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Indonesian Businesses: Coping with Redenomination Policy

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ABSTRACT

Redenomination discourse has been disseminated since the SBY governmental era. However, this has not been implemented yet in Indonesia. This research is aimed to explore potential positive and negative impacts of redenomination in Indonesia. Using grounded theory, this study has found that redenomination will raise economic growth and decrease inflation, if the government delivers adequate socialization using proper tools and media, also provides sufficient instruments to anticipate the possibility of psychological shock. In contrast, redenomination has potential to create hyperinflation if it is conducted in hurry and driven by certain political and economical interests.

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INTRODUCTION

The Indonesian government has officially disseminated redenomination program since 23 January 2013. This program is scheduled to take four to six years to complete (Sat, 2013) which consists of three phases: preparation, transition, and phasing out or removal (Ministry of Finance Republic Indonesia, 2013).

There are few countries has successfully redenomination, such as Turkey and Romania. Turkey has redenominated 1,000,000 old Lira, six zeros, become 1 new Lira (Mosley, 2005, Lianto and Suryaputra, 2012, Rowan, 2011). According to Mosley (2005), the success of Turkey and Romania have become a momentum of new economy emergence. Turkey experienced a 110% hyperinflation in 1980, while Romania was 255% hyperinflation in 1994. BNR National Banks (in Ioana, 2005) showed that a year before the redenomination, the inflation rate of Turkey and Romania respectively 12% and 9,3%, down to 8% and 7% during the period of redenomination, and finally to 4% and 5% in the years after the redenomination.

However, Ioana (2005) and Lianto and Suryaputra (2012) also showed a number of failure fact of redenomination in a number of countries was due to economic instability, such as in Ghana, Afghanistan, Russia, Zimbabwe, and Israel (Lianto and Suryaputra, 2012). Research of Dzokoto, Mensah, Twum-Asante, and Opare-Henaku (2010) in Ghana indicates there has been a money illusion in their people which resulted in high inflation. Dzokoto *et al.* (2010) revealed that the rate of inflation prior to the redenomination was 10.7% increasing to 20% after the redenomination which was caused by higher consumption behavior of its people.

In Indonesia, many economists assert that redenomination policy is not an urgent. For example, Prasetyantono (2013 p.1) states the Indonesian economy is "OK" with the present currency despite the trade deficit of US\$1.5 billion and the current account deficit of US\$20 billion. Similarly, Rizal Ramli (in Hatta, 2013 p.1) states redenomination will not deliver significant benefits to Indonesian economy and will potentially lead to forced inflation.

If forced inflation occurs, public sector will be depressed with soaring price as so private sector will experience operating cost pressures. The operating cost includes not limited to raw material price which will raise as the increase of inflation, a main predictor of redenomination policy (Mosley, 2005). In contrast, sales will decrease because a decrease of purchasing power as customer also experience rising prices of goods and services. Hence, firm productivity slow down and potentially cause employee termination and even collapse. This potential negative effect will continue. If many of firms, especially the big ones, are collapse, then there will be plummeted national productivity, negative economic growth, high unemployment, and a variety of ripple effect that leads to economic depression (Sukirno, 2011).

The failure of Ghana redenomination policy which was caused by money illusion and had resulted in hyperinflation potentially occurs in Indonesia as both countries have similar economy and demographic characteristics. Ghana has abundant natural resources and a collectivistic society as Indonesia (Raef *et al.* 2000;

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Triandis, 1989 in Dzokoto *et al.*, 2010). In addition, GDP of Ghana in 2010 increased 7.7% or GH¢24.187,3 from GH¢22.454,5 million in 2009 (Ghana Statistical Service, 2010). The inflation rate in Ghana was stable and moderate before redenomination, 10.5% in 2006 and 10.7 in 2007. However, the rate rose to be 16.5% in 2008 and kept raise to 20% in 2010. (Dzokoto *et al.*, 2010).

In their study, Dzokoto *et al.* (2010) concluded that the changing of spending behavior and generosity as effect of money illusion which emerge redenomination failure. Costumers spent more money post redenomination as product and service prices seemed cheaper. They were careless to convert their income and price into new nominal. Thus, public expenditure increased while the income was remained. Likewise, donation as part of social and religious activities in Ghana was strong. When people used to donate 1 (formerly 10,000) Cedi was considered as small value after redenomination. Therefore, people rose the donation to be at least 2 (formerly 20,000) Cedi, which is double than it was. These two had significantly spurred inflation and become the axis of redenomination failure in Ghana.

In Indonesia, the strong influence of religion and culture in daily activities of both individuals and organizations (Frantz and Mayer, 2013), as well as limited access towards information and formal education, will encourage money illusion on not only communities but also businesses, especially small and medium enterprises (SMEs). Price rounding up of main and supporting materials and also product selling price potentially occur considering that Indonesian government has not accommodated denomination for nominal below Rp100.00; they are Rp50.00 and Rp25.00. Whereas in business, accumulation of difference price of Rp50.00 and Rp25.00 each unit is still relevant consideration in the purchase decision. Similarly, philanthropy as part of social responsibility activities may increase, because the nominal of donation value psychologically seems small using new currency. This opinion has been supported by research of Prabawani (2013) in Central Java, Indonesia, which shows that the high businesses' concern, particularly SMEs, towards social elements are influenced by religious and cultural background. Therefore, a study to explore positive and negative impacts of redenomination in Indonesia from businesses' point of view of all sizes of business and industries is needed.

Methods:

This is an exploratory study which research is needed as studies relevant to certain topics, redenomination in Indonesia, is limited (Hussey and Hussey, 1997, Myers, 2009). A number of papers are limited as individual opinion, and not result of scientific research. This research applies inductive approach, grounded theory. This approach is chosen to develop theories through analysis of certain phenomena to obtain knowledge for extent communities (Neuman, 2006). Grounded theory is used to formulate potential impact of redenomination program because of business operation, as well as identify relationship between constructs of study. This allows researcher to analyze the problem from multiple perspectives (Yin, 2003, Cooper and Schindler, 2006, Myers, 2009).

The informant were key persons, owner manages, of firms as unit analysis who understand their business operation, particularly, if redenomination is implemented. This study involved 10 firms as unit analysis representing as micro/small (4), medium (4), and large (2) firms. The unit analysis also includes manufacture (4) and services (6) sectors. The data were collected through interviews using interview guide, but the interviews were developed depending on the informant mastery about the issues.

Findings:

Using pattern-matching and explanation-building for qualitative data analysis (Yin, 2003), this study manages the findings into three discussion. The first is current Indonesian economy condition, then opinion and the comprehension of the business about redenomination, and followed by potential impacts that may occur when redenomination is applied.

Current Indonesia Outlook:

Indonesian economy is in a good performance; however it does not mean the businesses welcome redenomination discourse. Pros and cons emerge among political and economic elites towards redenomination implications.

1) Fundamental Economy:

Indonesian economy is in stable condition even has positive growth. Presidential Election Day which was in tight competition has been well conducted without significant economy effect. Rupiah were even strengthened sometime after the election, as revealed by Gareth Leather (in Bbc Indonesia, 2014). In addition, the growth of Indonesia economy rose 2.47% compare to preceding quarter (q-to-q), or increased 5.12% over the previous year in the same quarter (y-to-y) in all sectors, even though it was dominated by 58.70% contribution of Java area (Central Bureau of Statistic, 2014b). In global, economy slowdown that hitting a number of developing countries such as China, Brazil, India, and Turkey since 2012, is not experienced by Indonesia, as mentioned by special

staff of SBY President, Firmanzah (in Melani, 2014). Hence, there is negative sentiment on capital flows and interest rate is risen to restrain capital outflows and to control inflation.

This recent period is considered as the right moment to implement redenomination because the new government is more trusted by public, domestically or globally. Despite assumptions that the last presidential election was conducted with a lot of cheating, the elected President and Vice President, were accredited as “good people”, not convicted of corruption, and have good track record. Even though Jokowi-JK’s first unpopular policy would be raising fuel price, it would not be as controversy as if SBY does so. It shows that the trust on government is important element in order to pave redenomination policy. In addition, the previous government has also made significant and variety efforts to improve the welfare of the societies (Skoufias and Olivieri, 2013), through for example, PNPM (Program Nasional Pemberdayaan Masyarakat Mandiri) program, a national program for communities empowerment, and BLT (Bantuan Langsung Tunai), a direct cash funding for poor families, as compensation of fuel subsidy reduction. Such of these policies seem will be implemented by the new President.

It is undeniable that a common Indonesian market has verbally use redenomination. A number of businesses have spelled Rp2, 000.00 (two thousand) for Rp2, 000,000.00 (two million). For instance, a motorcycle price is seventeen millions, but people say seventeen thousand, in fact the actual transaction price is seventeen millions.

2) *Infrastructure Problem:*

However, the results of this study indicate the businesses also have fears of economic chaos if redenomination is applied. They assumes that the government will not be able to formulate and implement policies to anticipate the impact of redenomination, because such as, rice distribution for the poor, direct cash funding, and fuel subsidy are not well managed. Therefore the businesses assessed redenomination will not be run better than any others previous programs. They have opinion that Rupiah will get better by itself if government provides infrastructure and good economy fundamentals.

The infrastructure development is an urge program. It is admitted that Indonesian economy has a good progress, but it has minus growth and the income distribution is uneven. According Skoufias and Olivieri (2013) infrastructure improvement is no less important than welfare distribution. Hence, it is not surprising that Jakarta, which has a better infrastructure than any other areas in Indonesia, is still a favorite place to find economic opportunity, especially for those who are young and highly educated (Liu and Yamauchi, 2014). Interaction model of infrastructure-economy will be effectively applied, according to Wismadi *et al.* (2012), if an area infrastructure development pays attention to infrastructure and economic opportunity of the neighboring village. So, infrastructure development will bring economy positive growth if the developments are evenly distributed in whole areas. Thus, rather than pursuing redenomination policy, Indonesian government should particularly improve economy fundamental, provide comprehend socialization, and prepare for the instruments within 5 upcoming years.

Community Comprehension:

In addition to relying on economic fundamentals, successful redenomination is also strongly influenced by business understanding of what and how redenomination will be run. These are important to be explored because confusion about redenomination application can trigger a rush, even an economic crisis.

The business people comprehend about the difference of redenomination and sanering. But, they are not sure whether societies and/or their customers understand the difference as well. The government socialization was insufficient, unclear, and only uses television as the media. In facts, rural people in Indonesia watch television for entertainment. Research of Olken (2009) has revealed that the more Indonesian watch television, the less concern they have towards social issues. Olken (2009) adds that the more Indonesian watch television, the lower their participation in their village meetings. Thus, the most appropriate media to communicate redenomination is RT/RW (village) meetings. In this forum, people can ask further information about redenomination to their community leader, and in this way they will be more confidence in the information obtained that redenomination does not diminish the value of money they had. Public confidence is critical to creating economic stability in future and post-redenomination. However, in order to expand the range of information dissemination, active socialization in print and electronic media should be continued. An active and massive socialization, however, need simple message in order to instill people confidence that redenomination would not have negative effect and necessary for improvement of Indonesian economy.

A business success is influenced by redenomination application. Therefore, the business people of this study, especially those engaged in financial service industry, has expressed their willingness to educate public communities. They have made the issue as discussion topic which the result will be recommended by Trade and Industrial Chamber (Kamar Dagang dan Industri, KADIN) for government. In addition, the business are also willing to directly provide insight to, for example, customers or buyers to explain the entirely steps before new money is released.

Potential Impact:

Redenomination will bring both positive and negative impacts. The assessment is however influenced by the informants' optimism and knowledge of Indonesian economy, politic, and social condition, and also the business condition themselves. In fact, the business only need economy stability because it will foster the confidence level of investors to invest in Indonesia. Political uproar in media using economy issue as the topic even makes negative image about Indonesia.

1) Positive Encounters:

This study has found that the pro-redenomination businesses suggest redenomination policy to be implemented and need to be scheduled by the new government. The numbers of Rupiah digits are considered unprofitable because it raises consumers' perception that prices of goods and services are expensive. Economic psychology indicates that the more expensive price, the less buying intention of people will have (Kauffman *et al.*, 2010). Moreover, Indonesian is known to have high price volatility which puts price as a critical determinant for purchasing behavior. This example was experienced by an owner of shop selling a wide range of specialties in the area of Central Java. With inflation rate of 8.38 in 2013 (Central Bureau of Statistic, 2014a), the increase in the price of snacks or dry food valued at a minimum of 8.38% per year is considered too high or expensive by the consumers. The results of this study are relevant to the research Dzokoto *et al.* ((2010) in Ghana which showed changes in spending behavior generosity since the implementation of the redenomination in Ghana where consumers spend more after the redenomination because the value of money seemed cheaper.

The pro-redenomination businesses assess that the policy will potentially strengthen the currency exchange rate of Rupiah. Rupiah is now 1US \$ = Rp12,000,00 and it will look strong when 1US \$ = Rp12,00, so that investors are expected to be more interested in buying Rupiah (Mosley, 2005), and it is expected that Rupiah will be more widely accepted and become hard money (Kuncoro, 2001). This effort is important in order to avoid, or at least reduce the image of Rupiah as garbage money (Lianto and Suryaputra, 2012), similar to the currency of Vietnam, Sao Tome, Iran, Laos, Guinea, Paraguay, Turkmenistan, Somalia, and Zimbabwe, where Rupiah is regarded as inconvertible currency or not easily exchanged for another currency (Kuncoro, 2001). With stronger currency, it is expected that more business partners can conduct transactions using Rupiah, or even want to keep it as an investment. Furthermore, stronger demand for Rupiah will reduce the amount of money in circulation (Sukirno, 2011), considering that Indonesia uses full floating exchange rate or a floating exchange rate system since 14 August 1997, which makes the exchange rate becomes more dynamic and susceptible in international capital traffic (Santoso and Iskandar, 1999, Sukirno, 2011). Increased demand for Rupiah has the potential to reduce rate of inflation as well (Sukirno, 2011).

Moreover, the currently low exchange rate of Rupiah does not indicate the actual condition of Indonesian economy. With a low exchange rate, Indonesia is considered as a country with an economy that does not show positive signals for investment. As a result, investors are reluctant to invest in the country, people lost employment and increased GDP opportunities, and public welfare is stagnant. To that end, redenomination is considered as one alternative to increase aggregate spending to reduce unemployment (Sukirno, 2011).

In addition, the informants from banks or financial institutions in particular, as well as other industries in general, consider redenomination as advantageous for financial accounting records. For example, writing a billion Rupiah which was originally written by nine zeroes, as in Rp1, 000,000,000.00 will be deducted into 6 zeros, as in Rp1, 000,000.00. According to Rowan (2011) the more condensed recording space for the presentation of financial accounting, the easier it is so that the financial reporting system is more flexible and the accuracy of financial calculations is improved.

However, the business community admits that a short-term culture shock will occur once redenomination is implemented. This is reasonable given the fact that it takes time for the public to be accustomed to using the currency with zero visually reduced, for example three digits, although verbally, three digits has been frequently omitted in business transactions. Indonesian business communities are "experienced" to crises. Macro issues such as increase in fuel or electricity tariff have often disturb the stability of the market price, and Indonesian companies, especially small and medium enterprises, can relatively cope with these crises so far. Therefore, the issue of redenomination will not be considered a big issue and will have an insignificant effect on the businesses. For the businesses, they generally do not prepare anticipatory steps for the implementation of the policy. The small businesses in particular assess the psychological impact of the new policy as only temporary, and that political factors weigh more on the success of the implementation.

Concerns that redenomination will add more costs for adjustment of various financial accounting records, particularly on information technology required in transition and phasing out, just does not arise. During the transition period, companies must use a dual price tagging which will lead to dual financial reports, one for using old Rupiah value and another using new Rupiah value. As for the phasing out period, the company must change or adjust the entire system of financial reporting, using new Rupiah. However, the two aforementioned adjustments are not significant constraints to businesses because, after all, the companies simply need to shift the nominal rate. The business communities opined that in the business operations, the application of redenomination

only a matter of time, mindset, and habits. For example, store businesses adjust to the changes by self-education, educating its employees and consumers about the new prices and policies.

2) Negative Encounters:

On paper currently, Indonesia's economy is eligible to apply redenomination. According to Darmin Nasution (in Firdaus, 2010), the Governor of Bank Indonesia at that time, there will be no negative economic turmoil when redenomination is applied. However, the government would need to pay attention to facts that occurred in other developing countries. They experience economic turmoil after the redenomination. For instance, Ghana experienced hyperinflation which was triggered by the money illusion (Dzokoto *et al.*, 2010). Dzokoto *et al.* (2010) in a qualitative study mentioned waive of increased goods and services prices, as well as changes in shopping behavior (economic factors), and social activities (social factors) as the cause. This has been supported by research Raghuram and Srivastava (2009) in China which shows that consumers need more consideration when making expenditures with one nomination \$20.00 compared with 20 nominations \$1.00. Denomination of great value according Raghuram and Srivastava (2009) is useful to control spending and avoid inflation.

However the state should be able to predict the risks that will be faced in the future. It seems that zero adjustment is easy, just eliminate the last 3 digits zero dollars. However, in reality businesses still take into account the price of the smallest unit. For example, material price Rp975.00 / kilo will still be an option entrepreneur than 950.00 / kilo with assumption that the quality is the same. The problem is, even though Bank Indonesia will issue smallest fragments for value old Rupiah smaller than 1,000.00, for example Rp100.00 to be 1 cent, but Bank Indonesia has not been thinking about converting a smaller value of Rp100.00 i.e. Rp50.00 and even Rp25.00 which is still significantly used in making purchasing decisions. Similarly, the banks should carefully determine the amount option of withdrawals at the ATM so that the money supply is controlled and does not lead to inflation (Amromin and Chakravorti, 2009).

The study also has found that businesses have orientation to raise or rather do rounding their price up. There is even a possibility of price jump, because price of the businesses' supplier must have gone up as well. Previous experiences of long economic crisis experienced by Indonesian since 1997/98 reveal that the issue of rising fuel prices has increased the market price. Hence, although business community is not likely to panic coping with redenomination, however there is a possibility of inflation triggered by the increases in the market price.

In principle, the businesses only require national and global economic stability. Government is asked to not only make a program to raise the image Rupiah. Currently, entrepreneurs and investors tend to "wait and see", wait and see what will happen when redenomination being applied, do market analysis, and then decide what strategies to do. In coping with redenomination, the business do not have certain plans yet, because the program which was initiated in Germany in 1923 by (Ioana, 2005) is deemed to be not beneficial and do not bring direct impact for the business. The businesses do not have a significant constraint with large digit nominal of Rupiah. Instead, the large digits make employees feel psychologically rich and has high-income. In addition, when the range of say regional minimum wage, for example, from Rp1, 200,000.00 only become Rp1, 200.00, this will lead to a high demand for wage increasing. The businesses are agreed with redenomination program, however, to cope with the program, investor prefer to do conservative expansion or not to expand the business. They keep their money as anticipation in case redenomination trigger economic chaos, such as rush or hyperinflation.

In summary, the potential of both positive and negative impact of redenomination policy described above can be illustrated in the following chart:

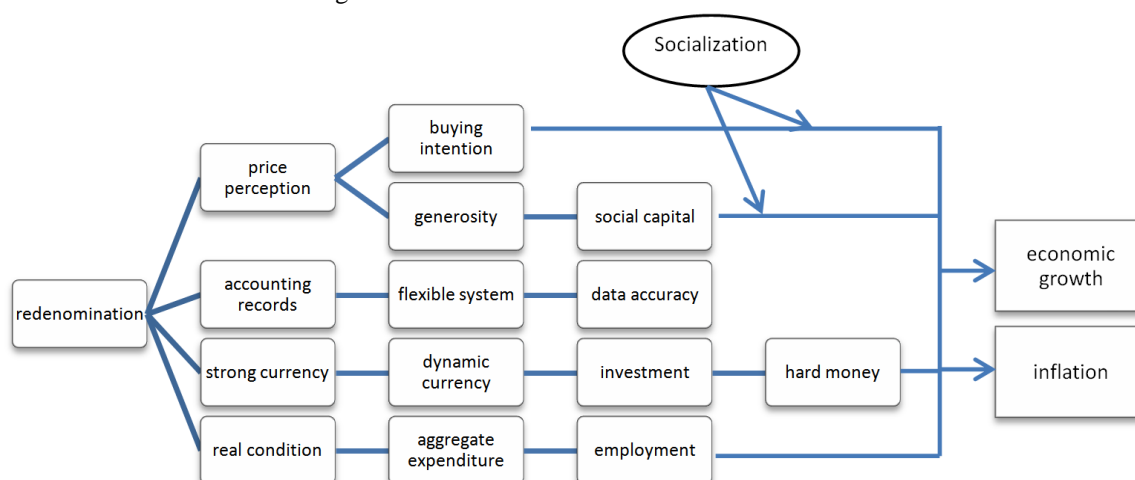


Fig. 1: Potential redenomination impacts.

The chart explains that redenomination would affect economic growth and inflation positively or negatively, depending on the government socialization. With psychological perception that prices of goods and services seem cheap with redenomination, buying intention and high generosity is a positive and lead to economic growth. But otherwise, when buying and charity desire is not properly controlled, it will lead to inflation. Thus, socialization becomes very vital.

Conclusion:

Using grounded theory, this research concludes several findings. Firstly, even though the macro economy is stable within several years back, however, several parties are doubt about the urgency of redenomination policy. There will be psychological shock in the communities which potential to emerge inflation, even though temporarily. Redenomination would bring significant benefits if it is delivered in a stable economic conditions, proper socialization, and high trust towards the government

Second, the large, medium, and small businesses have comprehended redenomination as simplification of nominal in currency. They have learned the issues from electronic media. However, society, for example the businesses' customers, are not understand what and how redenomination will affect business and economy, because electronic media as main media to communicate redenomination is only effective for educated people. Meanwhile, the characteristic of Indonesia people watching TV is only to look for entertainment. Therefore, village meetings are considered as a proper socialization means for the middle to bottom communities.

Third, trust on government has become an important factor for the success of redenomination policy. The trust will minimize the possibility of rush, thus the economy remains stable and conducive. Rupiah as hard money will be one of attractive portfolios for investors. This target might be too high, however, the government should have milestone plans to manifest the vision.

Fourth, redenomination seems like backword. In one side, this can improve expenditure for economic growth, but on the other side, redenomination can also ignite inflation if money illusion and price determination are not controlled.

Recommendations:

Referring to the discussion the research findings, this study provides a number of recommendations for relevant parties. First, Indonesian government should facilitate the smallest unit of currency, which is penny, in order to avoid price rounding up which is uncontrollable or too high. Secondly, redenomination issue should not be continuously be pulled and pushed merely as discourse without any certainty.

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