International Management in Action

Volkswagen's Challenges with Ethical Business Practices

In the fiercely competitive global automotive industry, the Volkswagen Group (VW) has pursued an ongoing global strategy that emphasizes both centralization and regional adaptation and leverages the range of capabilities from its various brands and their production. VW operates manufacturing facilities in nearly 30 countries, including two joint ventures in China, and sells its cars in over 150 countries. After two decades of sales leadership in Europe, VW reached a significant milestone in its 78-year history when, for the first half of 2015, it surpassed Toyota to become the top automobile producer by sales worldwide. However, celebrations would be short-lived.

In late 2015, VW found itself in a major ethical crisis after numerous independent investigations confirmed that VW's engine software was intentionally bugged to alter a car's performance when the vehicle was undergoing emissions testing. The VW-manufactured diesel engines were programmed to function in such a way that good gas mileage could be achieved during road tests (when emissions were not being tested) and acceptable nitrogen oxide readings were emitted during lab tests (when gas mileage was not being tested). In reality, however, the amount of nitrogen oxide emitted during regular road driving was nearly 40 times greater than what was emitted during testing, far exceeding permissible emissions levels regulated in the United States and Europe. In September 2015, the U.S. Environmental Protection Agency (EPA) formally issued a Notice of Violation to VW. The software modification was installed on nearly 11 million vehicles across the globe, affecting all VW diesel engines manufactured between 2009 and 2015. It has been speculated that over 30 management-level employees participated in or had knowledge of the intentional attempt to cheat on these emissions tests.

Within hours of the issuance of the EPA Notice of Violation, the scandal was receiving worldwide news coverage. Perhaps learning from the experience of other companies entangled in ethical scandals over the last several years, VW was quick to assume full responsibility. A number of key figureheads, including global CEO Martin Winterkorn and American President Michael Horn, resigned. Maintaining transparency, including open testimony before the U.S. Congress, was a key element of VW's approach to rebuilding public trust. "We've totally screwed up," stated former American VW President Horn.

The financial fallout from the scandal has been devastating to VW. After starting the year as the top global automaker, VW slumped in the final few months of 2015, and annual sales declined for the first time in 13 years. The company's stock price dropped by a third over the last several months of 2015. In the third quarter of 2015, VW posted its first quarterly loss in 15 years. VW has set aside over $7 billion to cover costs incurred due to the recall and repair of the vehicles. However, as of mid 2016, Volkswagen still did not have an economical approach to lowering emissions in the affected cars.

In November 2015, the company offered vouchers worth $1,000 to all U.S. affected customers, and in April 2016, Volkswagen gave U.S. customers the option to return their vehicle for a full refund. No compensation package, however, has been extended to those customers outside of the U.S. Fines and associated lawsuits are likely to cost VW even more in the coming years. The EPA has the ability to fine VW $37,500 per car sold in the United States—or about $18 billion. Over 500 lawsuits have already been filed in the United States against VW, with additional pressure due to a pending $46 billion suit filed by the U.S. Department of Justice.

In its 15-page code of conduct, published in the years prior to the emissions scandal, VW emphasizes its commitment to its strong reputation. The trust that the public placed in the VW brand aided in its growth from a small German automaker to a global giant. Now, that reputation appears to be in jeopardy. Will VW be able to recover?

Sources: Volkswagen website, www.vw.com/; Russell Hotten, "Volkswagen: The Scandal Explained," *BBC*, December 10, 2015, www.bbc.com/news/business-34324772.

The transfer of the labor force overseas creates an interesting dynamic in the scope of ethics and corporate responsibility. While most international managers concern themselves with understanding the social culture in which the corporation is enveloped and how that can mesh with the corporate culture, this recent wave involves the extension of an established corporate culture into a new social environment. The difference here is that the individuals being moved offshore are part of a corporate citizenship, meaning that they will identify with the corporation and not necessarily the outside environment; the opposite occurs when the firm moves to another country and seeks to employ local citizens. Accenture proves that it is possible to succeed with such an effort, but as more and more companies follow suit, other questions and concerns may arise. How will the two cultures work together? Will employees adhere to the work schedule of the home or the host country? Will the host country be open or reluctant to an influx of new citizens?