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Business
Review

Corporate Governance

What Does "Stakeholder Capitalism" Mean to You?

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From the Magazine (September–October 2023)

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Summary. Business leaders are being urged to adopt a multistakeholder approach to governance in place of the shareholder-centered approach that has guided their work for several decades. But through hundreds of interviews with directors, executives, investors,... **more**

The past few years have seen an outpouring of articles and statements heralding the arrival of a new and more inclusive form of capitalism, often called "stakeholder capitalism." It promises to bolster companies, improve outcomes for their constituencies, produce better returns for long-term shareholders, and ultimately strengthen the economy and society as a whole. In line with the new ideology, corporate boards and business leaders have been urged to adopt a multistakeholder approach to governance in place of the shareholder-centered one that has guided their work for several decades.

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In speaking with hundreds of corporate directors, executives, investors, governance professionals, and academics over the years, I've found wide differences in how stakeholder capitalism is understood. The failure to recognize those differences has been a source of much confusion and disagreement inside companies and in the public debate. The recent controversy over environmental, social, and governance investing is a case in point. In this article I describe four kinds of stakeholder capitalism—*instrumental, classic, beneficial,* and *structural*—which reflect significantly different levels of commitment to the interests of stakeholders and are based on very different rationales.

Four Versions of Stakeholder Capitalism

Proponents of stakeholderism take varying stances on the strength and basis of their commitment to nonshareholder stakeholders. The spectrum below explains those commitments, from weakest to strongest.

As more companies embrace stakeholder capitalism, it is important that corporate leaders have a shared understanding of what, exactly, they are embracing. Espousing a commitment to all stakeholders without clarity about what that actually entails puts directors and executives on a collision course with one another when decisions requiring difficult trade-offs among stakeholders' interests arise—as they inevitably do. It also creates expectations among stakeholders that if unfulfilled will fuel cynicism, alienation, and distrust—the opposite of what most proponents of stakeholder capitalism intend. Meanwhile, shareholders are left wondering what this new ideology means for them. This article is intended as a guide to help corporate leaders define what they mean by stakeholder capitalism and thus reduce the risk of such negative consequences.

[**Instrumental Stakeholderism**]

Maximizing Long-Term Shareholder Value

This version of stakeholder capitalism holds that considering the interests of all stakeholders can actually help maximize returns to shareholders, because how a company treats its nonshareholder stakeholders can affect shareholder value. Investing in other stakeholders may reduce shareholder value today but pay off for

shareholders in the future. Conversely, shortchanging other stakeholders may benefit shareholders for a time but be detrimental to them over a longer period. Thus even corporate leaders whose only objective is maximizing value for shareholders should consider the interests of other stakeholders.

That appears to be the dominant understanding of stakeholder capitalism in much of the investment community today. Certainly recent statements by heads of the "big three" asset managers in the United States—BlackRock, Vanguard, and State Street Global Advisors—seem to reflect this view. In his 2021 letter to CEOs, BlackRock Chairman and CEO Larry Fink stated: "The more your company can show its purpose in delivering value to its customers, its employees, and its communities, the better able you will be to compete and deliver long-term, durable profits for shareholders."

This view recognizes that actions taken today have consequences for tomorrow and that the interests of different stakeholders are often interdependent. Consider the simple example of investing in employees' development. Giving your salespeople time away from their jobs to learn new skills may dampen that quarter's sales, disappointing some shareholders and possibly hurting the stock price. But it will most likely help sales and fuel growth in the future, increasing shareholder value. By the same logic, forgoing such investment may improve the bottom line and benefit shareholders today but lead to declining sales, operational inefficiencies, and ultimately losses in shareholder value that exceed the earlier gains if your sales team's skills become outdated.

Defining Terms

How the expressions used in this article shift meaning depending on the context.

Stakeholder

What this term means and to whom it refers have been topics of much debate. The Darden professor R. Edward Freeman has defined it as "any group or individual who can affect, or is affected by, the achievement of a corporation's purpose."
(continued)

An instrumental approach to stakeholders in no way challenges shareholder primacy and is fully consistent with its four main tenets: treating shareholder-value maximization as the corporate objective; prioritizing accountability to shareholders over accountability to other stakeholders; subordinating the preferences of other stakeholders to those of shareholders; and giving shareholders the exclusive right to vote on directors and other governance matters. It differs from traditional shareholder capitalism in just two main ways: by giving explicit consideration to other stakeholders' interests, and by assessing shareholder value over a longer period.

Some commentators say those differences are inconsequential. But paying explicit attention to other stakeholders' interests can reveal risks that decision-makers often don't recognize when they're focused narrowly on shareholder value. Indeed, disregard for those interests has led to substantial destruction of shareholder value at numerous companies. Consider the fake-accounts debacle at Wells Fargo and Dieselgate at Volkswagen—to

name just two. Had leaders of those companies paid more attention to the interests of constituents who were not shareholders, they might have pursued different practices or strategies and ultimately done a better job for their shareholders.

Paying attention to stakeholder interests and taking a longer view can also reveal strategic opportunities. Corporate leaders narrowly focused on near-term shareholder returns would be unlikely to choose to build a new plant in their distressed home region rather than in a lower-cost location overseas. But Cummins did just that in 2010 when it decided to manufacture its new line of high-speed, low-emissions engines in Seymour, Indiana. Its decision meant that the company would have to make significant investments in the community and its schools—but it also presented an opportunity to raise educational attainment and income levels in the region and create a global hub for advanced manufacturing that would ultimately benefit the company. In 2015 Cummins began producing its new line of engines at the Seymour plant. And thanks in part to its collaboration with other companies and the region's civic and educational leaders, local residents' educational attainment, incomes, and wage rates improved as well.

Challenges for instrumental stakeholderism. This approach promises real benefits for stakeholders and society, but those benefits go only so far. Although it requires corporate leaders to take stakeholders' interests into account, it does not require them to *respect* those interests unless doing so would be financially beneficial for shareholders. From this perspective, an investment in the company's stakeholders, like any other investment, should be pursued only if it increases net present value, and investments in stakeholders that reduce long-term shareholder value should be avoided. While proponents of instrumental stakeholderism tend to focus on win-win examples like the Cummins case, corporate leaders frequently face pressure and opportunities to generate shareholder value in ways that do not benefit all stakeholders and may even do harm to some of them.

Espousing a commitment to all stakeholders without clarity about what that actually entails puts directors and executives on a collision course with one another.

The economists Roy Shapira and Luigi Zingales have shown, for example, that polluting the environment, even when it is against the law and harmful to public health, can sometimes maximize long-term value for shareholders. Using information disclosed in numerous lawsuits, they examined the decision DuPont executives made in 1984 regarding perfluorooctanoic acid (PFOA), a toxic chemical used in making Teflon that was seeping into the drinking water of the community where it was manufactured. Documents showed that executives knew about PFOA's toxicity to humans and persistence in the environment. As the authors reported in their paper "Is Pollution Value-Maximizing?," three options were considered: ending production of PFOA, continuing production with measures to abate the harmful emissions, and continuing production without abatement measures. Shapira and Zingales modeled the decision from the perspective of a shareholder-value-maximizing manager using the present value of the long-term costs and benefits to the company associated with each option. Their analysis found that the executives' decision—to continue producing PFOA without abatement—maximized shareholder value, even after taking into account legal liabilities, regulatory sanctions, reputational effects, and other costs to the company over the ensuing 30 years. In other words, the decision was perfectly correct from the perspective of instrumental stakeholderism, because an option that respected other stakeholders' interests would not have maximized long-term shareholder value.

Proponents of instrumental stakeholderism sometimes cite the clarity of its decision rule as one of its principal virtues. But predicting which course of action will most likely maximize long-term shareholder value is fraught with difficulty, especially when it requires putting a monetary value on outcomes such as health, clean air, and justice, which have no market price, or predicting how laws, policies, or public sentiment will evolve over the long term. The longer the time frame, the more speculative the exercise. The rule to maximize long-term shareholder value may be clear on its face, but it does not eliminate difficult trade-offs, and it can sometimes result in serious harm to other stakeholders and society at large.

[**Classic Stakeholderism**]

Respecting Stakeholders' Legitimate Claims

This version of stakeholder capitalism holds that at least some stakeholders' interests must be respected as well as considered. It differentiates among interests, prioritizing those protected by ethical or legal norms over those based on wishes or desires. The core idea is that the former, more fundamental, interests give rise to claims whose validity is not contingent on their contribution to shareholder value and underpin obligations to stakeholders that sit alongside financial and strategic imperatives. This type of stakeholderism recognizes that serving stakeholder interests often contributes to shareholder value, but that some stakeholder interests should be addressed even when it doesn't. (I call it "classic" because of its similarity to early expressions of stakeholder theory.)

The idea that corporate leaders are permitted, let alone required, to act in ways that don't necessarily maximize shareholder value may sound like heresy. But that is far from the case. Even the best-known proponent of shareholder primacy, Milton Friedman, acknowledged that shareholder value should be pursued within

the rules of society as embodied in law and "ethical custom." In his well-known *New York Times* article of 1970 he defined ethical custom quite narrowly, as requiring only that companies compete "without deception or fraud," but presumably he would have condemned deceiving *any* stakeholders—customers, employees, suppliers, shareholders, or communities—even if it could be shown to create long-term value for shareholders.

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A more robust form of this view is found in the Business Roundtable's 1981 statement on corporate responsibility, which declared that "the shareholder must receive a good return but the

legitimate concerns of other constituencies also must have the appropriate attention." And the American Law Institute's 1992 *Principles of Corporate Governance: Analysis and Recommendations* explicitly acknowledges that corporate decision-makers may pay heed to ethical considerations in their dealings with the company's stakeholders "even if corporate profit and shareholder gain are not thereby enhanced."

Recent court cases in Delaware go further, suggesting that in certain situations respect for some stakeholder interests may even be a matter of fiduciary duty. The 2021 case against Boeing's board of directors speaks to this point. After two fatal crashes of the 737 MAX narrow-body airliner, shareholders filed suit on behalf of the company, alleging that the board had neglected its duty by failing to oversee and monitor airplane safety. In allowing the case to proceed beyond the pleading phase, the court noted that although certain board and management communications mentioned safety "in name," they were not "safety-centric." That is, they focused on the financial, operational, public relations, or legal implications of safety rather than on safety itself.

To be sure, establishing a board's liability for a failure of oversight is extremely difficult, and the case was ultimately settled. For directors and officers, however, the case suggests that due regard for stakeholders' fundamental interests—not just their impact on shareholder value—is increasingly seen as integral to their roles.
Challenges for classic stakeholderism. Compared with instrumental stakeholderism, classic stakeholderism provides much stronger protection for stakeholder and societal interests. As critics of stakeholderism have noted, however, determining which interests must be respected is not always easy.

A useful starting point is the norms of corporate conduct that are widely accepted around the world. They include obeying the law, respecting human rights, truth and honesty, honoring promises, protecting health and safety, and so on. Nevertheless, corporate

leaders may face difficult judgments about which interests must be protected. Consider a corporate restructuring that involves mass layoffs. The company could save millions of dollars by eliminating its customary (but legally optional) practice of giving advance notice and severance packages to departing employees. Assume further that eliminating those measures would help management meet the guidance on margins previously announced to shareholders. Some managers would see the approach as perfectly valid, arguing that employees have no legitimate claim to advance notice or severance payments in this situation, while others would find it profoundly unfair to employees and thus inconsistent with the requirements of classic stakeholderism.

Classic stakeholderism differentiates among interests, prioritizing those protected by ethical or legal norms over those based on wishes or desires.

An equally if not more vexing challenge for classic stakeholderism is resolving conflicts among competing stakeholder claims. Even if the universe of claims is limited to those based on legal and ethical principles, corporate leaders can face difficult trade-offs. During the early days of the pandemic, for instance, some companies in the food sector were torn between ensuring the safety of employees working in plants plagued by Covid outbreaks and meeting their responsibilities to get food to distributors and consumers. Unlike instrumental stakeholderism, which offers “maximize shareholder value” as an all-purpose decision rule for resolving such dilemmas, classic stakeholderism holds that they can be resolved only through a process of deliberation that weighs and compares competing interests and seeks to minimize harm and maximize human well-being.

Critics of stakeholder theory often point to the lack of a single decision rule for resolving trade-offs as a major shortcoming. Proponents, however, see the demand for such a rule as based on an overly narrow conception of rationality, divorced from the messy realities of corporate leadership. They have a point. By its very nature, the job of corporate leaders entails multiple obligations. It is not possible to say in advance how conflicts should be resolved or whose interests should take priority. Both depend on the facts and circumstances of the situation and the nature of the particular interests at stake.

[**Beneficial Stakeholderism**]

Improving Outcomes for Stakeholders

This version of stakeholder capitalism seeks not just to meet stakeholders' basic claims but also to measurably improve their well-being. It comes in part from a belief that optimizing returns for shareholders over the past four decades has led many companies to underinvest in their other constituencies and has caused a disproportionate share of gains to go to the owners of capital. It is also driven by the idea that running companies to improve the lives of all stakeholders will help address some of the large-scale problems and inequities facing society today, thereby helping to protect the long-term health of the economy and quell growing discontent with capitalism.

I call this version "beneficial stakeholderism" because of its similarity to the benefit corporation movement, which includes efforts to certify traditional corporations as so-called B Corps and the adoption of legislation in numerous states and countries permitting businesses to organize themselves as "benefit corporations" or "public benefit corporations." Although the certification standards and statutes vary, they have in common a requirement that the company's directors "balance" or "consider"

the interests of its various stakeholders when setting policies and making decisions, and that the company periodically report on its progress in advancing stakeholders' well-being.

Beneficial stakeholderism has certain affinities with the benefit corporation approach to stakeholders, but an organization need not be a benefit corporation or a certified B Corp to adopt its basic tenets. Unilever's actions under the leadership of Paul Polman are an example. During Polman's tenure, from 2009 to 2019, the company pursued an agenda that delivered gains for many of its stakeholders. As detailed in Unilever's 10-year progress report on its Sustainable Living Plan, the company enhanced employees' health and well-being, made its pay system more equitable, paid all employees a living wage, and augmented the livelihoods of more than 800,000 smallholder farmers. It advanced human rights in its supply chain, raised the nutritional value of its products, improved the health and hygiene of more than a billion people, and made progress toward cutting its environmental impact in half by 2030. During roughly the same period, Unilever also delivered a total shareholder return of 290%—well above the median of 165% for 18 consumer goods companies in its peer group.

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Beneficial stakeholderism is similar to classic stakeholderism in attributing intrinsic (not just instrumental) value to certain interests of nonshareholder stakeholders. However, it calls for a more expansive commitment to the well-being of stakeholders. For example, classic stakeholderism is concerned with employee safety, equal opportunity, equal pay for equal work, and other interests that are protected by basic legal and ethical norms. Beneficial stakeholderism would add to that list dignity, inclusion, meaningful work, and economic equity in the broad sense—whether employees earn a decent livelihood, receive a fair share of the value they are helping create, and have sufficient opportunities for advancement.

Beneficial stakeholderism is more demanding than classic stakeholderism in other ways as well. It envisions ongoing improvement in the outcomes delivered to stakeholders, thus implying defined goals for each stakeholder group and methods for tracking, measuring, and reporting on those outcomes, along with appropriate compensation and incentive systems. It requires an imaginative approach to strategy in which stakeholder interests are essential building blocks rather than side

constraints. And it requires a holistic approach to decision-making and resource allocation. Corporate leaders must view each decision not in isolation but as part of a portfolio of choices aimed at achieving the desired outcomes for all stakeholders.

Like instrumental stakeholderism, beneficial stakeholderism rejects the short-termism of traditional shareholder-value maximization. The two versions diverge, however, in their approach to investment decisions. Instead of allocating resources solely on the basis of likely returns to shareholders, beneficial stakeholderism prioritizes projects with the potential to improve outcomes for multiple stakeholders. Although proponents have not, to my knowledge, spelled out precisely how such decisions should be made, the process presumably involves analyzing the expected impact on each affected stakeholder group and choosing either the project with the greatest benefit in aggregate or the one that by some methodology optimizes results across the groups.
Challenges for beneficial stakeholderism. Although this version of stakeholder capitalism holds out the prospect of ever-improving outcomes for all stakeholders, its critics are right to caution against expecting too much. Like classic stakeholderism, beneficial stakeholderism sometimes entails trade-offs among differing interests. But its concern for a broader set of interests can make those trade-offs even more challenging.

Moreover, there is a real question about how much corporate leaders can invest in their nonshareholder stakeholders without losing shareholder support or running afoul of their fiduciary duties. If, for example, the directors of a traditional Delaware corporation decide to sell the company, they are legally obliged to prioritize shareholders' short-term financial interests. But even when the company is not for sale, legal, economic, competitive, and capital-markets factors often constrain leaders' ability to promote the interests of other stakeholders.

Under Delaware law, considered the gold standard for corporate law in the United States, investments in other stakeholders must have a rational relationship to advancing the interests of the corporation. Commentators often brush off this limitation, noting that courts are reluctant to second-guess a board's business decisions. For conscientious corporate leaders, however, a rational relationship to the corporation's interests is an important benchmark. A proposed investment in nonshareholders that does not advance the interests of the corporation must be justified on some other basis. As noted, it might be required or allowed for legal or ethical reasons, or it could be permitted as a charitable contribution. If it cannot be justified in one of those ways, it is (legally speaking) a waste of corporate assets and grounds for legal action against the company's directors.

Beneficial stakeholderism is driven by the idea that running companies to improve the lives of all stakeholders will help address some of the inequities facing society today.

A more pressing issue for most corporate leaders is not what the law allows but what is realistic given the company's economic and competitive situation. Even stakeholder interests that are directly related to the business can be addressed only up to a point. Customers, for instance, almost always want better quality, better service, and lower prices, but a company's ability to satisfy those desires is not infinite. Investing more in customers typically means investing less in something else. And whether it is a traditional corporation or a benefit corporation, a company can undermine its own viability if its generosity to customers (or any other stakeholders) results in too many loss-making transactions. Many factors—the company's strategy, the expectations of other stakeholders, what resources are available, what competitors are

doing, how the industry is changing—affect how much corporate leaders can invest in any one stakeholder group. Even for fast-growing companies in thriving industries, delivering on a multistakeholder strategy can be difficult. For distressed companies and those in low-growth or declining industries, it is even more so.

Corporate leaders' ability to invest in other stakeholders ultimately depends on shareholders' willingness to support those investments. Shareholders who disagree with how resources are being allocated may sell their shares. If enough of them do so, the company's stock price will fall. If the drop is severe or prolonged, the company may become the target of a proxy fight or a takeover bid. Whatever decision-making discretion the legal system gives corporate leaders, their actual choices are constrained by the preferences of shareholders who, as noted, have ultimate power over the company's direction through their rights to buy and sell shares, elect directors, vote on major transactions, and challenge directors in court.

In summary, beneficial stakeholderism holds promise, but corporate leaders who embrace it face a challenging path. In comparison with instrumental and classic stakeholderism, beneficial stakeholderism envisions a more significant shift away from traditional shareholder-value maximization in how companies deploy resources and distribute the value they create, with a greater share of both going to nonshareholder stakeholders. But, as discussed, limits on their ability to advance other stakeholders' interests are real. Only 13% of directors responding to a recent survey by PwC agreed strongly that climate goals should be a priority even if they affect short-term financial performance. Perhaps that's because few investors in public companies appear willing to forgo meaningful returns for a greener planet or a more equitable society.

Increasing Stakeholder Power

The three versions of stakeholderism discussed so far all focus on the first pillar of shareholder primacy: Maximizing value for shareholders is (or should be) a corporation's principal objective. They all call for refinements or changes to that objective or how it is implemented, and they are similar in leaving the traditional governance structures and processes that define the balance of power between shareholders and other stakeholders largely intact. That is to say, they all accept another pillar of shareholder primacy: Shareholders are (or should be) the only constituency with a formal voice in corporate governance. A fourth version—which I term "structural stakeholderism"—calls for giving nonshareholder stakeholders voting or other powers in the governance process. Advocates of this version seek to hard wire the interests of other stakeholders into the process, rather than relying on corporate directors and business leaders to take them into account, typically by giving those stakeholders a defined role in selecting directors or formal representation on corporate boards.

Where this idea has been widely implemented, notably in Europe, employees are the stakeholder group (other than shareholders) that is most often given board representation. Germany's two-tiered board system is an example. By law and tradition one-third to one-half of the directors on the supervisory boards of German companies are elected by employees and the rest by shareholders. Other European countries take other approaches to employee participation. Although rare in the United States, employee representation on boards is not unheard of. A 1919 Massachusetts law (still in effect) permitted manufacturing companies to adopt bylaws empowering employees to elect one or more directors, and some unions have secured a seat on company boards. The board of Delta Air Lines, for example, includes a pilot nominated by the governing body of its pilot association. In the past few years more

than a dozen shareholder proposals about adding nonmanagement employees to boards have been voted on (and gotten scant support) at large U.S. companies, and several bills in the U.S. Senate would give employees of large companies the right to elect a certain percentage of the board.

> **A company can undermine its own viability if its generosity to customers (or any other stakeholders) results in too many loss-making transactions.**

The appointment of directors who represent the public interest has also been proposed from time to time. The idea gained currency among law and business academics in the United States in the 1970s, following a spate of corporate failures and scandals. It was actually tried on the boards of Irish banks that received government bailouts during the global financial crisis of 2008. Other commentators have proposed that customers, communities, and taxpayers or other stakeholders have board representation. For some, the term "stakeholder capitalism" itself implies that corporate boards should comprise representatives of various stakeholder groups.

Most advocates for adding stakeholder representatives to boards or extending voting rights beyond shareholders claim that more-robust involvement of other constituencies would strengthen companies' ability to create long-term value by boosting productivity, enhancing employee engagement, or sparking innovation. But for most, those are secondary consequences. The principal goal is to protect the interests of nonshareholder stakeholders and increase the weight given to them in corporate decision-making.

Challenges for structural stakeholderism. The call to add representatives of employees or other stakeholders to corporate

boards raises fundamental questions about the nature of boards and the duties of directors—and about the basis of directors' authority to govern. Although directors are sometimes referred to as shareholders' "representatives"—and, as noted, are elected by shareholders—they are legally more akin to trustees for the institution than to delegates representing a particular constituency. That is why other shareholders may protest when an activist hedge fund negotiates a seat on the board for its own nominee or offers additional compensation to that director for achieving its goals. As fiduciaries, directors owe care and loyalty to the corporation as a whole and are obliged to exercise independent judgment on its behalf—not to do the bidding of a subset of shareholders.

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Under the traditional legal model, a corporate board is thus closer to a fiduciary board than to a constituency board. Those two orientations lead to very different mindsets and very different requirements for director effectiveness. Fiduciaries for the institution must understand the interests of multiple constituencies and how they relate to the business as a whole. To maintain their objectivity, they need to keep some distance from interested parties seeking to exert influence. By comparison, representatives of a constituency are expected to engage closely with its members, carry out their wishes, and advocate for their interests. Fiduciary directors and constituency directors can thus take very different stances on issues that come before the board.

Few if any proposals to add employees or other stakeholders to corporate boards raise this issue explicitly, but many of them seem to envision those boards as constituency boards comprising representatives of various stakeholder groups. Although constituency boards are appropriate for some organizations, the model has troubling implications for business corporations. Perhaps the most worrisome is the potential effect on the speed and coherence of decision-making. If the principal duty of directors is to serve the interests of the groups they represent rather than the interests of the company, the prospect of lengthy negotiations and contentious standoffs quickly arises. Decisions about strategy, investments, leadership, acquisitions, divestments, restructuring, and the like must often be made quickly. In a rapidly changing business environment, taking time to solicit the views of various stakeholder groups and to negotiate a resolution of the differences among them may not be feasible. Moreover, without a shared duty to the company to anchor and focus the negotiations, the odds of a suboptimal result are high.

The concept of stakeholder boards runs counter to the ideals of director independence that are at the core of good governance today. For advocates of stakeholder boards, having an interest in the business as an employee, a customer, a supplier, or another constituent is a qualification for service. But it can also compromise a director's judgment and undermine boards' ability to make overall value-creating decisions. Proponents of stakeholder boards envision them as collaborative bodies working toward a single purpose, whereas skeptics envision them as thickets of competing claims that breed distrust and impair decision-making. Before embracing stakeholder boards, it would be wise to clarify the duties of their members and consider how they are likely to function in practice.

. . .

Stakeholder capitalism can be more or less than meets the eye—and more or less of a challenge to shareholder primacy—depending on which version is being considered. Each one involves a distinctive set of commitments and challenges, and each has very different practical implications for how companies and their boards function. Corporate leaders need a clear understanding of what those implications are. They also need to be honest about what their version can actually deliver for stakeholders, what it can deliver for society, and what it means for shareholders. We have passed the point at which concern about conflicts can be brushed off with easy appeals to a presumed long-term harmony of interests among shareholders, stakeholders, and society. The time has come to clarify what we mean by "stakeholder capitalism."

A version of this article appeared in the September–October 2023 issue of *Harvard Business Review*.

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