

Lessons from Volkswagen- part II

By

Ramki

PKF S&S LLP

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Sustainability award –seriously!

- Recall the Golden Globe award for Corporate Governance, Satyam got before the scandal broke?
- VW got the Dow Jones sustainability Index award for Automobiles & Components category in 2015!
- Now after all, these people go by data that is available and rules which they set- the cheaters beat the rules and normally are ahead of the pack- they have perfected the art of deception!

With apologies to Mahatma

- First the fraudsters ignore the fraud, then they laugh at the investigator, then they fight him, then they lose! –Lose BIG!
- This happens in every case, be it defective ignition switches at GM or the doctored software and ‘defeat device’ in VW.

Greenwashing-is it a BIG problem?

- Greenwashing
- i.e. showing you are more environmentally compliant than actually- seems to be a huge problem
- Companies use all types of methods –like using weak data to bogus certification
- Last year Kia and Hyundai paid \$300Mio to authorities in USA including EPA for overstating gas mileage

Principal- agent problem

- Ed Lotterman writes ‘is there a classic principal- agent problem here?’
- The management is supposed to act in the interests of the shareholders/owners
- While keeping only profit as the motive they get blind sided , they give incentives for all the wrong things and then boom! They hurt the owners badly
- He asks the question if a part would reduce cost but increase the possibility of accident what would the manager do? What is the message sent by the company?
- Result of this fraud- claims could top \$100B and wipe out the Company. They had their first loss in a quarter.

Aggressive management and unrealistic targets

- Martin Winterkorn, the ex-CEO, had a reputation for setting extremely ambitious goals and harshly disciplining subordinates who failed to meet them.
- Thus the culture was born where no one dared not to comply
- CEO's need not do frauds themselves they just need to drive employees to do unacceptable things by just setting unrealistic targets

A lame compensation?

- VW (also Audi) announced for those affected by Dieselgate a \$1000 gift card - \$500 can be spent anywhere and \$500 at the VW dealership only!
- Questions:
 - Is 'sorry money' a good idea?
 - Will it make the customers happy?
 - Is it a good compensation?
 - Is it good money after bad reputation?
 - Of course it says owner can still claim other compensation- so why not!

How did they do it? More news

- Apart from tweaking the software the engineers tried other tricks too
- Increased tyre pressure which lowered rolling resistance
- Mixed diesel fuel into motor oil
 - These could have had other consequences like more tyre blow outs etc
- And they also planned to use a secondary software in the Diesel cars for 2016 which VW withdrew later - this is also being investigated

And the wolves are closing in for the kill

- Over 350 law suits have been filed on behalf of consumers in USA alone
- These are by some of the two dozen lawyers who are famous for such law suits and who are specialists in this area
- Tens of thousands of claims would be heard
- Some lawyers are demanding VW buy back these cars!
- Texas state is suing both VW and Audi America
- Audi is under German investigation for diesel problems
- Positive news?- Leonardo DiCaprio has bought the film rights!- That should make a juicy story!

Who knew?

- A fish rots from its head
- Did the top management and board know?
- 3 members of the board and Mr. Winterkorn have said they did not know
- Investigators are looking at some 10 executives –mainly those working in Engine and Product development
- Michael Horn CEO America for VW said it was not a corporate decision but it was some employees' decision in a Congressional hearing in USA
- But he said he knew about emission problems in Spring 2014

Are other manufacturers having same problem?

- Many car manufacturers are found not to meet the European standards
- This is because NEDC (New European driving cycle test) is itself flawed.
- Its tests with all ancillary loads turned off and hence does not at all represent real world driving conditions
- But no one except VW has installed a 'defeat device' to cheat in testing!

VW comes clean

- VW at last admitted after a lot of beating around the bush that not one diesel car it sold in USA from 2009- 2025 met the norms!

And what are VW plans?

- Sell more electric cars, now a rage in USA
- Recall all the diesel cars (11 mio) and carry out corrections –this will start Jan 16 and end in Dec 16- many vehicles would require software correction and some would also need hardware replacements
- Cancel entire range of diesel cars for 2016

Role of Internal audit-more info.

- In German companies there are two boards –the Management Board and the Supervisory board
- The CAE (Chief audit executive) normally reports to the Management board
- In which case the Management Board would filter the Internal audit reports and ensure only good news reached the main Board!
- In 2011, according to SPIEGEL ONLINE (September 27), Volkswagen's Internal Audit department addressed the matter of European Union-Law No. 715/2007, which prohibits the use of systems that manipulate the analyses of car emissions, though the law is not enforced.

Lessons from Part 1 and 2

- Common thread between many frauds
 - Greed and the never ending push to be the best and biggest at any cost
 - Principal –agent problem in companies; Owners V management
 - Suppression of internal whistle blowing; turning a blind eye
 - Problem of ‘two boards’; CAE reporting to Executive board
 - The riding the tiger effect- all frauds start small and in the hope that it can be ‘corrected’ in the near future and then become out of control- Resist the temptation to mount the tiger

Lessons from part 1 and 2

- Failing to realise that you cannot cheat all the people all the time
- Companies which have a history of cheating may continue to cheat –a cheat gene exists?
- Awards do not mean everything in the Company is alright
- Is Greenwashing a widespread problem?
- Reputation built over decades can be lost in a few moments.
- People never learn from past mistakes!

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- Volkswagen Reveals Emissions Fix for Diesel Cars in Europe - The New York Times
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