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A FAILURE OF CULTURE AND LEADERSHIP:

The Volkswagen Emissions Scandal and its Uncertain Aftermath

An Interview with Robert C. Bird*

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In September 2015, the Environmental Protection Agency (EPA) discovered that Volkswagen AG, a German car manufacturer, had installed a device in cars with diesel engines that would selectively modify its performance in order to pass emissions tests. The result is a worldwide condemnation of the German manufacturer that imposes a substantial threat to VW's diesel market and its reputation. In this expert interview, Robert Bird of the University of Connecticut School of Business discusses the Volkswagen scandal and what it means for the long-term future for the organization as well as the impact of culture on an organization's ability to comply with rules. Professor Bird remarks that the scandal highlights the critical importance of not merely setting high standards, but building a deeply-held and sustainable culture of integrity is essential for any modern organization in a risk-laden regulatory environment.

VOLKSWAGEN HAS ATTRACTED SUBSTANTIAL CRITICISM FROM ITS MISUSE OF AN EMISSIONS DEVICE. WHAT FORMS OF CORPORATE MISCONDUCT ARE MOST DETRIMENTAL TO ORGANIZATIONS AND HOW CAN COMPANIES REACT IN THE IMMEDIATE AFTERMATH OF THAT MISCONDUCT?

Any corporate misconduct is bad for the firm, but certain types of misconduct are more perilous than others. Decisions that implicate substantial financial amounts, or put human lives or health at risk, are usually more damaging than incidents where the costs are small and the injuries remote. Misconduct that directly impacts consumers, is intentional rather than merely negligent, or is easily understood by the public will usually amplify the perception of misconduct. The most harmful reputational actions are ones that breach the public trust. Consumers build strong affiliations with the brands they consume, and corporate misconduct can generate irreparable damage to the brand's ability to influence consumer behavior. Punishments by a court or regulator generally end with sanctions, but a consumer who does not trust a brand may never return to using that product or service. Volkswagen's misconduct represent the worst kind of scandal – a premeditated, consumer-facing, and public misdeed that captured the interest of the media and provoked the derision of its customers.

The response of a firm to allegations of misconduct, particularly in Volkswagen's case, is important. A response that evades or denies responsibility can amplify the damage caused by a scandal. The timing of any response is also important. With news cycles so short in a modern age of information, firms cannot sluggishly deliberate. If a firm does not respond with a clear message from an emerging crisis, others will infer a harmful narrative about



the nefariousness of the organization. Once the company loses control of its message, it is hard to recover.

In short, a message in crisis must be rapid, clear, and unequivocally dedicated to fixing the problem. Silence, delay, or blame serve no purpose and can only make consumers assume the worst about the enterprise. Volkswagen must continue to respond without hesitation as future concerns arise about their products and integrity.

WHAT SPECIFICALLY WAS THE MISCONDUCT THAT VOLKSWAGEN ENGAGED IN THAT HAS TRIGGERED SUCH DISAPPROVAL?

Volkswagen had installed a software “defeat device” in a number of its diesel engines cars sold in the United States. Details are imprecise, but the software apparently was able to discern when the engine was under controlled conditions necessary for testing the car’s emissions. The software made this determination through monitoring various factors, including engine operation, air pressure, speed of the car, and even the position of the steering wheel. When the software detected the appropriate conditions, it placed the vehicle in a kind of safety mode which ran the engine at sub-normal performance levels. When the software detected real world road conditions, the engines left safety mode and operated normally. This apparently went on for several years before a nonprofit environmental research group discovered the excessive emissions in normal operations.

WHAT WAS THE IMPACT OF THIS DEFEAT DEVICE?

An accusation of excessive emissions might seem little more than a technical error. However, the scale of the excess pollutants circumvented by the software is staggering. When under normal road conditions and without the aid of the defeat device, Volkswagen diesel cars emitted nitrogen oxide pollutants at 10 to 20, and potentially up to 40, times over the permitted maximum US emission levels. At the same time, Volkswagen benefitted from \$51 million in green car tax subsidies.

While the impact may be limited due to few diesel cars in the US, the potential for harm is greater abroad. One analysis by a British newspaper concluded that the defeat software may be responsible for nearly one million tons of air pollution annually in the UK. That is equivalent to the annual emissions output of the UK’s vehicles, industry, agriculture, and power plants combined. Nitrogen dioxide, the pollutant most concerning from the



Volkswagen emissions, in high concentrations has been associated with lung airway inflammation and can interact with other pollutants and create secondary health problems.

OTHER COMPANIES HAVE VIOLATED EPA RULES IN THE PAST. SOME VIOLATIONS HAVE BEEN FLAGRANT. WHAT MAKES VOLKSWAGEN'S CASE SO DIFFERENT IN THE MINDS OF REGULATORS AND THE PUBLIC?

At least three factors I believe contributed to the widespread public outcry against Volkswagen. First, the scale of the violation was quite high. Volkswagen cars were allowed to release pollution in vastly greater quantities than other autos of similar type and size. This was no mere minor deviation from technical rules, but a flagrant and substantial violation of important emissions standards. Second, intent is important here. This was not just a careless mistake. Volkswagen made a deliberate decision to break the rules. The company deliberately circumvented legal standards with the goal of giving the impression of a clean and environmentally friendly automobile. Unlike other car company misconduct where firms were merely careless, Volkswagen's intentional actions give this scandal a sinister quality. Third, Volkswagen is a public-facing company and breached the trust of consumers who believed in the Volkswagen product and its advertising of an environmentally friendly vehicle. Loyal Volkswagen customers felt lied to, and reacted strongly to the disclosure of the defeat device and its consequences. These three factors created a perfect and justifiable storm of outrage from government, consumers, advocacy groups, and the public at large. The failure is particularly striking in that it happened to a company that prides itself on engineering prowess and corporate responsibility engagement. This scandal is a symptom of deeper problems that had been plaguing Volkswagen for some time.

WHAT WERE THOSE DEEPER PROBLEMS IN THE ORGANIZATION?

It may never be entirely clear what truly motivated Volkswagen employees to install and maintain the defeat devices, and also what processes specifically failed to detect and prevent this illegal conduct. There were signs, however, that this was a troubled organization. Volkswagen was facing weak sales in the US and having difficulty cutting costs at home. Executives under pressure tend to take risks, and this creates an environment where corner-cutting can become an acceptable practice.



Volkswagen also had problems with domineering control. The company was tightly administered by three powerful interests: labor unions, government, and the billionaire family of the descendants of company founder Ferdinand Porsche. Independent shareholders control only 12 percent of company shares. This control by these dominant owners was enforced down to even insignificant details – drivers to headquarters were even forced to park only in one direction. Volkswagen culture possessed a dominant trait, commentators have remarked, and that is to be aggressive at all times. While aggression was a powerful force at Volkswagen, an unyielding pressure to conform to organizational standards appears to also be a significant cause of the misconduct.

VOLKSWAGEN HAS EMPHASIZED THE ROLE OF A SMALL NUMBER OF ENGINEERS IN CREATING THE DECADE-LONG DECEPTION. HOW MUCH OF THIS CAN BE TIED TO THE ROGUE BEHAVIOR OF A FEW EMPLOYEES?

Volkswagen executives and board of directors have stated that a small group of engineers are responsible for the misconduct. Management has also stated that they were not aware of the illegal behavior. Both of these statements may be literally true, but it does not absolve management or the board from Volkswagen's actions. In fact, the conduct of Volkswagen leadership likely had an influential role in causing the conduct.

WHAT ROLE DID LEADERSHIP PLAY, IF NOT BEING DIRECTLY AWARE OF THE ONGOING MISCONDUCT?

The values of any organization begin from the tone at the top. The leaders set the rules and the ethics of the firm, and it is the employees that take their cue from top management. Two men at Volkswagen dominated the firm's culture for over twenty years. Ferdinand Piëch was chief executive from 1993 through 2002 and remained as chairman of the board of directors. Piëch was a skilled, some would say obsessive, engineer who could spot problems in designs that other engineers had missed. His relentless pursuit of technical improvements, while displaying an indifference to people skills, can be sufficient traits for a successful engineer. When that engineer is promoted to management, or even the chief executive office, the lack of interest in personal diplomacy can be a liability. "My need for harmony is limited", Piëch said in his autobiography, and that attitude permeated his interaction with organizational stakeholders. During his tenure he aggressively pursued growth and doubled the number of brands. He was also at the helm when Volkswagen was tied to a charge of corporate



espionage when a departing General Motors executive, which Volkswagen had courted, had taken confidential GM documents to his new employer. Piëch was distinctly authoritarian, and authoritarian organizations tend to charge forward at great long-term financial risk.

Piëch's successor, Martin Winterkorn, reinforced this culture. He wanted Volkswagen to be a lead player in the world's largest automobile market, the United States, where it had floundered in the past. An already stressful organization became even more pressured, and those that disagreed either departed on their own or were managed out of the business. Winterkorn simply refused to accept failure of any kind. When test driving a VW car, Winterkorn noticed a slight bump in the paint. The paint thickness of the car exceeded standards by less than a millimeter, but Winterkorn used this as an opportunity to lecture his employees anyway about the wasted paint. Executives described their relationship with him as one of respect, but also fear and distance. He could lash out with little warning. One executive reported that upon hearing bad news he could be loud and quite demeaning. This only bolstered what Piëch set firmly in place – that Volkswagen was infected with an authoritarian culture that discouraged frank discussions and demanded excellence at virtually any cost.

CHIEF EXECUTIVE OFFICERS TYPICALLY EXPECT EXCELLENCE FROM THE COMPANY. THEY CAN ALSO BE DEMANDING OF THEIR EXECUTIVES AND EMPLOYEES. HOW IS VOLKSWAGEN'S CONDUCT ANY DIFFERENT?

There is nothing wrong with demanding excellence. A CEO would likely not last very long if he or she didn't pursue high standards. There comes a point, however, where a work culture shifts from being demanding to despotic. Excellence comes from an iterative engagement between leaders and their workforce. Effective leaders inspire their workforce, conceive strategy, and set goals. Effective leaders also encourage and incorporate feedback even when that feedback challenges current thinking. Bad news does not trigger a tirade, but an analysis of what went wrong and how management and employees can collaboratively solve pressing problems. Building harmonious relationships motivates employees toward excellence more than any punishment or rebuke.

Dictatorial leadership, even if that leader is technically competent, discourages dissent and suppresses innovation. Any employee that sticks her neck out risks it getting chopped off. That kind of climate creates a culture of fear. Once a culture of fear



permeates a workforce, it is only a matter of time before that fear indirectly or directly causes mistakes or misconduct.

WINKLEHORN HAS HIS DEFENDERS. SOME HAVE SAID THAT WINKLEHORN WOULD HAVE NEVER ALLOWED THE DEFEAT DEVICE TO BE IMPLEMENTED IF HE HAD KNOWN ABOUT IT.

That may be true, but it may also be unimportant. Winklehorn thoughts are less important than his words and deeds. Winklehorn and his predecessor sent clear and unequivocal messages to the Volkswagen workforce that failure of any kind would not be tolerated. Employees that did not conform were mercilessly forced out. They both imposed hyper-aggressive ambitions on the Volkswagen workforce to capture new markets and attain higher standards. Employees apparently did not follow Winklehorn because they believed in him, they followed Winklehorn because they were afraid of him. Employees likely knew their jobs were on the line if they did not produce results. The fear of retaliation from management for failure was likely so powerful that workers felt they would rather break the law than face management's wrath. And so a few employees quietly installed the defeat device that would forever change the trajectory of the company.

VOLKSWAGEN HAS REPLACED NUMEROUS EMPLOYEES AND EXECUTIVES, INCLUDING THEIR CEO, AND NEW CEO MATTHIAS MÜLLER HAS PROMISED TO END BUSINESS AS USUAL. HOW SHOULD WE INTERPRET MÜLLER'S PROMISE?

Müller is certainly no Piëch or Winklehorn. The scandal is not just a problem to be solved, but a chance to transform the company's culture, and it's clear that Müller knows this and will seize the opportunity. Müller is aggressively trying to change the inflexible hierarchy that has dominated Volkswagen for so long. Müller has made symbolic changes, such as dropping the corporate Airbus jet, leaving his office door open while Winklehorn kept other executives away, and ripping out a silver carpet on a stage that made executives look like royalty. He also commenced real changes. Müller has reduced the size of the management board and replaced over a dozen senior executives, including heads of major auto units. Outsiders are being recruited that are not beholden to the prior culture. They are also granted significant autonomy. Executive bureaucracy is being reduced. These changes are promising.



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That being said, a burst of high profile personnel changes are not sufficient to turn a company like Volkswagen around. The old culture has been cemented in place for decades. Managers have been able to survive in the old culture through obedience, and it is likely that some of these managers will be passed over as outsiders are hired over their heads, possibly breeding resentment. For employees, they may have been so conditioned by the Piëch and Winklehorn leadership styles that it will be difficult for them to change their ways. There's no assurance that once the scandal passes, and Müller possibly moves on, that the company won't return to its old habits. Learning to trust is a risk, and Müller will have to expend substantial effort in order to build a new culture of respect, inclusiveness, and integrity.

VOLKSWAGEN HAS AGREED TO A NEARLY \$15 BILLION SETTLEMENT TO RESOLVE THE EMISSIONS MISCONDUCT IN THE UNITED STATES. ISN'T THIS A STEP IN THE RIGHT DIRECTION?

Volkswagen's settlement with the EPA is indeed a step in the right direction, but full resolution of liability is far from complete. Most of the settlement, \$10 billion, is allocated toward consumers through buybacks, repairs, lease terminations, and other forms of compensation. This represents an extraordinary concession, the highest settlement payment ever made by an automaker in the United States, and one that will go a long way to resolving outstanding disputes. This agreement may also represent the beginning of rebuilding Volkswagen's goodwill in America. It also shows Müller's willingness to accept blame on behalf of Volkswagen.

However, resolution of liability in the European Union remains unresolved. Consumer advocates are calling for similarly generous compensation for European drivers of Volkswagen cars. In meetings with EU officials, Müller made clear that equally generous compensation for European drivers would not be forthcoming. Müller argued that tougher emissions standards in the United States escalated the cost of repairing the cars, and similar payments are not necessary in Europe due to differing European standards. Such a large settlement would impose unsustainable financial damage. In other words, Müller claims that Volkswagen simply does not have the resources to pay such an award and survive. Müller must admit blame, but he also has an interest in protecting the sound viability of the organization. This may come at a cost, however, as European consumers feel cheated by arguably not receiving the same justice as their American counterparts. Volkswagen took accounting charges in 2015 of \$18 billion in anticipation of fixing vehicles and paying the settlement, but it's unlikely that the amount will be enough. Law firms are currently collecting plaintiffs for the inevitable class action lawsuits to follow.



HOW DOES CORPORATE SOCIAL RESPONSIBILITY IMPACT VOLKSWAGEN'S POST-SETTLEMENT STRATEGY?

Corporate social responsibility can be part of Volkswagen's long-term strategy to rebuild consumer confidence. While socially responsible practices in other areas will be helpful, installation of the defeat device was fundamentally a breach of environmental integrity. Environmental protection and preservation must therefore take prominent roles in any socially responsible initiatives.

While laudable, Volkswagen should not merely donate to environmental causes and consider itself remediated. Such efforts without more can be perceived as mere inauthentic 'greenwashing' of a tarnished brand. Instead, their commitment to the environment must be thoroughly embedded in their organization. Volkswagen executives should redouble their efforts to remain environmental leaders in automotive production and technology. Production methods can be made best-in-class for environmental awareness. Automobiles can be at or near best-in-class for emissions standards. Consumers must be made aware that Volkswagen remains committed to green technologies and practices even after the misconduct, and is worthy of consumers' trust in its products.

Broken trust is difficult to repair, and it will be some years before consumers return to pre-scandal attitudes towards the organization. Volkswagen must demonstrate that it is committed to honesty, integrity, and responsibility over the long-term. Corporate social responsibility is one way to rebuild its relationship with the customer.

WHAT HAPPENS TO VOLKSWAGEN AND OTHER COMPANIES IN LONG-TERM?

Such predictions are difficult to make. One likely long-term effect is the erosion of trust. Trust is fundamental in order for a business to function. If consumers do not trust a company's product, that company is doomed. No amount of money can erase what happened in the minds of the public, who may view Volkswagen differently for quite some time.

This effects of this scandal go beyond Volkswagen. Other car companies are being investigated as well for potential emissions misconduct. This could result in a cascade effect across the auto industry. Some are referring to this scandal as Dieselgate, implicating not only Volkswagen but any diesel automobile. The 'Made in Germany'



reputation may even be impaired, as the term ‘German engineering’ takes on a more insidious meaning.

A well-known quotation is that, while it takes a lifetime to build a reputation, it requires only a few seconds to destroy one. For Volkswagen, it was a few lines of code and years of authoritarian management that brought down its reputation around the world. It remains to be seen whether Müller has the leadership and staying power to restore Volkswagen to its former stature.

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