

DO COMPANIES HAVE TO BE SELFISH TO BE COMPETITIVE IN THE MARKET? BUSINESS STRATEGY ON A VALUES-BASED APPROACH IN THE CIRCULAR ECONOMY: THE GERMAN MITTELSTAND

Emin Akcaoglu and Rainer Wehner

*University of Applied Sciences Würzburg-Schweinfurt, Bavaria,
Germany*

Abstract: *The world has been struggling with an economic crisis since 2007 in general. Next to the economic crisis based on diminishing growth and employment, the world economy has also been facing unprecedented environmental and social problems. The current state of the world economy is directly connected to the orthodox Neoclassical Economic Theory which has been claiming that businesses are only profit making and all economic agents including company owners and managers must be acting only for their very own wealth maximisation. This is very well reflected in 'the shareholders' wealth maximisation' approach of the Anglo-American stock-market-based economic system. Therefore, the Neoclassical Model provides its legitimacy to such actions caused environmental and social problems such as global warming and huge income discrepancies. However, recently new concepts such as 'circular economy' have also been introduced and widely accepted by sensible companies and governments. In addition, new discussions have also gained a momentum in the public scene regarding 'sustainability of business'. In this paper a simple conceptual framework is introduced to integrate strategic management, ethics or moral values with business sustainability in the new circular economy with a special focus on the German SMEs sector (Mittelstand) to reflect the practical examples of sustainable and ethical approaches to business. This is important and interesting since the German economy has been doing the best among other European countries in the current economic crisis.*

Keywords: *Strategic management, business ethics, sustainability, corporate social responsibility, circular economy, Mittelstand, SMEs*

Introduction:

After a significant economic growth in the post-Second World War period, the world has been struggling with an economic crisis since 2007. In the EU the Mediterranean Club has still been suffering: Greece, Spain, Italy and even France have severely been affected. The German economy has been doing the best among other European countries. Though traditionally economic crises are based on diminishing growth and employment, the world economy has currently also some other and bigger problems. Perhaps technological revolution has brought unprecedented wealth to some countries, but its dual nature has also been reflected in many environmental and social problems. Overconsumption of natural resources caused unsustainable increase in greenhouse gas emissions and therefore global warming. In fact, there are huge differences between countries' per capita income and consumption levels. Paradoxically, some populous countries like China are increasing their wealth and hence their consumption. The world's population has also been increasing significantly and expected to reach 9 billion by 2050. The World Wildlife Fund (WWF, 2016) claims that the earth's resources will not be enough to carry on the current level of consumption and, environmental

problems will be unsustainable by 2050. In addition, though the ability to produce more goods and services than ever before, we are facing a potential erosion of the social structures in many countries. For instance, only eight richest men currently own the same amount of wealth as the poorest half of the world (Oxfam, 2017).

Moreover, before and after the great financial crisis of the 2000s, a number of accounting scandals came out in the United States and in some other countries. For example, one of the then leading accounting firms Arthur Andersen had a significant role in the Enron Scandal by certifying fraudulent financial statements. Though more than half of the fees were charged for non-audit services, Enron paid Arthur Andersen \$154,8 million in total only in three years (Freier, 2004). Not only those at Arthur Andersen but also at other major firms, professionals had been behaving in nonprofessional and also unethical ways by maintaining very close connections with the companies that they were supposed to be auditing. They had been violating regulations, certifying statements that fraudulent or at least misleading, and often obscuring the line between consulting and auditing (Freier, 2004; Gardner, 2006).

The sketched current state of the world economy is directly connected to the orthodox Neoclassical Economic Theory which has been claiming that businesses are only profit making and all economic agents including company owners and managers are acting (and must be acting) by the *Homo Oeconomicus*, the means-end rational model man who focus on only his own wealth maximisation. This is very well reflected in ‘the shareholders’ wealth maximisation’ approach of the Anglo-American stock-market-based economic system with the focus on short-term stock price. Therefore, the neoclassical model traditionally provides its legitimacy to such actions caused environmental problems and huge income discrepancies. According to Milton Friedman, one of the leading neoclassical economists, “the only responsibility of business is to its shareholders” and thus “the social responsibility of business is to increase its profits” (Gardner, 2006).

Is this really true? The recent events at least in the last two decades have clearly indicated that when owners or top managers only focus on their own selfish interests to increase the share prices or company growth, other stakeholders such as small investors and employees can suffer extremely. Moreover, environmental problems are quickly increasing to unsustainable levels. In this line, many economies are facing resources problems while environment is also a major concern. Under such conditions, new concepts such as ‘circular economy’ or ‘sharing economy’ are introduced and widely accepted by sensible companies and governments. In addition, new

discussions have gained a momentum in the public scene regarding ‘sustainability of business’ in general.

Similarly, and in direct connection to this discussion, the ‘business ethics’ and the ‘corporate social responsibility’ (CSR) movements have been gaining momentum globally with several initiatives. Currently, even the mainstream academic journals admit the relevance of ethical, moral or value-based challenges to the dominant discussion. In addition, there are brand-new journals particularly devoted to critical and interdisciplinary research and discussion to cover issues around ethical behaviour in business and economics, and corporate social responsibility, environmental sustainability, globalisation, international business etc. In fact, the number of publications is really huge and increasing in these areas. For instance, when we searched for “circular economy” on the web we found only 452,000 pages; but for “corporate social responsibility” that number was 19,900,000 pages on 2 March 2017. However, we think that these two concepts are strongly and directly related.

Within these various but interrelated discussions, one of the questions that would be raised is what makes the German economy different from the rest at least in Europe. Therefore, in this short paper we aim to understand how and why the German SMEs seem to perform better in general than their counterparts in some other countries. In this respect, we will analyse how *the values-based management mind-set* can be an important ‘resource’ of a company. Furthermore, how this resource can be used as a strategic competitive advantage. With that regard, in this paper we will also attempt to construct a simple conceptual framework to integrate strategic management, ethics or moral values with business sustainability in the circular economy. To that end, we will suggest that strategic management is directly related to ethical values of top management of any company. Within this framework we then focus on the German SMEs sector (Mittelstand) and the German Social Market Economy model to reflect the practical examples of our conceptual suggestions.

Therefore, in the following sections of the paper, first the circular economy concept will briefly be explained. This will be followed by a discussion on business strategy for competitiveness and sustainability before the conceptual framework is set. The rest of the paper will focus on the German case.

The Circular Economy:

Though, its roots are much older, the concept of circular economy is a recent phenomenon and hence it has not yet an agreed definition. However, it is generally considered as a new economic model that is opposed to the linear economy of resource consumption. The dominant model of production and consumption in the 20th century was 'linear'. In this traditional model, economic resources are taken or extracted → used for manufacturing and then → disposed. This process creates a lot of waste that puts threat to the environment ecologically, and it is not sustainable. As a result, a new approach has just been adopted under the name of the 'circular' economy. In this new model, the focus is on recycling and the repetitive use of economic resources by creating new business models which make such actions possible. Its objective is to increase efficiency in resource use and eliminate waste harmful to the environment. Furthermore, the circular economy model also promotes a service economy in which the rental of goods system replaces the sale of goods system. It is a radical new thinking of the relationships between companies, customers, markets, use of natural resources and environment. It also represents a huge opportunity for companies to create competitive advantage, restructuring the way we produce and consume through innovative business models and recent digital technologies. Therefore, the transition to the circular economy can be the greatest opportunity for how we organize production and consumption in the world economy (The Ellen McArthur Foundation, 2013a; 2013b; 2014; 2015; Radjou and Prabhu, 2015; Lacy and Rutqvist, 2015; Gallaud and Laperche, 2016).

There are many benefits of adopting a circular economy framework; such as reducing waste for ecological rationality, greater independence with respect to the supply of raw materials, and hence increasing competitiveness. These are particularly important for countries especially dependent on imports of costly raw materials and energy like Germany. In addition, since the circular economy requires simplified product design, companies will be forced for innovation and increased interaction with their customers. Reducing waste will contribute environmental as well as business sustainability. With that regard, the Ellen MacArthur foundation has highlighted two development scenarios for Europe; a transition scenario with savings of 12 to 14%, regarding costs of materials, and an advanced scenario with savings of more than 20% around 2025. The possible savings, in terms of resources, could reach more than one billion dollars per year (The Ellen McArthur Foundation, 2013a; 2013b; 2014; 2015).

Adoption of the circular economy approach depends on a number of factors such as regulations introduced by governments, a technical infrastructure capable of practically dealing with operational problems and we

believed that most importantly *an appropriate mind-set* which is ready for such an adoption. We think that this component is much more important than the others and in fact the lack of a ready mind-set to adopt the circular economy model may create the greatest obstacle in comparison with the lack of other factors mentioned.

Some authors suggest that the issues of business ethics and corporate social responsibility are not relevant within this context (Lacy and Rutqvist; 2015; Qi et al., 2016). We do not share such views. As we have pointed earlier we believe that the concept of circular economy cannot be belittled only to resource utilisation and environmental sustainability in economy. It has also surely some aspects in relation to ethics and social responsibility and these have a direct connection with *the mind-set of decision makers*. Not only in regulatory authorities but also in companies. In parallel, the mind-set of decision makers cannot be separated from their value judgements, beliefs and understandings (i.e. moral, ethical or whatever). But more importantly, the importance of an appropriate mind-set in economic activities can be easily seen in different countries economic systems. For instance, as mentioned earlier, the Anglo-American system is based on certain value judgements focusing on short-term share prices. However, let us say, the German economy has been operating in a quite different path since the end of the Second World War. Influenced by the First World War, the economic and financial crises of the 1920s and 1930s as well as the Second World War they developed a philosophical base which is called the Social Market Economy, or the Rhine Capitalism.

Business Strategy for Competitiveness and Sustainability

The area of strategic management is based on a very simple question: “Why do some firms perform better than the others in the market?” Though the question is very simple, answering this question requires a lot of hard work. We can start this with two other simple questions: “What is a business firm?” and “What is the purpose of a business firm?” As we will focus on the first question in the Conceptual Framework section below, here we particularly concentrate on the second question: “What is the purpose of a business firm?”

There may be various answers to this question. For instance, the possible answers could be ‘making money’ or, ‘increasing the share price as much as possible to make the shareholders richer and the wealthier than ever before’. All these answers may be accepted correct till a certain extend. As earlier emphasised, the orthodox Neoclassical Economic Theory claims that businesses are only for profit making and all economic agents including firm owners and managers must act rationally. In this context, rationality means

focusing only on his own wealth maximisation, and therefore the only responsibility of the business is to its shareholders. In such an understanding there is no room for social responsibility. But there is not a single unique form of capitalism in the world and in fact there are varieties based on different value-sets in different parts of the world. That is why nobody can claim that there is only one single truth in these types of discussions. We agree that for profit-making businesses a firm's initial objective is profit making. For large corporations (even for smaller ones) enhancing the shareholders' value could be the major concern, and profitability of business forms the base for the shareholders' value. In addition, though in reality there are only a handful of companies that can survive longer than a decade or a couple of decades, theoretically a company's life time is endless and there are no contradictions between targets of life span and shareholder's wealth maximisation regarding the operations of a firm.

On the other hand, there are some studies that prove the opposite views. For instance, in their famous book *Built to Last*, Collins and Porras (1994) search for the major reasons behind their success of the most successful companies such as 3M, American Express, Boeing, Procter & Gamble and Wal-Mart. They call such companies '*visionary companies*'. In this respect, they suggest that one of the myths of such huge success is that they exist first and foremost to maximize profits. They say that contrary to widely accepted myth "maximizing shareholder wealth" or "profit maximization" has not been the prevalent driving force or primary objective of such visionary companies. They rather pursue a group of objectives. Making money is definitely one of those but not necessarily the primary one. However, they are equally guided by a core ideology that is based on some core values and objectives beyond just making money. Paradoxically, such companies make more money than purely profit-driven companies.

Similarly, De Geus (1997) focus on this issue by categorising companies under two major types in accordance with their primary reason for being in business namely 'the economic company' and 'the river company'. He states that economic company exists only for profit making but nothing else. By contrast, the river company exists for the community or around the community. It does not mean that the river company does not care about profits or return on investment. It does. However, such a company is itself a community and longevity is also a major reason for existence. Therefore, "to produce both profitability and longevity, care must be taken with the various processes for building a community: defining membership, establishing common values, recruiting people, developing their capabilities, assessing their potential, living up to a human contract, managing relationships with

outsiders and contractors, and establishing policies for exiting the company gracefully” (De Geus, 1997: 126).

Mackey and Sisodia (2014) say that there is another way of thinking about capitalism and business that is really needed now under the current state of the world economy. They call this ‘*conscious capitalism*’ in which conscious businesses are motivated by higher purposes that integrate the interests of all their major stakeholders. Their consciousness enables them to see the interdependencies that exist among all the stakeholders, and in turn, this allows them to discover and harvest synergies from situations that otherwise cannot be utilised due to trade-offs.

Therefore, now we can ask: Which approach is the correct one for a higher competitiveness but more importantly sustainability in the longer term? We can suggest that each approach has its own assumption. For instance, the first one is based on the assumption of “business as war”, or the other one is based on the assumption of “business as value creation” (Hansen and Smith, 2006). When you look at the business literature you can find plenty of books and articles which are favouring one or the other. As both of them are based on different assumptions, probably it is better to say that there is not a correct answer to the initial question. However, such a discussion makes one point clear: The mind-set of a management executive is critically important for his or her decisions when strategy formation process occurs. Similar to other social sciences in business and economics, all theories are assumptions-based. Depending on the period, such theories and assumptions may also be widely regarded correct or not. Though, the orthodox assumption of money making was widely regarded as the sole business motivation by the latest financial crisis; after the crisis many authors have started to argue that currently the problem is either the lack of ethics in the business world or the wrong ethics that is based on the dominant assumption about how the game is played (Hansen and Smith, 2006). As a result, public and private organisations currently have attributed more attention to the improvement of ethical business behaviour all over the world. The business community’s ethical and social responsibilities have thus become a public concern. Even many business schools have introduced business ethics courses to their curriculums.

Conceptual Framework: Competitiveness and Culture – A Values-Based Approach

The Resource-Based Theory (RBT) of the Firm, which is in the centre of our conceptual framework, simply defines a firm as a bundle of resources. We hence classify all available resources for a firm under three basic categories as:

Firstly, physical / visible / *tangible assets* such as land, capital, equipment etc. Secondly, non-physical / invisible / *intangible assets* such as brands, patents, license etc. (i.e. intellectual property). All such assets, tangible or intangible, are under legal protection in connection with ownership rights.

However, there are also some assets that cannot be put under the first two groups; and cannot be protected legally. But they are still extremely important for the firm's operations. These are called '*capabilities*' in general and refer to tacit knowledge, work routines, organisational culture, and trust among the people in the firm etc. We think that this third group of resources also include *the mind-set of all the people involved but particularly of the top management*. And, the mind-set cannot be separated from the value judgements of the people. Interestingly, though these assets cannot be under legal protection, this would not be a problem of the firm as these are the ones which can rarely be transferred or imitated.

Competitiveness of a firm will depend on that firm's resource base. Depending on the industry in which the firm operates, the importance hierarchy of these three resource groups may differ. For instance, operating in the iron and steel or petro-chemical industries would require heavy capital involvement (the first group of assets) while pharmaceutical or computer software industries may require a large stock of intellectual property (the second group of assets).

This takes the issue to organizational culture. Organizational culture can be a source of competitiveness or vice versa. Organizational culture is directly related to the top management's values. If the top management cares about the ethical behaviour, social responsibility, environmental concerns etc., the culture of the organization will be strongly influenced by this standing. Even it might be easier in small and medium-sized enterprises and family firms where the smaller size fosters personal interactions for value transfers; there are also examples of multinationals who act in that way.

The German Mittelstand and Entrepreneurship:

When we focus on, let's say, the German small and medium-sized enterprises, we realize that firstly, they are entrepreneurial organisations. Secondly a great majority of them are owned by families and those families have had their own traditions. Traditions which are value based. Influenced by the disaster of two lost world wars and the economic and financial crisis in the, late 1920s and 1930s the fathers of the German constitution after World War II created an economic system which was not a plain copy of the Anglo-American stock market system.

Based on the Ordoliberal Ideas of the Freiburg School which was founded by Walter Eucken and Franz Böhm in the 1930s they added a social component to the liberal market economy and created the Social Market Economy which drove the post-war "German Wirtschaftswunder". It was the ordoliberal credo of "freedom" and "responsibility" that created an entrepreneurial spirit and influenced especially the family owned small and medium-sized enterprises.

A decisive role in this system however played the state that was responsible to create an open, value based, legal business environment without boundaries and corruption and with a reliable administration. In such a trustworthy business environment entrepreneurs felt fair treated and were able to grow and expand their businesses on a free and open market. On the other hand, they had no reason to play unfair, cheat or avoid and evade taxes because they had a transparent, reliable partner in the state.

This was the beginning of the German Mittelstand which consists mainly of family owned small and medium-sized enterprises. Those companies are characterized to show a greater responsibility in their decisions than big multinational corporations usually do. Not only against financial decisions because they are dealing with their own private equity, but also against the environment, their employees and the society in total. Obviously their aim is making profits, but money doesn't seem to be their one and only target. The value approach in their business approach let them treat their employees in a responsible way by i.e. paying fair and appropriate wages.

This economic behaviour, which is sometimes labelled as stupid by short-sighted officers of big cooperation's, has two major advantages. Firstly, the employees feel fair treated and are satisfied with their working conditions. Secondly, they are usually able to save some of their monthly salary for future expenses. They might think about buying real estate, a house or a flat, or starting a family. By doing this, the regular employee is able to claim more responsibility against his personal environment and has the chance to develop himself as a member of a middle class society. This is how an open society ideally should be. If we look at the business world of today, we see a big

number of perfect multinational corporations driven only by money orientation covered as “shareholder value”. We also realize a growing gap between super rich and poor who will probably never have the chance to develop themselves as responsible members of a middle class society.

The small and middle-sized enterprises in Germany, described as “Mittelstand” always played a vital role in developing a middle class society in the post war Germany. Without their responsible behaviour against the state and the society the “Wirtschaftswunder” of the 1950s would never have taken place. The fact that those companies kept their value based traditions and acted responsible against their environment in the last decades stabilized the German economy and society in a way that Germany was not affected as hard as other European countries by the influences of the economic and financial crises of the last years. The German Mittelstand acts according to the “life and let life”. Besides making profits the target was always the development of a middle-class society which is the basis for every democracy. Abolishing the middle-class society that we can observe nowadays in quite a lot of highly developed democratic countries has deep impacts on democracies and societies in total.

Conclusion – Integrating Business Strategy with Ethics and Corporate Social Responsibility in the Circular Economy:

Germany is one of the forerunners of circular economy together with the Netherlands, Japan and China. Germany is in an impressive position in terms of recycling activities since the early 2000s when it initiated a sustainable development policy. The optimal material use has been in the centre of this policy next to a resource efficiency program called ProgRess which has a special raw materials strategy aiming at ensuring the security of the strategic metals supply to its industrial structure. Germany is also one of the countries which best use renewable energy sources (Gallaud and Laperche, 2016).

SMEs are very important in Germany where they play a big role in forming a middle class society (so called the Mittelstand). The Mittelstand is the backbone of the dynamism of the German economy. But since the number of SMEs in any economy is overwhelming, they contribute substantially to GNPs and also to employment. For instance, over 99% of all German companies were SMEs in 2014. The number of SMEs in the country was 3.55 million and they were employing more than 24 million people, by also generating more than 60% of the GNP. Even if these figures show dynamism and success, German SME's are often family run businesses with a long tradition. It is the mutual respect of employers and employees and a value based management that make those type of companies so successful. These

companies are entrepreneurial in their nature and not always growth oriented individually. Many small business owners do not aim to grow the company size at all.

References:

- Brandt, F. and Georgiou, K. (2016). Shareholders vs Stakeholders Capitalism. Comparative Corporate Governance and Financial Regulation. Paper 10. As Part of the Global Research Seminar between Goethe-University Frankfurt am Main and University of Pennsylvania Law School.
(http://scholarship.law.upenn.edu/fisch_2016/10)
- Bilkey, W. and Nes, E. (1982), "Country-of-Origin Effects on Product Evaluations", *Journal of International Business Studies*, Vol.13, Spring/Summer, pp. 89-99. doi:10.1057/palgrave.jibs.8490539
- Chisik, R. (2002), "Reputational Comparative Advantage and Multinational Enterprise", *Economic Inquiry*, Vol.40, No.4, pp.582-596. doi:10.1093/ei/40.4.582
- Collins, J. and Porras, J. I. (1994). *Built to Last – Successful Habits of Visionary Companies*. Harper Collins, New York.
- De Geus, A. (1997). *The Living Company – Growth, Learning and Longevity in Business*. Nicholas Brealey Publishing, London.
- Ellen McArthur Foundation (2013a). *Towards the Circular Economy: Economic and Business Rationale for an Accelerated Transition*, Vol. 1. Cowes.
- Ellen McArthur Foundation (2013b). *Towards the Circular Economy: Opportunities for the Consumer Goods Sector*, Vol. 2. Cowes.
- Ellen McArthur Foundation (2014). *Towards the Circular Economy: Accelerating the Scale-up Across Global Supply Chains*, Vol. 3. Cowes.
- Ellen McArthur Foundation (2015). *Towards the Circular Economy: Business Rationale for an Accelerated Transitions*. Cowes.
- Freier, D. (2004). *Compromised Work in the Public Accounting Profession. The Issue of Independence*. GoodWork® Project Report Series, No. 35, Harvard University, Cambridge, MA. (http://thegoodproject.org/pdf/35-Compromised-Work-7_04.pdf)
- Foster, R. N. and Kaplan, S. (2001). *Creative Destruction – Why Companies That Are Built to Last Underperform the Market – And How to Successfully Transform Them*. Currency, New York.
- Gallaud, D. and Laperche, B. (2016). *Circular Economy, Industrial Ecology and Short Supply Chain*. Wiley, London.
- Gardner, H. (2006). *Five Minds for the Future*. Harvard Business Review Press, Boston, Massachusetts.
- Glauner, F. (2016). *Future Viability, Business Models, and Values – Strategy, Business Management and Economy in Disruptive Markets*. Springer, Heidelberg.
- Itami, H. and Roehl, T. W. (1991). *Mobilising Invisible Assets*. Harvard University Press, Cambridge, Massachusetts.

Hamel, G. (2011). 'Foreword' to The New Capitalist Manifesto by Umair Haque (the author), Harvard Business Review Press, Boston, Massachusetts.

Hansen, F. and Simith M. (2003). 'The Ethics of Business Strategy', in Handbook of Business Strategy, Vol.7, Iss.1, pp.201-206.

Koslowski, P. (2010) Elements of a Philosophy of Management and Organization. Springer, Heidelberg.

Lacy, P. and Rutqvist, J. (2015). Waste to Wealth – The Circular Economy Advantage. Palgrave MacMillan, Houndmills.

Lampert, S. I. and Jaffe, E. D. (1997), "A Dynamic Approach to Country-of-Origin Effect", European Journal of Marketing, Vol.32, No.1-2, pp.61-78. doi:10.1108/03090569810197471

Mackey, J. and Sisodia, R. (2014) Conscious Capitalism. Harvard Business Review Press, Massachusetts.

Mahoney, J. T. (2005). Economic Foundations of Strategy. Sage, Thousand Oaks.

Oxfam (2017). An Economy for the 99%: It is Time to Build a Human Economy that Benefits Everyone, Not Just the Privileged Few. Oxfam Briefing Paper.
(https://www.oxfam.org/sites/www.oxfam.org/files/file_attachments/bp-economy-for-99-percent-160117-en.pdf)

Racko, G. (2017). 'The Values of Economics' in Journal of Business Ethics, published online: 19 January 2017, Springer.

Radjou, N. and Prabhu, J. (2015). Frugal Innovation – How to Do More with Less. The Economist Books, London.

Singer, A. E. (2007). Integrating Ethics with Strategy. World Scientific Publishing, Singapore.

Qi, J., Zhao, J., Li, W., Peng, X., Wu, B. and Wang, H. (2016). Development of Circular Economy in China. Springer, Singapore.

Werhane, P. H. (1999). 'Environmentally Sustainable Business and the Rashomon Effect', in Werhane, P. H. and Singer, A. E. (editors) Business Ethics in Theory and Practice. Springer, Dordrecht.

Werhane, P. H. and Singer, A. E. (editors) (1999) Business Ethics in Theory and Practice. Springer, Dordrecht.

The World Wildlife Fund (WWF, 2016). Living Planet Report – Risk and Resilience in a New Era.
(http://d2ouvy59p0dg6k.cloudfront.net/downloads/lpr_living_planet_report_2016.pdf)