valid
	B4	0.823		Valid
	B5	0.735		Valid
Islamic Charitable Donation Pesantren Gontor (X3)	W1	0.840	0.719	Valid
	W2	0.805		Valid
	W3	0.910		Valid
	W4	0.853		Valid
	W5	0.828		Valid
Poverty Reduction	P1	0.956	0.735	Valid
	P2	0.911		Valid
	P3	0.843		Valid
	P4	0.790		Valid
	P5	0.772		Valid

Source: Research Finding

Table 3. R-Square

Variables	R-Square	R-Square Adjusted
Human Resources Development	0.284	0.259
Islamic Charitable Donation Pesantren Gontor	0.692	0.669
Poverty Reduction	0.862	0.857

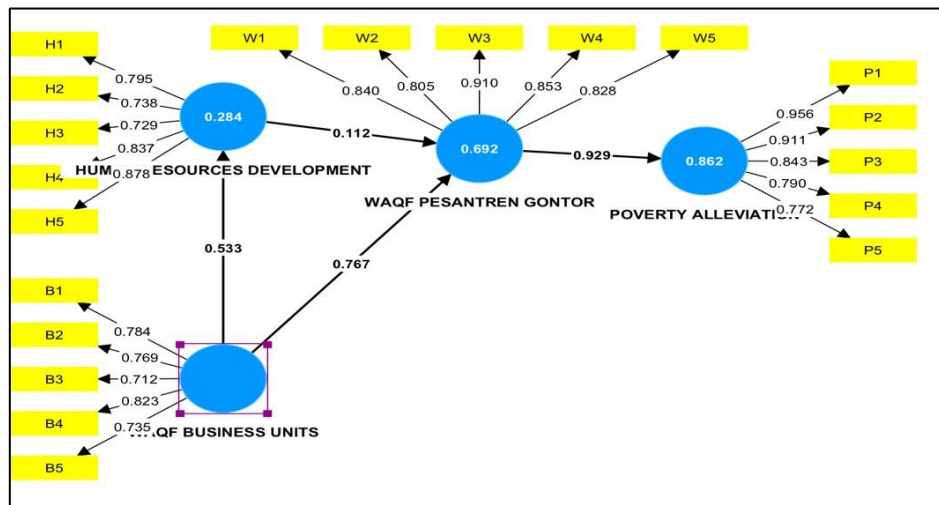
Source: Research Finding

### Research Hypothesis Testing

In this study, bootstrapping was utilized to determine the statistical significance of the path coefficient and to obtain the t-values. Each determined value is displayed in Table 3. The t-values of the hypothesized path of Islamic Charitable Donation business units and Human Resources development is 4.245, which above 2.57 ( $\alpha=0.01$ ; two-sided test) and p-values is 0.000. Therefore, the hypothesized path of Islamic Charitable Donation business units and Human Resources development of the inner model is statistically significant.

The t-values of the hypothesized path of Human Resources Units and Islamic Charitable Donation Pesantren Gontor is 1.056, which below 2.57 ( $\alpha=0.01$ ; two-sided test) and

p-values is 0.291. Therefore, the hypothesized path of Human Resources Units and Islamic Charitable Donation Pesantren Gontor of the inner model is not statistically significant.



Source: Research Finding

Figure 2. Structural Equation Model (PLS algorithm)

The t-values of the hypothesized path of Islamic Charitable Donation business units and Islamic Charitable Donation Pesantren Gontor is 9.947, which above 2.57 ( $\alpha=0.01$ ; two-sided test) and p-values is 0.000. Therefore, the hypothesized path of Islamic Charitable Donation business units and Islamic Charitable Donation Pesantren Gontor of the inner model is statistically significant.

Table 4. Research Hypothesis Testing

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics	P Values
Hypothesis 1	0.533	0.558	0.126	4.245	0.000
Hypothesis 2	0.112	0.115	0.106	1.056	0.291
Hypothesis 3	0.767	0.771	0.077	9.947	0.000
Hypothesis 4	0.929	0.932	0.028	32.830	0.000

The t-values of the hypothesized path of Islamic Charitable Donation Pesantren Gontor and Poverty Reduction is 32.830, which above 2.57 ( $\alpha=0.01$ ; two-sided test) and p-values is 0.000. Therefore, the hypothesized path of Islamic Charitable Donation Pesantren Gontor and Poverty Reduction of the inner model is statistically significant.

**Conclusion**

The result show that Islamic Charitable Donation managed by Pesantren Gontor is statistically significant and effective for poverty reduction. Also, Islamic Charitable Donation business units is statistically significant with Human resources development and Islamic Charitable Donation that managed by Pesantren Gontor. However, only variable of Human resources development is not statically significant with Islamic Charitable Donation of Pesantren Gontor due to the programs of development human resources in Pesantren Gontor

still need focus in concentrating development of Islamic Charitable Donation such as accounting, programming and digitilizing.

This paper implies policy recommendation by the regulators to maximize the untapped potential of Islamic Charitable Donation in the form of cash to uplift and empower the rural society. This paper proves that poverty reduction can be effective by way of utilizing business units from charitable donation and hence the profit can be used to reduce poverty program. Therefore, this study can be used for benchmark as well for government instrument to reduce poverty.

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