

Considerations on the Application of Blue Ocean Strategy to Avoid the Risk of Bankruptcy to Small Enterprises

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Abstract. In Romania, SMEs are facing with great financial problems, which led, during 2008 - 2011, to about 60.000 bankruptcies, 200.000 firm suspension and to an increased number of unemployed from 568.000 at 31.12.2008 to 711 000 unemployed at the half-year of 2011. Professors W. Chan Kim and Renee Mauborgne, authors of Blue Ocean Strategy concept, have identified two working-tools, namely: Strategic Sail and EDDC matrix, which can be used to reduce the risk of bankruptcy of small and medium enterprises. The article presents an example of using these workink- tools for a small enterprise, specialized in financial and economical consulting.

Keywords: enterprise, risk, bankruptcy, strategy, Blue Ocean, Red Ocean

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1. Introduction

After October 2008, when the economic crisis started in Romania, economical agents are facing with economical-financial problems of unprecedented gravity. Solving these problems can be accomplished through state intervention, but also through economic restructuring, by applying a new "entrepreneurial culture". In an economy where the demand for products and services has dropped dramatically, economical agents are required to implement new methods to reduce costs and/or the performance of their economical products and to radical change their distribution and marketing system. A relevant strategy to reduce costs and improve performance of products and services offered for sale, is the strategy of Blue Ocean, whose foundation were made by professors W. Chan Kim and Mauborgne Renee.

2. Blue Ocean Strategy

Modern entrepreneur is a visionary entrepreneur, ie entrepreneur who identifies a market that innovate a product, finance it, promote it, and sell it in terms of profitability. Innovation is to identify the product or service from Red Ocean which is characterized by activity at present, fierce competition and low price. Based on capital injections, Red Ocean niche must be transformed into a Blue Ocean niche characterized by activity in the future, small competition, relatively high price. Blue Ocean Strategy was developed by W. Chan KIM, Professor of Strategy and International Management at INSEAD, the firm Boston Consulting Group Bruce D. Henderson together with Rene MAUBORGNE, Professor of Strategy and Management in INSEAD, Fontainebleau, France, (2005) in a famous book of marketing strategy that was sold in millions of copies and translated into 41 languages (Romanian too at Curtea Veche Publishing House, 2007).

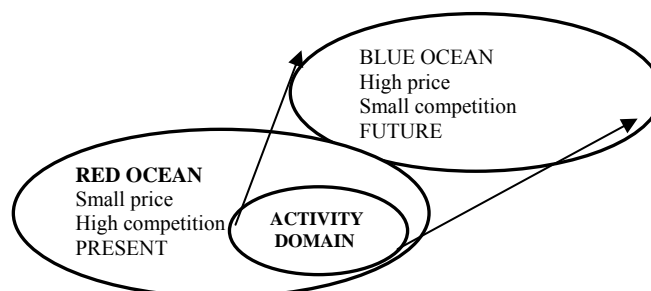


Figure no. 1: Blue Ocean

Their conclusion is based on a market universe, composed of two sorts of oceans: some red, others blue. Red oceans represent all nowadays fields. This is the known market. Blue oceans today means all

areas not yet existing. This market area is unknown. The strategy is developed taking into consideration the idea that: it is pointless to continue the fight in "red oceans" with ferocious attacks on the competitive market share and profits, but must look or to create "blue oceans", free from competition, where you can grow rapidly and profitably. In the red oceans of existing market you operate in and fight to be better than competitors, exploiting existing demand and choosing between differentiation and lowest cost. In blue oceans, you create a new market where competitors are irrelevant, develop and manage demand and get the lowest cost and differentiation.

In comparison with the traditional theories according to which companies can create value for customers at a higher price (differentiation strategy) or obtain a reasonable value at a lower cost (lowest cost strategy), the strategy of Blue Ocean propose the way of "value innovation" that create value and reduce costs simultaneously. Companies need to move beyond mere competition, and to possess potential returns and to take advantage of growth opportunities, they need to create blue oceans. Red Ocean strategy, based on competition, assumes that all branches of economic structural conditions are predetermined and that companies are forced to fight in a given frame. Scientists call this structuralist vision or environmental determinism. In contrast to this vision is Blue Ocean innovation of specific value (see figure below):

Table no. 1. Red Ocean strategy versus Blue Ocean strategy

Red Ocean strategy	Blue Ocean Strategy
Compete in an existing market area	Create an undisputed market areas
Upgrading competition	Transformation of competition into an irrelevant element
Exploiting existing demand	Creating and attracting new requests
Compliance report value / cost	Abolition of value / cost report
Adaptation of the whole system of activities of the company to the option of differentiation or low-cost strategy	Adaptation of the whole system of activities of the company to the target of differentiation and low cost

Source: W. Chan Kim, Renee Mauborgne, "Blue Ocean Strategy" Curtea Veche Publishing House, Bucharest, 2007, p. 36.

3. Blue Ocean Strategy, a method of avoiding the risk of bankruptcy

The first step in fundamentation of the Blue Ocean strategy refers to **the redrawn of market borders**, which is necessary to separate the competition in creating blue oceans. The challenge is to successfully identify, from the many existing opportunities, those opportunities appropriate for their ocean blue and commercially adapted. The strategy identify six fundamental ways to redrawn the market border:

1. Investigate alternative areas;
2. Search the strategic groups in the fields;
3. Research the types of buyers;
4. Investigate the offers of complementary products and services;
5. Search the functional-emotional existence of buyers;
6. Search the temporal landmarks.

Scientific, the six ways of tracking the border, are shown in the following table:

Table no. 2. From the "shoulder to shoulder" competition to Blue Ocean creation

	Competition "shoulder to shoulder"	The creation of Blue Ocean
Scope	It focuses on rivals in the same field	Investigate alternative areas
Strategy Group	Focuses on competitive position within strategic group	Strategic groups in the field study
Segment of buyers	Focus on better serving the segment of buyers	Redefines the category of buyers in the field
Vastness offer of products and services	It focuses on maximizing the value of products and services offer in the field	Analyze complementary product offerings and services
Functional-emotional orientation	The report focuses on improving the performance / price while respecting the functional-emotional orientation domain	Rethink of functional-emotional orientation of the field
Time	Focus on adapting to external trends, as they appear	Participates in shaping external trends over time

Source: W. Chan Kim, Renee Mauborgne, Blue Ocean Strategy, Ed Old Court, Bucharest 2007 pg. 114

In order to be viable, the strategy have to accomplish three characteristics:

1. Focus on objectives;
2. Uniqueness, difference from the general trend in the industry (it is a new trend, to try to reduce chain and distribution network and to address to the final consumer with import prices; here the phenomenon of globalization that is active, plays an important role by providing access to cheap supplies);

3. Intent, a great slogan.

But the real solution is more innovation, to be ready again to seek a new blue ocean.

Blue Ocean strategy becomes even more interesting in the context of the following observations:

1. There is not always great industries. Attractiveness increases or decreases after a period of time.
2. There is not always excellent company. Companies rise and fall over time.
3. Creating a blue ocean is a catalyst for companies or industries.
4. Blue oceans are created by old players or new arrivals.
5. Oceans appear blue not only technological innovation but the innovation in value.
6. Creating blue oceans is correlated with strong and profitable growth.

A second step in stepping from Red Ocean to Blue Ocean is **the funding of required capital infusion**. Ghenea Marius in his book "Entrepreneurship - the road from idea to opportunity and success in business" has the following steps to complete funding strategy:

- A. Bootstrapping: tightening the belt as a source of business financing;
- B. Personal sources being conscious that risk everything in a business; alluded to the courage to mortgage the apartment where you live.
- C. The three "P": parents, friends and other persons
- D. Angel investors: USD, dragons or sharks (design contests)
- E. Banks: good debt and bad debt
- F. Investment funds (agricultural credit, insurance funds)
- G. European funds: free money or worked money?
- H. Listing on the stock exchange and other financing sources.

Working tools for elaboration the strategy of Blue Ocean are EDDC matrix (Eliminate, Diminishes, Develop, Create) and Strategic Sail, which are going to be presented below.

4. EDDC Matrix (Eliminate, Diminishes, Develop, Create) – the third step in Ocean Blue strategy fundamentation

Table no. 3. Eliminate-Diminishes- Develop- Create matrix, for GLOBAL PROPERTY MANAGEMENT Company

Eliminate Payment work for working time; Personal phones during the service; Different software on company computers; Works, shares, personal views during the service.	Develop Works based on models; Professional training program .
Diminishes Talk time; Phones without substance.	Create Company website; New collaborators; New customers; Procedure; Verification of works.

Sursa: Own contribution

4. Strategic Sail – the forth step in Blue Ocean fundamentation

Is a tool which highlight the news or are comparing two business depending on certain features that are present in a corridor value: low level - high level. The following is an significant example of strategic sail and economic advice (Global Property Management Company).

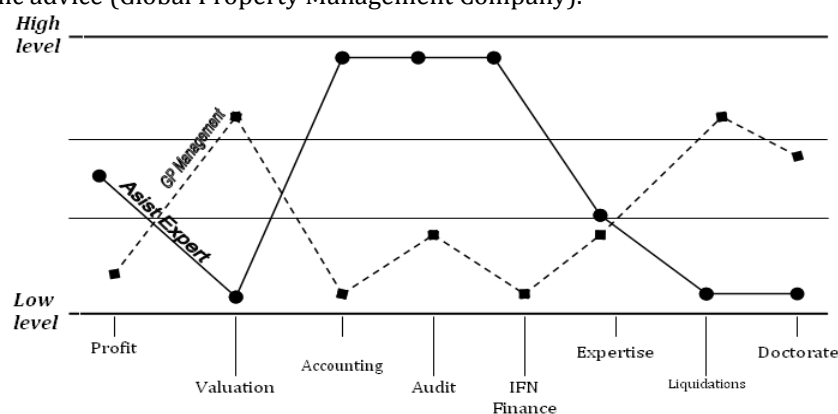


Figure no. 2: Strategic sail for consulting services

Source: Own contribution

5. Case Study: avoiding bankruptcy risk for small enterprises – opening of a new business line „On-line Consultancy 24h/24h

5.1. Current situation

First of all we start with the presentation of the current financial and economic situation of GLOBAL PROPERTY MANAGEMENT Company and we will use Altman model of determining the risk of bankruptcy to determine the actual risk affecting the organization. We will build then the Blue Ocean Strategy and we'll evaluate the company's chances of economic recovery, applying the same Altman model of determining the bankruptcy risk for the resulting economic indicators.

Between 2007-30.06.2011, assets and liabilities of GLOBAL PROPERTY MANAGEMENT Company is as follows:

Table no. 4. Actives and debts for GLOBAL PROPERTY MANAGEMENT Company

Nr. Crt.	Indicator	2008	2009	2010	iunie 2011
1	Fixed assets	8,702.00	16,185.00	15,893.00	15,893.00
2	Assets	55,368.00	188,955.00	173,987.00	173,987.00
3	Liabilities	42,097.00	85,660.00	98,838.00	101,123.00
4	Proper capital	23,473.00	136,285.00	109,848.00	107,123.00
5	Total revenues	79,204.00	236,668.00	11,523.00	0.00
6	Total expenditure	51,486.00	99,781.00	37,252.00	0.00
7	Income tax	4,445.00	22,075.00	2,708.00	0.00
8	Net Profit / Net Loss	23,273.00	114,812.00	-28,437.00	0.00

The dynamic of company's assets and liabilities

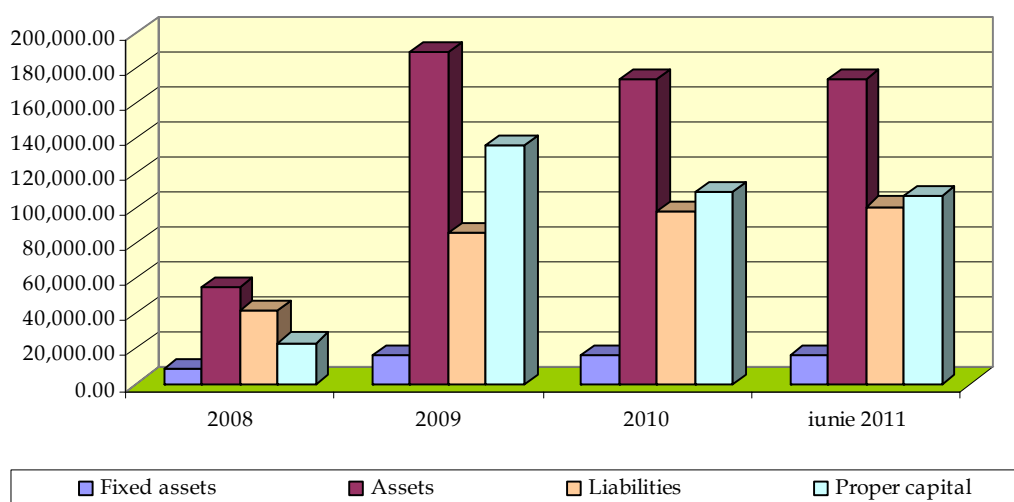


Figure no. 2. The dynamic of company's assets and liabilities

Source: Own contribution

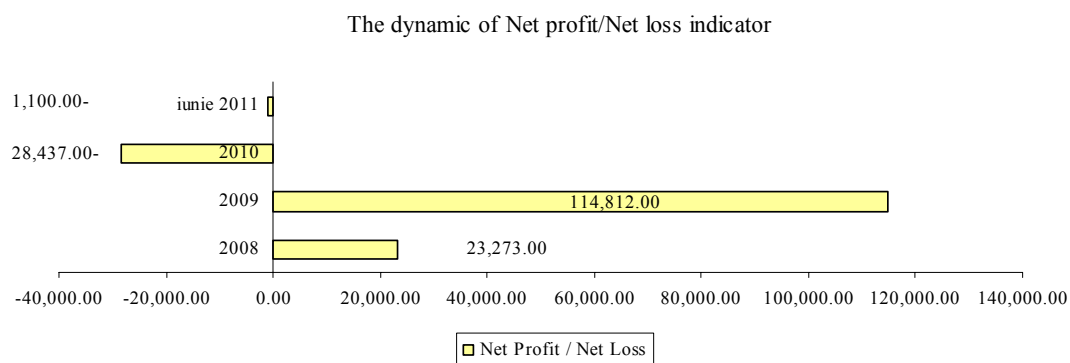


Figure no. 3. The dynamic of Net Profit/Net Loss indicator

Source: Own contribution

GLOBAL PROPERTY MANAGEMENT Company holds the following assets partially depreciated:

Table no. 5. Partially depreciated assets

Simbol of account	Name	BALANCE AT 30.06.2011
214	Furniture, office equipment, protective equipment and materials of human values and other tangible assets	10,518.00
281.04	Depreciation of other tangible assets	2,958.49
	<i>Remaining value after depreciation of other tangible assets</i>	7,559.51
	<i>Total amount after depreciation for tangible assets account</i>	7,559.51

Table no. 6. The Altman bankruptcy risk assessment

Year	Symbol	Formula	2008	2009	2010	June 2011
Indicator						
Proper working capital	FRpr.	CP-AI	14,771.00	120,100.00	93,955.00	91,230.00
Total active	TA	AI+AC+Cavans-Vavans	106,167.00	290,800.00	208,685.30	208,685.30
X₁		Proper worker capital / Total Active	0.14	0.41	0.45	0.44
Reserves	R		23,273.00	23,273.00	23,273.00	23,273.00
X₂		Reserves / Total active	0.22	0.08	0.11	0.11
Gross Profit	GP		27,718.00	136,887.00	-25,729.00	0.00
X₃		Gross profit / Total active	0.26	0.47	-0.12	0.00
Social Capital	SC		200.00	200.00	200.00	200.00
Medium and long term debt	DtIm		42,097.00	42,097.00	42,097.00	42,097.00
X₄		Social Capital / Medium and long term debt	0.00	0.00	0.00	0.00
Turnover	CA		79,204.00	79,204.00	79,204.00	79,204.00
X₅		Turnover / Total active	0.75	0.27	0.38	0.38
Z		$Z = 1,2X_1 + 1,4X_2 + 3,3X_3 + 0,6X_4 + 0,1X_5$	1.41	2.19	0.33	0.72

It's noted that $Z < 2.675$, so the company is exposed to bankruptcy due to poor financial situation.

5.2. Blue Ocean Strategy application – opening of a new business line " On-line consultancy 24 h/24 h"

It's a business for sale and it's based on a group of organizations that serve for final the opportunity to respond to questions of economic and financial consulting field 24 h of 24 h, 7 days a week and 365 days year. The group of organizations should include an NGO, ACEAR (The Association of Consultants for Business Expertises in Romania), one or more SME's and many PFA's (freelancers).

Contractors should possess knowledge PECO management organizations (European Computer Driving Organizations) which requires the completion of 7 modules of knowledge, namely:

Module 1 – Foreign Language: Business English that broadens specialized vocabulary business. English language develops business skills - from the spoken English on the phone and written simple reports (at lower levels) to business presentations, teamwork and negotiation (advanced levels).

Module 2 - ECDL (European Computer Driving License) with the seven modules : Module 1 - Basic Concepts of Information Technology, Module 2 - Using computers and files (Windows), Module 3 - Processing text (Word), Module 4 - Spreadsheet (Excel), Module 5 - Databases (Access), Module 6 - Presentations (Power Point), Module 7 - Information and Communication (Internet and E-mail).

Module 3 - Legislation: Law no. 31/1990 of companies, republished and updated in 2009, updated Labor Code, Law no. 85/2006 on insolvency proceedings, updated, the Tax Code, updated.

Module 4 - Creating a business: Opportunity study, feasibility study, business plan, european projects.

Module 5 - Managing a Business: Report of management, balance sheet, profit and loss account, financial annexes, statements.

Module 6 - Redesigning Business: Strategic diagnosis, assessment report, the redesign of management.

Module 7 - Closing a business: liquidation, audit, merger, division, ethics, communication, conflict.

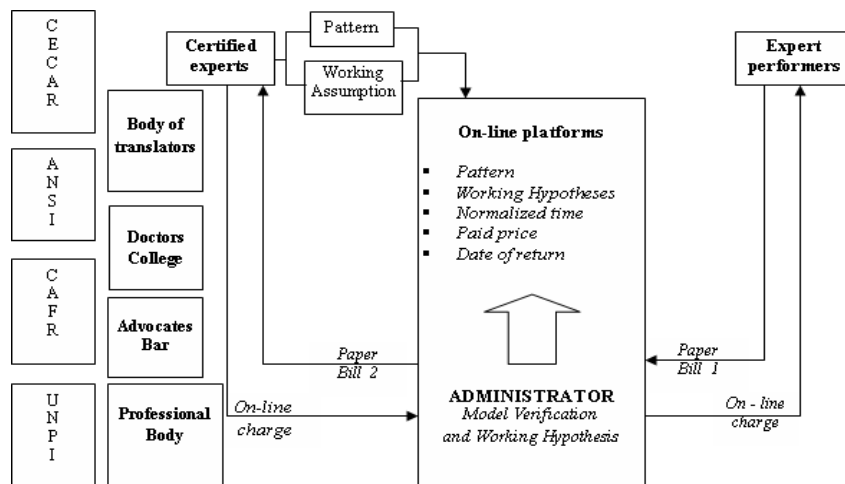


Figure no. 7: IT Platform

At this stage we have identified a niche in economic consulting in the Red Ocean. The main problem now is how to transfer from Red Ocean niche in a niche in the Blue Ocean: high price, without competition, future activity. Strategic Sail shows that, from professional point of view, GLOBAL PROPERTY MANAGEMENT Company is under local competition and has no perspective in terms of national, regional or international.

We should find answers to fundamental questions such as:

1. Employees like what they're doing?
2. They can become in a relatively short period the best in the field?
3. There is a marker, an identified indicator to show growth of the team from economic and knowledge acquired point of view?
4. Do you respect the criteria "twice as good at half price"?
5. What you enter in the system so that the first four criteria are easy to be achieved?

To try to answer pertinent to the questions above, we built a Blue Ocean strategy scheme criteria, which is presented below:

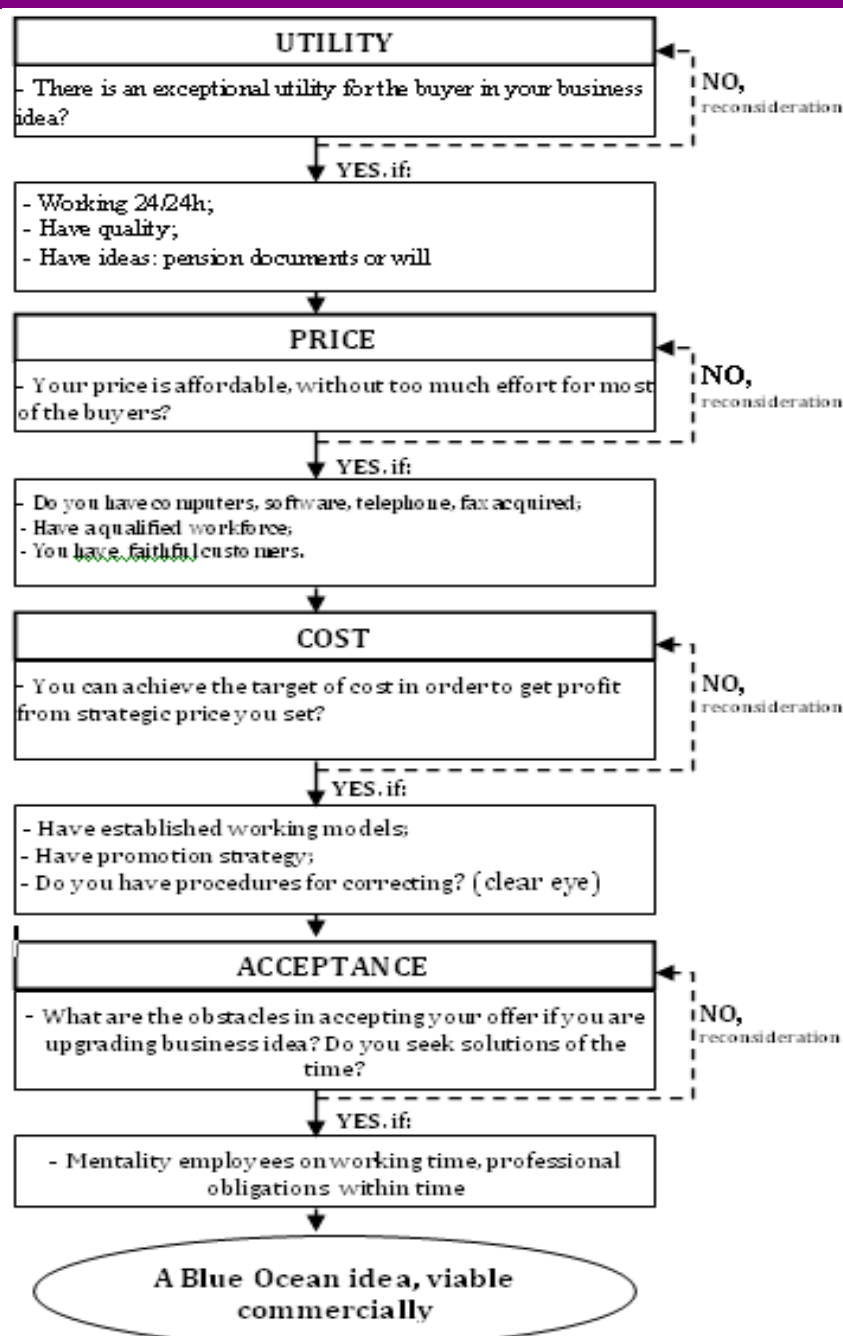


Figure no. 8. Blue Ocean strategy criteria

5.3. Evaluation of economic recovery chances for the company GLOBAL PROPERTY MANAGEMENT

Table no. 7. Cash flow forecast for GLOBAL PROPERTY MANAGEMENT Company

INDICATOR	Year 2011	Year 2012	Year 2013	Year 2014	Year 2015	Rezid
Income	46,295	231,475	416,655	555,540	611,094	
Cost of sold services	9,259	46,295	83,331	111,108	122,219	
Gross margin	37,036	185,180	333,324	444,432	488,875	
Operating expenses	11,574	57,869	104,164	138,885	152,774	
Amortization	1,315	1,315	1,249	1,249	1,187	
Gross profit	24,147	125,996	227,911	304,298	334,915	
Income tax	3,864	20,159	36,466	48,688	53,586	
Net profit	20,283	105,837	191,445	255,610	281,329	
Cash flow	20,283	105,837	191,445	255,610	281,329	854,505

INDICATOR	Year2011	Year 2012	Year 2013	Year 2014	Year 2015	Rezid
Discount factor	0.8772	0.7695	0.6750	0.5921	0.5194	38.45%
Discounted cash flow	17,793	81,440	129,223	151,346	146,119	525,921
Sum of discounted cash flow	525,921					
Residual value / terminal updated	328,584					
Enterprise value	854,505					

Table no. 8. The picture of revenue projected for GLOBAL PROPERTY MANAGEMENT Company

Activity	Year 2011	Year 2012	Year 2013	Year 2014
Income from sales for the current activity	11,574	57,869	104,164	138,885
Income from sales on new strategic directions proposed	32,407	162,033	291,659	388,878
Other income	2,315	11,574	20,833	27,777
TOTAL REVENUES	46,295	231,475	416,655	555,540

Table no. 9. The picture for projected costs for GLOBAL PROPERTY MANAGEMENT Company

Name of expenses	Year 2011	Year 2012	Year 2013	Year 2014
Raw materials and consumables expenses	9,259	46,295	83,331	111,108
Other operating expenses	11,574	57,869	104,164	138,885
Other expenses	1,315	1,315	1,315	1,315
TOTAL EXPENSES	22,148	105,479	188,810	251,308

Table no. 10. The Altman bankruptcy risk assessment when applying Blue Ocean Strategy

Year	Symbol	Formula	2011	2012	2013	2014
Indicator			100,353.00	110,388.30	121,427.13	133,569.84
Indicator						
Proper working capital	FRpr.	CP-AI	250,422.00	300,506.40	330,557.04	363,612.74
Total active	TA	AI+AC+Cavans-Vavans	0.40	0.37	0.37	0.37
X₁		Proper worker capital / Total Active	23,273.00	23,273.00	23,273.00	23,273.00
Reserves	R		0.09	0.08	0.07	0.06
X₂		Reserves / Total active	24,147.45	125,996.45	227,911.25	304,298.00
Gross Profit	GP		0.10	0.42	0.69	0.84
X₃		Gross profit / Total active	200.00	200.00	200.00	200.00
Social Capital	SC		80,839.55	62,184.00	47,834.00	36,795.00
Medium and long term debt	Dtlm		0.00	0.00	0.00	0.01
X₄		Social Capital / Medium and long term debt	46,295.00	231,475.00	416,655.00	555,540.00
Turnover	CA		0.18	0.77	1.26	1.53
X₅		Turnover / Total active	0.95	2.01	2.94	3.45

It is noted that since 2013, „Z” factor exceed the threshold of 2,675 times, so the company is out of bankruptcy risk and will have a solid financial stability.

Conclusions

Companies in Romania is facing a chronic lack of liquidity, which contributes to the increasing of bankruptcy risk, especially after October 2008, significantly. Determining a probability of entry into insolvency based on economical-financial analysis elaborated by a neutral consulting company, without

interest in the company where is analyzed the likelihood of entry is bankruptcy, is a method which allows to be taken the appropriate measures to avoid loss of customers, suppliers and reducing employees .

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