Conscious Capitalism: A Better Way to Win

A Response to James O’Toole and David Vogel’s “Two and a Half Cheers for Conscious Capitalism”

Rajendra S. Sisodia

Professors O’Toole and Vogel have provided a thoughtful assessment of the idea of “Conscious Capitalism.” I appreciate this opportunity to respond to their article.

The authors correctly state that Conscious Capitalism cannot address all of the shortcomings of traditional capitalism as they have described them. However, we have never claimed that Conscious Capitalism addresses all of the challenges that free markets face. We make no claim as to its ability to do away with boom and bust cycles, completely eliminate short-termism, or affect even the distribution of wealth between nations. What we do believe is that companies that subscribe to the tenets of Conscious Capitalism will, in the long-term, outperform other companies along multiple dimensions, financial included, while having a greater beneficial impact on the world at large.

The idea of Conscious Capitalism goes considerably beyond being “virtuous” or seeking to “do well by doing good.” It creates an entirely new superstructure for business and its reasons for existing. The four tenets of Conscious Capitalism are interconnected and rest on a foundation of extant knowledge about leadership and management. They build on important academic work relating to purpose, stakeholder management, leadership, and culture:

- **Higher Purpose**: Business can and should be done with a higher purpose in mind, not just with a view to maximizing profits. A compelling sense of purpose creates an extraordinary degree of engagement for all stakeholders and catalyzes the generation and release of tremendous amounts of organizational energy.

- **Stakeholder Orientation**: Conscious businesses are explicitly managed for the simultaneous benefit of all of their stakeholders, represented by the acronym SPICE: Society, Partners, Investors, Customers, and Employees. A conscious business aligns the interests of all stakeholders, so that what is...
good for one is good for all. Society is listed first for an important reason: businesses must ensure that they are on the “right” side of society, i.e., that they have a positive net impact on the world.

- **Conscious Leadership**: Driven primarily by service to the firm’s purpose, rather than by power or money, conscious leaders lead by mentoring, motivating, developing, and inspiring people, not through command-and-control or the use of “carrot and stick” incentives.

- **Conscious Culture**: Captured in the acronym TACTILE: Trust, Authenticity, Caring, Transparency, Integrity, Learning, and Empowerment, the word “tactile” also suggests that the cultures of these companies are very tangible to their stakeholders as well as to outside observers; you can feel the difference when you walk into a conscious business versus one that is purely driven by a profit motive and run just for the benefit of shareholders.

These four elements of Conscious Capitalism are mutually reinforcing, and describe a comprehensive systems perspective on business that is far richer and more complex than traditional machine metaphors. In our research, we found that companies that adhere to these principles outperformed the market by a 9-to-1 ratio over a ten-year period (1111% versus 123% for the S&P 500). Beyond financial wealth, these companies also create many other kinds of societal wealth: far more engaged and fulfilled employees, loyal and trusting customers, innovative and profitable suppliers, thriving and environmentally healthy communities, and more.

**Responses to the Critique**

Professors O’Toole and Vogel’s critique has several key themes. In this essay, I will respond to the following five themes. Each is a paraphrasing of related points made in the critique.

**Theme 1: Conscious Capitalism is not universally applicable; it seems to work mostly for companies selling expensive products to affluent and socially or health conscious customers. Other business models are equally valid; there are many examples of companies that have been very successful without practicing Conscious Capitalism. For example, many successful companies treat their employees poorly, pay high salaries to CEOs, focus primarily on producing great products, outsource production to lower labor costs, and/or lay off employees to benefit shareholders.**

Conscious Capitalism does not advocate for “virtuous” behavior per se, and the superior performance of conscious businesses is not a direct consequence of their acting more virtuously. Rather, it is because they act more wisely. These companies have recognized the true drivers of value creation in contemporary enterprises. They have tapped into the practical power of higher
purpose and the extraordinary levels of employee engagement that are made possible when personal passions align with corporate purpose. Their higher consciousness enables them to see the interdependencies that exist across all stakeholders, and it allows them to extract synergies from situations that are otherwise replete with trade-offs. They create enduring and endearing cultures that enable them to continue operating in this manner even after their founders have passed from the scene. Their leaders focus on building great organizations that are inherently self-organizing, self-motivating, and self-managing. They are not reliant on the charismatic leadership of particular individuals.

We agree that particular business strategies or business models are inherently unsustainable. However, Conscious Capitalism is not a business strategy or business model. It is a comprehensive philosophy of doing business. A well-thought-out philosophy can be broadly applicable and long-lasting. Of course, we are not so arrogant as to presume that the way we have defined Conscious Capitalism is the final word. What we have offered is a dynamic definition, one that will evolve as our consciousness grows.

A firm that uses financial incentives alone to attract and motivate a CEO will get precisely what it pays for: a CEO who is primarily motivated by money. Our firm belief is that such leaders are inherently incapable of inspiring their employees to achieve extraordinary levels of engagement, creativity, and performance. The most effective leaders are those who transcend self-interest; they are primarily motivated by purpose and service to people.

We do not believe that a firm that treats its employees unfairly can prosper in the long-term in the transparent and incredibly connected world we now inhabit. Good employees have a choice, and over time will migrate to firms that offer them not only fairness, but more importantly the opportunity to find meaning and purpose in their work. Companies cannot offer attractive, innovative products if they do not have engaged employees and high quality suppliers. The companies mentioned in the article (Apple, E-Bay, Microsoft, Facebook, and H&M) are all gradually moving towards a more conscious way of being, as are many other companies such as Wal-Mart, McDonald’s, General Electric, and Procter & Gamble.

Many companies do outsource production to low-wage locations to lower costs, and many lay off employees to improve their financial performance. Our experience with conscious businesses is very different. Customers are increasingly aware that there are good ways and bad ways to lower costs. Conscious businesses lower their costs and offer attractive prices to customers by eliminating wasteful spending, not by squeezing their employees or suppliers.

There is nothing inherently bad about outsourcing. If it is done in a conscious manner, outsourcing creates opportunities in less-developed parts of the world and helps to lift people out of poverty. However, if it is done purely to reduce costs without regard to its human consequences, it is no doubt harmful.

When sales decline, conscious businesses do not automatically revert to layoffs in order to lower costs. In the recent economic downturn in the U.S., conscious businesses such as The Container Store and REI made it through by
operating with a sense of shared sacrifice. Despite steep declines in sales, they chose to protect the jobs and pay of their most vulnerable employees: those who work part-time (referred to by The Container Store as “primetime” employees). Salaried employees took across the board pay cuts to get through the downturn. Such companies have emerged from the recession with stronger cultures and a deeper sense of shared purpose than they had before.

Conscious Capitalism is not a luxury good that is only affordable to a select few. In our research, we have come across numerous companies that offer high levels of affordability to customers while practicing the tenets of Conscious Capitalism. Examples include Costco, Southwest Airlines, JetBlue, Trader Joe’s, and IKEA. Conscious companies that are positioned at a higher point in the price spectrum still offer great value to customers, because of the quality of their offerings and the level of service experience that they provide. Examples of such companies include Whole Foods, The Container Store, and Starbucks.

Theme 2: The Conscious Capitalism vision is seductive, but it raises unrealistic expectations for performance and is hard to sustain. Companies can only practice Conscious Capitalism as long as they are profitable.

Corporate performance must be viewed as a multivariate construct. The financial dimension of corporate performance depends on a company’s ability to grow its revenue and improve its efficiency. Conscious businesses are superior on both of these dimensions, because they are better aligned with the true needs of customers and are focused on investing money where it makes a difference (such as on rank-and-file employees and high-quality suppliers) and saving money in non-value adding areas (such as excessive marketing costs and high levels of employee turnover). Currently, much of the growth of conscious businesses comes at the expense of their less-conscious competitors. If their competitors also become conscious businesses, such companies can still find healthy ways to grow by creating additional value through meeting the higher-level needs of their customers. As competition among conscious businesses increases, it creates further impetus for innovation that benefits the companies and all of their stakeholders. For example, Whole Foods Market and Trader Joe’s have each become much better companies as a result of competing with each other. Whole Foods has created more affordable offerings to be able to compete with Trader Joe’s, while Trader Joe’s has added more natural and organic food choices to compete with Whole Foods.

We have been working to understand how conscious businesses are able to operate with superior financial results while creating many forms of wealth and well-being for all of their stakeholders, including society. It boils down to something quite simple: these companies knowingly operate with lower gross margins than they could achieve, but are still able to achieve higher net margins than their traditional competitors.

Most companies try to maximize their gross margin by looking for the cheapest suppliers they can find, and then using whatever bargaining power
they have to squeeze them as much as they can to get ever-lower prices. As a result, they end up with low-quality suppliers who struggle to stay profitable, and who can ill afford to invest in new technologies or anything else that will improve their quality or make their products more innovative.

Most companies also try hard to keep their payrolls down, minimizing what they pay to their rank-and-file employees, and are stingy with critical benefits such as health insurance. They try to use part-time employees as much as possible, keeping them under the threshold where they would qualify for any kind of benefits. They provide minimal training to their employees, and accept high employee turnover as inevitable.

Conscious businesses are very selective about their suppliers, looking for innovative, quality-focused companies that also operate in a conscious manner. They enter into mutually beneficial long-term partnerships with them. Suppliers are well paid, and in turn pay their own suppliers and employees well. Conscious businesses also pay their rank-and-file employees very well, significantly above the industry norm, and are generous with benefits. Since their direct costs are higher, the gross margin of a conscious business is typically lower than average.

The next line item on the income statement is “SG&A” (Sales, General & Administration), and this is where conscious businesses really shine. Traditional businesses squander their hard won high gross margins by spending heavily on marketing, managerial overhead, legal fees, and high levels of executive compensation. They incur high recruiting and training costs due to high employee turnover. Their employees are disengaged and unproductive. Their product quality is suspect, leading to low customer loyalty and high levels of product returns.

Conscious businesses typically have to spend very little on marketing. This is because they have legions of satisfied and delighted customers who are loyal and passionate advocates for the company. We have found that many conscious businesses spend as little as 10 to 25% of the industry average spending on marketing. This represents an enormous cost saving, at a time when marketing costs have been growing rapidly for most companies. For example, retailer Jordan’s Furniture spends a quarter of the industry average on marketing (as a percentage of revenues) but achieves sales per square foot that are six times higher. Such companies receive the benefit of the best kind of marketing there is—free marketing—not only from their customers, but also from their employees, their suppliers, their communities, and the media.

Conscious businesses typically operate with extremely low levels of employee turnover, thus saving greatly on new employee hiring and training. Turnover at The Container Store, a perennial on “best places to work” lists, is in the low single digits, in an industry where turnover often exceeds 100%. Employees at such companies are loyal, experienced, highly engaged and extraordinarily productive. Such businesses take great care to hire people whose personal passions are aligned with the corporate purpose. At a time when overall employee engagement levels are shockingly low, conscious businesses have employees who are loyal, passionate, energetic, and creative. For them, their
work is not just a job or a career, it is a calling. For example, REI is passionate about reconnecting people with nature, and all of its employees are outdoor enthusiasts for whom every day at work is deeply fulfilling because they get to help customers discover the joy and beauty of being with nature.

Conscious businesses have lower administrative costs because they continuously strive to eliminate non-value adding expenses, gathering ideas from their employees and suppliers about how to do so. They also look to control essential expenses such as health care costs, not through across the board cuts, but by devising creative ways to achieve win-win outcomes. For example, Whole Foods Market is combating rising healthcare costs through a range of comprehensive employee wellness initiatives that go way beyond what you would find at a typical company. They are not only lowering costs; they are transforming lives in the process.

Conscious companies typically operate with much leaner management structures than do traditional businesses. They have created systems in which the right people are doing the right jobs and are given a great deal of autonomy. Most employees operate in the “value zone,” where they are actively creating real value for customers rather than “managing” each other. These companies are designed to be largely self-organizing, self-motivating, and self-managing.

Finally, conscious companies operate in a system of very high trust between all stakeholders, and thus their legal costs are much lower than the norm. They understand their customers deeply, produce outstanding products (due in no small part to the fact that they have world-class suppliers), and thus have much lower levels of product returns.

The notion of pay equity at such companies is driven more by internal rather than external considerations. Senior executives at such companies are modestly paid relative to their peers at other companies. For example, Whole Foods Market has adopted a policy that no one can be paid more than 19 times the average salary (the typical ratio at large publicly traded companies is 450-500 times). The only way for executives to earn more at such companies is to raise the average salary of all employees.

The authors cite the example of British textile mill owner Robert Owen to make the point that “virtuous capitalism is difficult to sustain.” We take away different lessons from this experience. A more enlightened approach to capitalism can indeed be difficult to sustain if a leader is not able to stand up to external pressures to change. More importantly however, we must recognize that our reality today is very different than it was in 1825. We now live in a transparent, connected world in which the level of human consciousness is far higher than it was then. In such a world, knowledge about enlightened business practices spreads much faster, and the pressures for positive change are constant. Further, just because something is difficult to do does not make it not worth our while. The worthy challenge we face today is understanding how to institutionalize such change and enable it to endure in the face of shortsighted opposition and through periodic changes in leadership.
Just like humans, no companies are perfect, and some companies that we have identified as conscious businesses have stumbled in recent years. The authors point to Johnson & Johnson and Toyota as recent examples of companies that have failed to live up to their highest ideals. However, these companies have only to rediscover their own essence in order to get back on track. Even the most conscious individuals sometimes act unconsciously. This does not negate the value of being conscious. The test of a truly conscious business is its ability to learn and grow from such experiences, and to emerge even stronger and more committed to a conscious way of being.

**Theme 3: A company often ceases operating as a conscious business when it gets acquired or when the founding CEO leaves.**

It is indeed the case that conscious businesses must exercise great care when merging with larger companies or seeking an injection of capital from private equity sources. Rather than being acquired, conscious businesses should be the ones doing the acquiring of other businesses. They should then ensure that those businesses are fully integrated into their conscious way of being. Whole Foods has done this numerous times in the past, and we expect that Southwest Airlines will do this with their recent acquisition of AirTran. If conscious businesses do get acquired by larger more mainstream companies, they must ensure that the Board of Directors of the acquiring company understands what makes them special, that they commit to maintaining those qualities, and that they make them part of the DNA of the merged entity.

Two companies that have managed this transition well in recent years are Stonyfield Yogurt and The Container Store. Stonyfield Yogurt has been acquired by the French company Groupe Danone. However, Stonyfield founder Gary Hirshberg retains operating control over the business. In fact, Stonyfield is now influencing the culture of the much larger parent company, an approach that other large companies should emulate when acquiring smaller conscious businesses. In the case of The Container Store, the private equity firm Leonard Green Associates has wisely left the current leadership team with operating control. This was a condition of accepting the injection of outside capital, and it has proven to be highly successful for both parties.

Companies operating consciously can be vulnerable when new CEOs are appointed from the outside. This suggests two things. First, such companies have not adequately institutionalized their approach to doing business and are therefore dependent on a particular leader to keep them on track. A conscious approach to business needs to become part of a company’s DNA, as it has at Southwest Airlines. Second, it is very important that boards of directors be deeply committed to this way of being and appoint CEOs whose approach is consistent with the philosophy. Even companies where a conscious approach to business is deeply entrenched can be demolished if they hire a determined leader with a narrow and short-term mindset. An edifice that takes decades to construct can be significantly damaged in a short amount of time with the wrong kind of leadership.
Theme 4: Discussions of Conscious Capitalism do not address the “other cells” in the Profitable/Virtuous matrix; it is assumed that all businesses can fall into Cell 1.

The authors have provided a useful framework to classify business activities. I interpret the word virtuous to signify that a business is “on the right side of society.” In other words, a virtuous business is one that has a net positive impact on the world. The most interesting cells in this matrix are Cells 2 and 3. In each case, we believe that the way to move the businesses to the desired Cell 1 is through higher consciousness, greater creativity, and enlightened public policy.

Cell 2 businesses are unprofitable but virtuous. In these cases, the role of enlightened public policy becomes very important. In the United States, the government provides large subsidies for many agricultural products as well as fossil fuels. As Gary Hirshberg of Stonyfield Yogurt has pointed out, the U.S. government’s “subsidy pyramid” is almost an inverted version of its well-known food pyramid. In other words, the government subsidizes many of the foods that are identified as harmful to health in excessive quantities, such as butter and cheese. The government should remove subsidies from products that are harmful; in fact, a strong argument can be made that such products should be taxed at a higher rate. Some of the funds thus raised should be used to subsidize products that are good for customers and for society, such as natural and organic food and renewable, nonpolluting forms of energy. In the long-term, such businesses should strive to be viable without the need for subsidies.

Cell 3 businesses are profitable but not virtuous. Examples of such businesses would be fast food, soft drinks, and tobacco. These businesses can and must move towards becoming virtuous by altering their product mix so that they once again are on the right side of society. For example, McDonald’s and PepsiCo are both moving to add more healthy food options to their offerings. This reflects a rising consciousness that the needs of society today have shifted from what they were when these companies were first established. At that time, we had neither an obesity crisis nor a diabetes crisis. Companies in such positions can unleash the creativity of their employees and suppliers to come up with new offerings that are desired as well as desirable. At the same time, we can also use the levers of public policy to make non-virtuous businesses less profitable and virtuous ones more profitable.

Theme 5: Since Wall Street is notoriously focused on the short-term, do conscious businesses need to avoid the equity markets altogether?

We do not believe that the equity markets are a major constraint on conscious businesses. We have studied a large number of publicly traded companies that are conscious businesses and have found that they are able to operate in a conscious manner despite the short-term pressures that may come from certain analysts on Wall Street. In the long run, equity markets do reward sustained superior performance, which is what conscious businesses deliver. Most analysts may not understand how these firms are able to deliver superior performance,
but that is not a hindrance as long as the leaders of these businesses are resolute and stay true to the principles of Conscious Capitalism. It is only when they start operating according to the conventional performance models used by many analysts that such firms begin to suffer.

**Rethinking Capitalism**

The unique contribution of Conscious Capitalism is that it is a more rooted, inclusive, and holistic approach. It differs from other movements because it is explicitly rooted in an evolutionary change underway since the beginning of humanity—the shift to greater levels of consciousness. It seeks to synthesize the broad ideological roots of capitalism with the personal depth of the world’s great wisdom traditions. Table 1 shows how Conscious Capitalism differs from three other recent conceptualizations of how capitalism should evolve.

**Conclusion**

Businesses create and destroy many kinds of wealth and well-being. Too many generate financial wealth at the expense of social, cultural, environmental, intellectual, physical, and spiritual well-being. They are value extracting rather than value creating. Conscious Capitalism is about doing business with a spectrum of positive effects, not having one positive “main” effect and many negative “side” effects. Conscious businesses spend money where it makes a positive difference. They don’t waste money on unnecessary advertising, gimmicky promotions, and the revolving door of high employee and supplier turnover. They empower people and engage their best contribution in service of a higher sense of purpose. They make a net positive impact on the world. We believe that it is simply a better way to win.

**Notes**

**TABLE 1.** How Conscious Capitalism Differs from Other Recent Conceptualizations

(continued on next page)

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<th>The Basic Idea</th>
<th>Shared Value Capitalism (Michael Porter and Mark Kramer)</th>
<th>Creative Capitalism (Bill Gates)</th>
<th>Capitalism 3.0 (Otto Scharmer)</th>
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<td>Shared Value Capitalism (SVC) refers to practices that make a company more competitive while enhancing the economic and social well-being of communities in which it operates. Companies should broaden the definition of value, and more closely align value for shareholders with value for society. Many societal needs on a global basis are still unmet, while big companies largely focus on manufacturing demand among affluent customers. The past focus on a narrow definition of value has led to a growing divergence between business and society. Companies can create shared value in three ways: by rethinking products so they are good for customers and create social benefits; by making the value chain more efficient and sustainable; and by enabling local cluster development. Concludes by asserting that “Not all profit is equal. Profits involving a social purpose represent a higher form of capitalism, one that creates a positive cycle of company and community prosperity.”</td>
<td>Expand the reach of market forces so they can benefit more people at the lower end of the income spectrum. Work with governments and nonprofits to meet the needs of the poorest. Invest in innovation specifically aimed at the “base of the pyramid.” This especially applies to products with high fixed costs and low variable costs, such as software and pharmaceuticals. Companies can use variable pricing to make such products affordable to poor people and still have a positive impact on profits. Companies benefit through public recognition and enhanced reputation, as well as the ability to hire and retain more talented employees.</td>
<td>Building on work by Peter Barnes, Scharmer describes three stages of Western capitalism: Capitalism 1.0 or laissez-faire capitalism, focused on growth; Capitalism 2.0: European-style stakeholder capitalism, with an emphasis on redistribution; and Capitalism 3.0: a vision of an “intentional, inclusive, ecosystem economy,” focused on ecosystem innovation. Scharmer identifies seven dimensions of economic thought that need to change: coordination mechanisms based on “shared seeing and common will;” earth-to-earth design of all production and consumption cycles; expanded economic human rights for workers; capital flows redirected to serve all sectors of society, along with commons-based property rights; aligning technology development with societal needs and aspirations; leadership oriented to “learning from the emerging future;” and greater citizen awareness and participation.</td>
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创意资本主义（比尔·盖茨）
资本主义3.0（奥托·沙尔默）

### 如何与传统资本主义不同

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<td><strong>如何共享创造价值</strong></td>
<td>更加重视社会价值的创造，超越股东财富最大化。它明确认识到公司无法在受苦的社区中长期繁荣。</td>
<td>创意资本主义在金字塔的底部明确聚焦于弱势群体，提供服务弱势消费者的实际途径。它强调的是影响力最大化，而不是利润最大化。需要在更繁荣和不繁荣的客户之间进行交叉补贴。</td>
<td>资本主义3.0是一种带有理想主义色彩的愿景，尚未实现。它推进了我们对商业在社会中作用的思考，但它没有提供一个可行和测试的模板。</td>
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| **如何与社会资本不同** | 共享资本主义是关于共享价值观，以及共享价值。共享资本主义对社会的绩效影响尚不清楚，但它为我们提供了大量关于如何和为什么社会企业能够表现得更好的证据。共享资本主义非常专注于务实、操作性强的商业实践活动，它没有涵盖那些给共享资本主义赋予其力量的无形因素。 | 创意资本主义是一个附加到传统商业模式中的东西。它仅仅要求公司在更细分的市场中开发服务，包括对弱势市场。它非常重视提供低价格和低可变成本产品的声誉价值。 | 共享资本主义是一种公司正在实践并取得成功的哲学，而资本主义3.0则是一个遥远的梦想。资本主义3.0主要在系统层面运作，而共享资本主义的主要重点是公司在公司层面的运作。资本主义3.0更难实施，而实现共享资本主义所需的步骤则相对简单。

**注释**

- a. 迈克尔·E. 波特和马克·R. 克莱默，“创造共享价值：如何重塑资本主义—并释放创新与增长的潜力”，《哈佛商业评论》，89/1-2（2011年1月/2月）：62-77。
- b. 比尔·盖茨，“使资本主义更具创造力”，《时代》杂志，7月31日，2008年；访问于<http://www.time.com/time/business/article/0,8599,1828069,00.html>。
- c. 奥托·沙尔默，“七个改变资本主义的穴位”，《牛津领导力杂志》，1/3（2010年6月）：1-21。