# Reflections On The Volkswagen Emissions Scandal From The Perspective Of Corporate Governance

Volkswagen group was founded in 1937, headquartered in Wolfsburg Germany. The brands of Volkswagen group include Volkswagen, Audi, Skoda, Lamborghini, Bentley, Bugatti, Scania, Volkswagen commercial vehicle, Porsche, MAN and motorcycle brand Ducati. With a strong global brand strategy system include civilian brand, luxury brand, sports car brands and commercial vehicle brand, now it has become one of the biggest automakers in the world. During 2013 to 2016, a fairly large number of vehicles of the Volkswagen group have been recalled for various reasons; including the most famous emission scandal.

The emission scandal first started with a report published by the Center for Alternative Fuels, Engines & Emissions at West Virginia University, which tested three in-use passenger cars, including a VW Jetta, a VW Passat, and a BMW X5 (Eger & Scheafer, 2018). The results of the test revealed the NOx emissions was respectively 35 times and 20 times higher than the US law permitted standards for Jetta and Passat, while only BMW X5 met the standard requirements. This report triggered more than 10 government authorities worldwide to open investigations into VW by September 2015. On 18 September 2015, the Environmental Protection Agency (EPA) in the US declared that VW had illegally installed software into diesel cars that allowed cars to recognize and cheat laboratory emission tests, which violated. The statement from EPA also revealed they were emitting toxic gases up to 40 times above permitted levels (Coleman, 2015). The scandal causes Volkswagen group enormous loss in numerous aspects: sharply decreasing profit, approximately 260 billion dollars in compensation and fines so far, reputation damage, environmental damage, impact of the whole auto industrial chain, and some experts even believe the pollution of the emission may be the indirect causes of dozens of human deaths.

This essay is aimed to identify and discuss the reasons resulted from poor governance, combining predecessors’ literatures and the UK Corporate Governance Code 2018 to demonstrate that to a fairly large extent the emission scandal was down to poorly corporate governance, and discuss the external factors that may be the causes of the emission scandal. According to discussions and evidences, this essay would offer constructive suggestions for possible future improvements at the end.

Stakeholder theory regards organizations as an aggregation of the resource level, market level, and socio-political level influence (Phillips, 2003). Under circumstances that large organizations are rising, the ultimate purpose of them are to gain competitive advantages and maintain sustainable development. Volkswagen company mission statement announced their core values are integrity, servants’ attitude, accountability, continuous improvement, teamwork and fun. Nevertheless, the emission scandal reveals the management deviate from the company’s values. A company’s all misdeeds can be explained by economic benefits. Volkswagen group in order to crack American market, increasing market share, blindly pursue low cost and high profit under the premise that their technology failed to meet the legal standards. UKCGC (2018) declares organization’s culture should promote integrity, be responsible for both shareholders and wider stakeholders. That means, because the executives have more power than the employees, they should be able to positively influence the company’s overall objectives and cultural constructions. Parker (2014) states that the moral level of the management team determines the outcome of investment. However, integrity is easier said than done. The positive culture needs a complete system and other company policies to support. Without corresponding system and policies, integrity would be an empty talk. In order to improve inner monitoring and supervisory mechanism, the board of supervisors should guarantee the independence of supervision and avoid to be manipulated by the board of directors.

UKCGC (2018) states, “the principle of remuneration policies and practices is that they should support corporation’s strategy and promote long-term sustainable success, and executive remuneration should be aligned to company values and the long-term strategy”. Studies showed that senior managers’ remuneration package is positively related to corporation fraud (Li, et al., 2018). High reward increases the possibility that senior managers only focus on short-term performance, and neglect even damage the organization’s long-term strategy. High remuneration package comes along with high pressure, which infiltrate from the top executives to the bottom engineers, workers. Armour (2016) states that when incentives are linked with compensation solutions, managers tend to be more likely to taking risks, even in those firms that do not ostensibly pursue ‘shareholder value’. Volkswagen’s strategy of market, time and budget limits, and the pressure placed on their employees, could lead them to prioritise the company's set performance instead of meeting legal and ethical standards (Crête, 2016). Ironically, one of the executives from Volkswagen blamed several software engineers for the scandal (Reuters & Associated Press, 2015). From the aspect of remuneration, Volkswagen’s corporate governance failure is from top executives to the bottom employees. The top executives set high objectives with high remuneration, while under various limits, pushing the employees to achieve the objectives.

The board of Volkswagen lacks effectiveness and its internal conflict could be another problem of corporate governance. UKCGC (2018) in the ‘Board Leadership and Company Purpose’ chapter indicates that the board of a successful company should be effective and entrepreneurial. The board of directors of Volkswagen group consists of twenty members. As most listed company in Germany, the supervisory board consists representatives from large investors and labor. Despite it is a large multinational company, the board is still narrow. Five members are from the Porsche and Piech families, and 17 of them are from Germany or Austria (Marcus, 2015); only one independent voice exist, Annika Falkengren, a chief executive of Swedish bank SEB (Bryant & Milne, 2015). One weakness of Volkswagen worthy of attention is that the top management group lacks diversity of opinions, or high concentration of power. Although in the statement by Winterkorn (Volkswagen Newsroom, 2015) he claimed he did not know about the scandal details in the company, Nelson (2016) in his study described how the top management group pressure the rest of the company to achieve ideal results in Volkswagen. This shows that either the board lost overall control of its management group, or the fraud was conscious and calculated, instead of what they claimed. German news magazine Der Spiegel (Hawranek, 2015) reported that at least 30 people in the Volkswagen management group knew about the deceit for years. Despite whether the top management knew the fraud or not, Volkswagen as a huge company was suffering from system ossification and bureaucracy.

As a company grows, its specialization increasing, evasiveness of responsibilities comes along. Rhodes (2016) described Volkswagen as a performance-oriented company with strict hierarchical system. Under the impact of various factors, pressure, fear of being excluded from the generous bonus system, the employees tend to be silent about the questionable decisions made by their superiors. On the other hand, as companies grow, they tend to be organized as highly specialized divisions, which increases the difficulties of internal information transfer. Bryant and Milne (2015) reports that under the leadership of Piech and Winterkorn, the decision-making system in Volkswagen was highly concentrated, thus many junior managers was afraid of the consequences of speak their mind. With a highly specialized organizational structure, decision-makers are usually away from the production and research front line, so they are more likely to set unrealistic objectives. Meanwhile, the hierarchical system determines that, for the employees on the front line of research and production, it is nearly impossible to overcome the hierarchical gap and report the precise information to the decision-makers. Even they do speak out their worries, there is high possibility that their voice would be ignored. To a certain extent, this phenomenon reflects that internal information transfer lacked transparency, and the fulfilment of corporate social responsibility was not full employee participation.

Other possible causes of the emission scandal are poor risk management and accountability. Frankfurter Allgemeine Zeitung (2015) revealed that a company employee from Volkswagen had warned the board about the suspicious emission practices. Its parts supplier Bosch, which developed the software, had written a letter to Volkswagen group in 2007, warning that the software should be used for test purpose only. This implies that some executives were aware of the emission device as early as 2007 (Arvinth, 2015). However, during this period, no one has paid attention to the potential criminal act, which reflects either there was a serious risk management problem or accountability problem. The striking fact exposes the urgent need for individual liability to those who are deliberately engaged in potential criminal activities or responsible for poor implication of risk management. The former could be individual criminal liability, but it faces evidentiary difficulties; the latter, however, did not legally state the personal liability problem (Armour, 2016).

The causes of this fraud are not only the company’s internal governance mechanism failures, also the auditors, regulators, banks, and institutional investor failed their respective responsibilities. In 1974, Volkswagen was fined by the Environmental Protection Agency due to similar reasons as 2015 (Gardella & Brunker, 2015). Not only Volkswagen, other auto manufacturing companies had also been exposed that similar problems existing in the past decades. This indicates that there are industry-wide governance failures existing. Nelson (2015) states that the failure of the law to impose individual accountability causes the increasing illegal activities at the middle management level of corporations. In addition to the company’s inner supervision, the external supervision of governance mechanism should be strengthened, and the regulators should play a positive rule in order to regulate the companies to meet the lawful standards.

In conclusion, to a fairly large extent that the emission scandal of Volkswagen was caused by poor corporate governance. Brand image is the most valuable intangible asset to any large corporations as Volkswagen. In order to establish a favorable brand image, the company should consider corporate social responsibility as an essential part of its strategy. Sustainable long-term development indirectly impacts the shareholders’ economic profits. As mentioned before, the failures of Volkswagen group’s corporate governance were top to the bottom. That means, in order to reverse the trend and redeem the fault, the company needs a systematic reform from the top executive management to the junior management group. On the one hand, company value and culture need to be reflected on the top management group; they need to attach importance to integrity, effectiveness, then lead by example. The board urgently need diversification, so that they could absorb independence opinions from various specialist; the employees and junior managers should not be afraid to give their suggestions or worries. The company should create a culture of protect the environment by promoting their technology as well. On the other hand, the company systematic policies need to be less bureaucratic. The board should effectively monitor their subordinates and the supervisory board need to find their voice in the company. According to empirical studies, the remuneration policies should not only depend on the performance; the company needs to find more comprehensive methods for remuneration to avoid individuals' inappropriate activities for bonuses. In addition, accountability and risk management are other two points to consider. Accountability policies could be use as a threat of potential consequences of individual misconduct, which could be a method of regulate employee behaviors. Furthermore, the external supervision parts of the system, such as the regulators, auditors, have failed their respective roles in the corporate governance system. In addition to strengthening government supervision, the government should consider adjusting the environmental policies to reduce the growing pressure of the companies.

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