Case Study: Volkswagen's Diesel Emissions Control Scandal

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This case study traces the events that led VW to evade U.S. carbon emission regulatory standards, and actions undertaken by its CEO Mathias Müller to restore profitability and public trust in the company. Despite admitting its guilt, the company faced many unanswered questions. The scandal caused VW's stock to lose 35% of its value in the week following the shocking discovery. The case addresses three areas: (1) What things led to VW's unethical actions? (2) What was VW doing to correct its transgressions? and (3) What strategic actions was VW undertaking to restore market confidence and trust in the company?

INTRODUCTION: VW TAKES AN ETHICS HIT

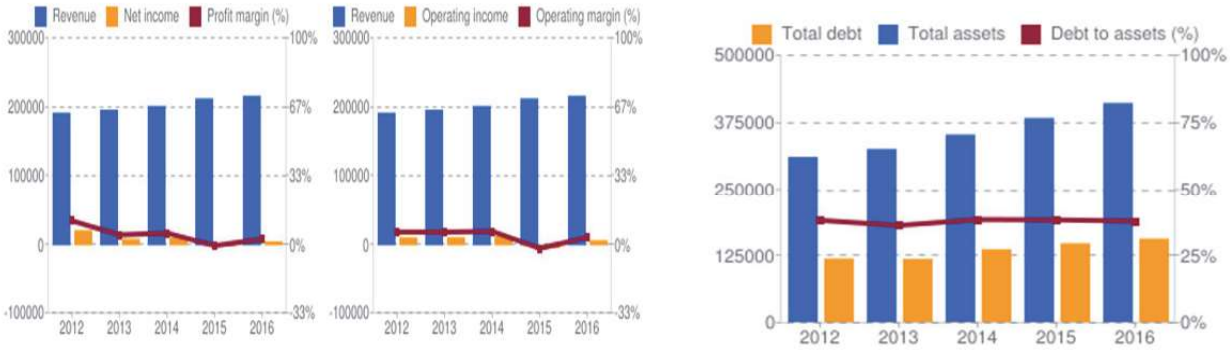
When Volkswagen A.G., the parent company of the Volkswagen brand, disclosed that its top engineers installed software in its diesel-powered cars to bypass emission control standards during routine EPA testing, the disclosure shocked the company and revealed a tangled web of deceit and mismanagement. The admission also raised social and governmental concerns about the entire global auto industry pattern of unethical behaviors and competitive practices. The increased public and congressional scrutiny of VW came at time when automobile manufacturers were facing heightened turbulence and uncertainty worldwide. Slowing growth in emerging markets, international currency instability and volatility, regulatory reform, and a rising pro-labor populist movement all posed serious barriers to Müller's turnaround strategy.

As Matthias Müller, CEO of Volkswagen Group A.G., prepared to pay the latest settlement of over $10 billion to buy back or repair nearly a half million diesel cars equipped with defeat devices, he wondered if he had finally reached the end of the costly scandal (Boston, 2016). While there were positive signs that the new strategies he orchestrated were moving his company in the right direction, he still had concerns of whether or not it would be enough to profitably transform his business. His vision called for the evolution of VW into a technology company where the bulk of revenue stemmed from software and services. The strategy also called for increased production of all-electric vehicles by 2025 (McGee, 2016; McGee, 2017). The technology and service transition would shift the company from a primarily metal, internal combustion engine carmaker and marketer, to a technology company. As industry analysts and next-generation car makers had predicted, the automobile was rapidly becoming a modern day version of a smartphone on wheels (Sharman, 2015).This transformation was converting the

car into a connected Internet device, reshaping the whole transportation infrastructure as well as significantly influencing car buyers' experience and purchasing decision.

By early 2017, VW's U.S. bill for the emissions scandal posted at $15.3 billion and was still rising. In all, analysts and researchers estimated the entire U.S. and European settlement charges and penalties would be a record $50 billion (McGee, 2017). The scandal resulted in Volkswagen reporting its largest ever annual loss in 2015, with the prospects for 2016 equally gloomy. The scandal also caused VW's stock to lose 35% of its value in the week following the announcement with a continued underperformance for months afterward (see Figure 1: Volkswagen Group Financial Highlights; and Figure 2: Volkswagen Stock Performance – Pre-Post Scandal Compared to DJI).

FIGURE 1
VOLKSWAGEN GROUP FINANCIAL HIGHLIGHTS



Source: *Google Finance*. (2017, April 10). Retrieved from https://www.google.com/finance?

FIGURE 2
VOLKSWAGEN STOCK PERFORMANCE –
PRE-POST SCANDAL COMPARED TO DJI

Source: *Yahoo Finance*. (2017, April 10). Retrieved from https://finance.yahoo.com/chart/VOW.DE?.

Repeated Denial

Müller and Winterkorn denied any culpability and knowledge of the wrongdoing prior to September 2015 after both an independent research agency and the EPA publically released their investigations of VW (Boston, 19 June 2015; Boston, 21 June 2015). Winterkorn and Herbert Diess, head of VW's passenger car brand, were facing a probe by German prosecutors for not informing investors quickly enough about the potential losses in connection with the defeat device scandal. In March 2016, *Fortune* reported that Müller infuriated U.S. regulators when he stated in a National Public Radio interview in January that the emission testing software installed in the U.S. cars was an honest mistake. He blamed a technical error, stating, "We had not the right interpretation of the American law…we didn't lie. We

didn't understand the question first" (Smith & Parloff, 2016). *Fortune* reported, "VW's misbehavior did not come out of nowhere. The company had a history of scandals and episodes in which it skirted the law. Each time – till now – it has escaped without dire consequences" (Smith & Parloff, 2016). The mal-behavior of VW executives revealed a complex VW system where the iconoclastic company seemed immune from public scrutiny, especially in Germany.

VW COMPANY BACKGROUND

The VW Group, headquartered in Wolfsburg, Germany, is not only a leading manufacturer of automobiles and commercial vehicles, but also the largest carmaker in Europe. Volkswagen operates more than 100 factories worldwide and has over 600,000 employees. The Group, spawned out of post-World War II Germany, was founded by Hitler in 1936 and later reorganized under a new governance structure. The company, rescued by the British Army after the war, became privatized in 1960 ("Ferdinand Piëch," 2017). The German State of Lower Saxony and early on, the German Federal government, were given special ownership rights and board seats. The new system was designed around deep connections between management, workers (unions and work councils), and local politicians.
The Group developed, designed, manufactured, and marketed 12 brands of cars and trucks worldwide including: Volkswagen Passenger Cars (50% of all Group sales), Audi, SEAT, ŠKODA, Bentley, Bugatti, Lamborghini, Porsche, Ducati, Volkswagen Commercial (Truck) Vehicles, Scania, and MAN. In 2016, the company surpassed Toyota, becoming the largest automaker in the world with sales of 10.3 million units. It had also maintained the largest market share in Europe for over two decades and ranked seventh in the 2016 Fortune Global 500 list of the world's largest companies ("Ferdinand Piëch," 2017). By the end of 2015, VW sold over 10.8 million diesel powered vehicles worldwide with 2.8 and 1.2 million sold in Germany and the UK respectively.

Ferdinand Piëch: Architect Behind VW's Success

An industrial scion and engineer, Piëch transformed VW from a regional carmaker into a global powerhouse during his 32 year reign as CEO and Board Chairman. Piëch was the grandson of Ferdinand Porsche who developed the classic VW Beetle under a 1934 contract with Hitler and first introduced the Porsche sports car. The younger Piëch began his career at Porsche before leaving for Audi after an agreement that no member of the Porsche or Piëch families should be involved in the day-to-day operations of the company. After leaving Porsche, Piëch became the head of VW's Audi brand. He was credited with evolving and growing Audi into a competitor that equaled Mercedes-Benz and BMW (Cremer, 2017). In 1993, Ferdinand Piëch became Chairman and CEO of Volkswagen Group. At that time, Volkswagen was only three months away from bankruptcy. Piëch was credited with orchestrating VW's dramatic turnaround.

Piëch led VW as chief executive from 1993 to 2002 and was widely known as one of the last towering figures in the auto industry. Piëch aggressively moved VW into new markets. Under his leadership, VW transformed from a European regional car marker into one of the auto industry's largest automobile manufactures. Among Piëch's major acquisitions were the purchases of Lamborghini and Bentley, as well as the founding of Bugatti Automobiles. Piëch integrated the Volkswagen, Škoda, SEAT, and Audi brands into a ladder-type structure similar to that used by Alfred Sloan at General Motors. In 1998, when VW's former CEO Carl Hahn's efforts to revitalize the Volkswagen market share in North America failed, Piëch reversed VW's fortunes by manufacturing the Volkswagen New Beetle. The move dramatically boosted Beetle sales and VW's market share in North America ("Ferdinand Piëch," 2017).
In 2002 (per VW policy) Piëch, now 65, retired as VW's longtime CEO; though he did stay on as Chairman of the Company's Board of Directors. As Chair, he was actively involved in the company's strategic decisions. In 2011, *Automobile Magazine* named Piëch as its "Man of the Year." In April 2015, shortly before the news of VW's emissions scandal became public, Piëch resigned as Board Chairman, but remained on the Board (Cremer, 2017).

THE AUTO INDUSTRY: A CHANGING ROAD

Competition in the global automobile market proved fierce in early 2017. Rivals frantically poured money into software, services, electric vehicles, and other game-changing technologies. In addition to the macro-economic, political, and social uncertainty, all automobile manufacturers were up against several major transitions in traditional markets that were rapidly revolutionizing the industry. Driving the industry's transformation were several radical technological, political and social factors. Some examples of the technological innovations entering the industry include Internet manufacturing, all-electric vehicles, driverless cars, and the "internet of things" (Sharman, 2015). In addition, car companies faced stricter regulatory requirements for safety, fuel economy, and the environment. All these factors, while presenting opportunities, came at an added cost of doing business, shrinking short-term operating margins and profits.

The business models more representative of high technology software companies began challenging the business models of traditional auto companies. For example, Google and Apple were developing their own versions of next-generation, all-electric vehicles. Meanwhile, Uber, Amazon, and others engaged in the radical redesign of the transportation industry with their efforts to make driverless cars and trucks – the transportation mode of the future. Tesla, several traditional carmakers, and other venture-backed technology start-ups were racing to cement the all-electric vehicle as the industry standard by 2030 (Davies, 2016). As a result, traditional competitive forces of the auto industry were facing an all-out assault. Apple, Google, Amazon, Uber, and a host of others outside the auto industry threatened to extract most of the profits generated by car sales turning traditional automakers into low margin, equipment suppliers (Ewing, 2015; Clark & Sharman, 2015).

Just as mainframe PCs were being replaced by smartphones and cloud technologies in the computer industry, the automobile – according to industry followers – was rapidly becoming a bundle of software apps, information and data networks, and valued added after sales services (Sharman, 2015). In 2015, PWC *Auto Industry Trend* reported that several trends were reshaping the automobile industry: shifts in consumer demand, expanded regulatory requirements, and increasing availability of data and information.

Regarding the first major trend, PWC reported that consumers appeared to be rethinking their long love affair with individual automobile brands and were beginning to view cars more as transportation machines instead (Hirsh, Singh, & Wilk, 2017). This shift in consumer behavior affected how much buyers were willing to pay for their automobiles given that maker differentiation and quality were converging across brands. This trend would impact consumers' purchasing decisions by making once highly regarded brand differentiation less important as buyers demanded more sophisticated infotainment systems and other standard features on high-end models, but at lower prices. PWC also reported that consumers were inundated with easily accessible information regarding automobile specifications, prices, discounts, quality, and performance, giving buyers greater bargaining power.

Secondly, expanded requirements for tighter corporate average fuel economy (CAFE) regulations in the United States and the rest of the world increased costs for automakers. Regulators were also adding to vehicle costs by mandating more safety-related features, such as backup cameras, collision avoidance systems, and advanced monitoring devices. In order to comply, automobile companies needed to achieve higher volume sales to amortize the increased costs.

Finally, increased availability of data and information regarding vehicle usage and driver behavior was proliferating as sensors and telematics systems became more common. According to PWC report, while all players across the automotive value chain were interested in collecting more customer and car statistics, there was widespread uncertainty in the industry as to how to use and monetize this data (Hirsh et al., 2017).

THE DEFEAT DEVICE EMISSION SCANDAL

On September 18, 2015, the U.S. EPA announced that Volkswagen had installed a defeat device software code in the diesel models sold in the States since 2008. The code was designed to detect an

emissions test being conducted and alter emissions controls for better compliance. Off the test stand, the controls were relaxed and emissions jumped 35 to 40 times regulatory levels according to investigators at West Virginia University and the California Air Resources Board. The defeat device was installed on 482,000 vehicles in the U.S. resulting in a potential $18 billion ($37,500 per violation) in fines, penalties, and criminal and civil ligation (Spector & Harder, 2015).

The admission also resulted in the resignation of CEO Winterkorn, prompting an apology from its U.S. President Michael Horn at a contentious U.S. congressional subcommittee investigation. Because of VW's indiscretions, the German automaker announced in early October 2015 that it would cease selling diesel-powered vehicles in the U.S. for the foreseeable future due to its failure to receive U.S. certification for carbon emissions standards (Spector & Boston, 2015). Volkswagen also halted production at its plant in Chattanooga, Tennessee, which accounted for over one-third of its diesel car output. The company remained unclear as to how it would rectify the lack of EPA certification for its U.S. diesel powered cars. Now VW owners possessed vehicles that not only failed U.S. emissions testing, but were also practically worthless in the resale markets. Similarly, VW dealers and suppliers were strapped with an inventory of unsellable cars and components (Neil, 2015).

Robert Bosch GmbH: Supplier Involvement

The VW emission scandal probe went beyond the company when investigators expanded their examination to include Robert Bosch GmbH, one of the world's biggest auto suppliers (Campbell & Stothard, 2016). German investigators found that Bosch informed VW in a September 2007 letter to company management that the software provided by Bosch could be illegal. In a June 2008 email from a Bosch employee concerned about being discovered suggested that Bosch rig engines to recognize testing. In another email exchange between the two companies, Bosch demanded that Volkswagen indemnity it of any anticipated liability arising from the Bosch-created defeat device. Prosecutors claimed that Winterkorn was not only aware of the exchanges, but also participated in the negotiations. Volkswagen defended Winterkorn by stating that as CEO, he was inundated with emails and never viewed the email exchanges with Bosch (Campbell et al., 2016). By the end of 2016, industry analysts and investors were predicting that the emission scandal would cost VW upwards of $46 billion (Bennett, 2015). VW senior management blamed the scandal on the actions of a few senior engineers and repeatedly denied any knowledge of the defeat devices prior to the company's September 2015 admission of guilt (McGee, 2017; Spector & Harder, 2015).

VW: A Pattern of Scandals

Unfortunately, scandals for VW Group were nothing new. In 2003, VW experienced industrial espionage and later in 2005, prostitution and bribery scandals. Early on in 1993, Piëch initiated one of the biggest disputes in the auto industry when he orchestrated the hostile pirating away of Jose Ignacio Lopez from General Motors. This action resulted in an onslaught of insults, lawsuits, and criminal investigations between the two companies alleging espionage, stolen documents, and patent infringements. Lopez had a reputation of squeezing suppliers, negating long-term contracts, and relentlessly cutting costs. Piëch wanted Lopez to aid in reversing VW's dire financial situation. The controversy ended only after Lopez was expelled from VW (Smith & Parloff, 2016).

In 2005, VW became embattled in a prostitution and bribery scandal. Klaus Volkert, head of VW's powerful works council and a supervisory board member, was found guilty of breach of trust by illegally receiving a €2 million payment from another VW board member. The illegal payment came at the same time when members of the works council went on trips allegedly involving prostitution, shopping excursions for wives, and "Viagra paid by Piëch." Chairman Piëch claimed "the scandals were 'irregularities' of which he had known nothing" (Milne, 5 November 2015; Milne, 11 November 2015).
In 2015, in addition to the emissions scandal, Volkswagen was embroiled in another defamation involving a safety flaw in the keyless ignition of its vehicles. Volkswagen management had spent the prior two years attempting to withhold reports of the flaws in the keyless ignition from the public domain (Milne, 5 November 2015). Just prior to the VW emissions scandal, the EPA reached 14 settlements and

won court orders against several auto manufacturers for not complying with the Clean Air Act. A number of these cases involved Chinese-made, all-terrain vehicles and motorcycles, as well as Honda and Kia vehicles. The biggest case prior to the VW scandal was in 1995 when the EPA and Justice Department collected $11 million in fines from GM for installing "defeat devices" that overrode emission control testing on 470,000 Cadillacs (Shepardson, 2015).

ETHICS VIOLATIONS IN THE AUTOMOBILE INDUSTRY

Analyst and industry insiders noted several factors behind VW and other automakers' ethics violations. The deadly consequences of several auto manufacturers' failure to disclose vehicle safety defects in a timely fashion added to a host of governmental, regulatory, social, and legal pressures and demands on an already fiercely competitive industry. GM's defective push button ignition switches, Takata's malfunctioning vehicle airbags, and the sudden and uncontrollable acceleration of Toyotas, were just a few of the high profile governmental investigations resulting in billions of dollars in penalties, fines, legal costs, and damaged brand loyalty. These violations of law resulted from industry-wide behaviors where auto executives engaged in questionable actions to gain and maintain a competitive edge over rivals. They assumed the added benefits of playing this dangerous game outweighed the risk of playing it. Others believed they had to engage in this behavior because of burdensome government regulation. Industry executives argued that government market interference stole investment dollars away from needed research and development. Stricter regulations were being imposed at a time of major change in the automobile industry. This fast-paced evolution, (which some industry experts foresaw) transformed automobile companies from one of merely making cars to one of converting cars into smartphones on wheels (Sharman, 2015).

Factors Driving VW's Emission Scandal

What elements might have accounted for VW's emission scandal? Several factors including, but not limited to: ambitious sales goals (to become the number one global brand in total units and revenues by 2018); abnormally high labor and manufacturing costs; and the "VW System" – an unwieldy, complex governing structure and company culture that fostered dysfunctional behaviors.

Ambitious Revenue and Vehicle Goals

VW's position as the world's largest automobile company became seriously threatened as a result of its rigged carbon testing. In 2014, Volkswagen generated $246 billion in revenue and $13.2 billion in net income with 592,586 employees. In comparison, Toyota had $227 billion in revenue and $18.1 billion in net income with 344,109 employees; while General Motors had revenues of $155.9 billion and a net income of $3.95 billion with 216,000 employees ("Volkswagen A.G.," 2017). Winterkorn had set a lofty goal of 10,000,000 cars in annual production by 2018. Ironically, he reached that goal in 2014 ("Volkswagen A.G.," 2017), but VW struggled to remain profitable under Winterkorn and Müller's leadership. VW had been plagued with high labor and manufacturing costs, an excess of unprofitable or low margin cars, too many brands and models, and unbridled spending as it raced to overtake Toyota and GM in sales and profitability. While VW's global expansion into other markets went well as it doubled its number of plants worldwide (expanding into North America as well as China, Russia, Brazil and other emerging markets), only China provided any significant growth (Boston, 2016). VW's troubles only multiplied with fluctuating currency exchange rates and significantly higher operating costs – particularly in Germany – compared to its arch rivals Toyota and GM.

High Labor and Manufacturing Costs

In testifying to the subcommittee, Horn noted that the cheating scandal may have been prompted by cost pressure at home and abroad in the U.S. VW engineers experienced difficulty in developing a diesel-powered engine that could deliver on both its carbon emissions and MPG (miles per gallon) efficiency goals. While refusing to give full refunds to U.S. customers for their cars, when asked by U.S. lawmakers,

Horn noted that Volkswagen had set aside $7.5 billion to help address the problem. Horn also reported he had recently learned that the cheating was the work of senior engineers Ulrich Hackenberg, Audi's chief engineer; Wolfgang Hatz, developer of racing engines; and Hienz-Jakob Neussr, head of development for the Volkswagen brand (Spector & Harder, 2015).

Early attempts at rationalizing and restructuring VW labor and manufacturing costs did not produce the desired results. VW manufacturing plants also made most of its parts as separate component units for each of its 12 brands. Previous plans to consolidate manufacturing plants and add more efficiency to its development and manufacturing of components were blocked by strong work councils and board members, particularly the State of Lower Saxony. Cost cutting efforts included job reductions, internal biddings across its internal component manufacturers, and outsourcing more components to external suppliers. One long-time VW employee commented that restructuring would require "… a sea [of] change in the way VW does business." He noted that the complete absence of competition for supplying parts had created internal inefficiencies. VW required cost reductions to boost profitability due to the astronomical material cost at VW plants, rising from €80 billion in 2010 to €144 billion in 2015 (Smith & Parloff, 2016).

The Volkswagen Group's System

Several analysts labeled the company's inability to learn from its past transgressions as the "VW System." The emission scandal revealed a complete system failure, according to Richard Milne (5 November 2015; 11 November 2015). He blames the emissions scandal on the VW System, a structure that fosters a dysfunctional culture in which company politics block real change. VW's Board of Directors, unlike U.S. companies, operates under the principle of co-determination. This principle divided the Board into two groups possessing 10 seats each: (i) a supervisory Board consisting of the work council seats (10 seats), and (ii) a group composed of Porsche and Piëch family members (five seats), German State of Lower Saxony (2 seats), Country of Qatar Investment Group (one seat), IG Metall union (one seat), and one held by the CEO of the Swedish bank SEB. The German State of Lower Saxony held 12.7% of the company's shares, granting it 20% of the voting rights. According to governance experts, the VW system closely aligned the Board Chair with the work council board members. This close relationship was evident when the head of the IG Metall union was appointed Interim Board Chair after Winterkorn's resignation (Milne, 2015). Shortly thereafter, Hans Dieter Pötsch was appointed Board Chair. Pötsch, previously VW Group's finance director, was close to family members on the Board. The VW system was made even more complex by several layers of family and state ownership on its Board. Following the 2005 scandal, VW changed it governance structure when the Porsche and Piëch families – and later the country of Qatar – joined Lower Saxony as VW Group's dominant shareholders. For local politicians, the union, and Saxony, the VW system proved crucial for protecting jobs.

For investors and non-workers, however, critics claimed the Board had no independent outside members. They argued that since SEB was an advisor to one of VW's 12 brands, this Board member should be disqualified as an independent director. They also contended that the Board was dominated by family ownership intertwined with a complex company culture and structure making it difficult for members to exercise their fiduciary responsibilities. The system, they asserted, fostered a dysfunctional corporate culture that stressed profitability (Milne, 2015).

MATTHIAS MÜLLER: STEERING A NEW STRATEGIC COURSE

In June 2016, Müller announced VW's 2025 strategy as the company struggled to keep pace with industry leaders and its profits lagged behind its main rivals Toyota Motor and General Motors. Müller aimed to streamline VW's company operations by cutting 5% of its workforce and rationalizing manufacturing including cutting 30,000 jobs in Germany. Müller wanted to increase VW's operating margins to 6% by 2025 at a time when industry margins were already being squeezed. His strategy entailed moving aggressively into electric vehicles, self-driving cars, and digital mobility. He told company top executives, "We have to catch up with the best." Müller reported that he intended to use the

scandal "…as a catalyst to impose cost discipline, and make the 12 brand group a big player in electric cars, producing between two and three million vehicles by 2025" (Boston, 2016). To meet this ambitious electric car goal, VW would need 150 gigawatt hours of battery capacity. Other elements of Mueller's 2025 strategy include (Boston, 2016; "Together 2025," 2017):

- Sell 1 million all-electric cars per year
- Begin building all-electric vehicles in the U.S. by 2021
- Invest in technology and limit R&D spending to 6% of sales
- Find investment funds through reduced costs and productivity improvements
- Achieve short-term cost savings without mandatory job reductions through attrition

Industry analysts widely regarded the pillar of VW's strategy comprising the restructuring of its component business as a black hole. Critics noted that real change and cost reductions would prove difficult. Union Chief Bernh Osterloh claimed that Müller and Diess were using the scandal as an excuse for cutting costs and implementing job reductions. In a scathing letter addressed to both leaders, Osterloh demanded protection for 12,000 of the 120,000 VW jobs in German factories. The letter signaled a major break in the union's collaborative relationship with management. Osterloh claimed that the work council did not share the same close relations that it had with Winterkorn and warned of a "grave lost of trust" between the unions and the State of Saxony where most of the jobs were located (Foy & Politi, 2015; McGee, 2016). He also stated that with Winterkorn, labor disputes were largely contained to the background away from the public eye.

Müller's strategy had other critics outside of labor, asserting that any VW "Pact for the Future" with unions would be futile. They pointed out that even after planned labor reductions, VW's labor cost would only be second to BMW. They also noted that after previous rounds of cut backs in 2006, VW's head count reductions quickly recovered. Ultimately, critics wanted to know *can electric cars be made more appealing to European drivers?* Could VW's higher costs of developing and manufacturing electric cars be sufficiently reduced without cutting operating margins? One analyst, Arndt Ellinghorst at Evercore ISI stated, "…the bulk of VW's rising costs stem from unnessary complexity and out-of-control engineering projects." He added, "Cost savings are not about squeezing suppliers, but managing the business well" (McGee, 2016; Campbell, 2016; Boston, 2016).

CONCLUSION: A FAMILY DIVIDED

In early April 2017, former Chairman Ferdinand Piëch agreed to sell his 14.7% ownership stake in Porsche Automobile Holdings (PAH). PAH controlled 52.2% of the voting shares in Volkswagen A.G. and planned on exercising its right of first refusal on buying Piëch's shares. Since the emissions scandal, Piëch's relationship with VW's Board and family members had soured. His resignation from the Board and according disputes with Winterkorn and family board members also caused a major chasm in the company's governance structure. Piëch was ousted as VW's chairman in 2015, months before the emissions scandal became public. Piëch battled on the board with his billionaire cousin Wolfgang Porsche, the chairman of Porsche. Porsche and other top players on VW's Board sided with Winterkorn in the dispute with Piëch. The media reported in February 2016 that Piëch had informed investigators that his cousin and other board members knew about the emissions test cheating earlier than publically stated (McGee, 2017; Cremer, 2017). Müller, the former Chair of Porsche, succeeded as CEO of VW when Winterkorn resigned under pressure from the emissions scandal. Since resigning as chairman, Piëch has reportedly become reclusive and unwilling to defend the company that he brought to global prominence. Will Piëch's decision to sell his ownership stake and consequential estrangement from VW's Board be the final factor that derails VW's emission scandal defense and Müller's 2025 turnaround strategy? Or could Müller actually overcome the scandal and restore trust and profitability to the company? Many stockholders, analysts, and industry experts question whether or not VW would ever change (Smith & Parloff, 2016). The company, they argue, needs a radical overhaul – and they doubt this would happen

given its legacy of a complex governance system that fosters interpersonal rivalries, competing interests, and gross inefficiencies.

TEACHING SUGGESTIONS

This case provides students with a foil to explore corporate governance, and the illegal and unethical practices of a major global vehicle manufacturer, Volkswagen Group A.G. It can be used to better understand senior management and board responsibilities to stockholders and society as it pertains to behaviors of a highly aggressive, growth company. There is no question among scholars that business organizations must not only abide by the law, but also consider the ethical and moral obligations that go beyond the law. The study of business ethics, especially through case studies, is not only topical, but also critically important to the professional and personal development of students in gaining a better understanding of their own moral fabric. The VW case fits nicely into introducing topics that focus on philosophical, theoretical, and conceptual foundations of business. From this perspective, understanding the ethical implications of questionable management practices requires students to be aware of and understand the specific unethical and illegal actions and practices that they may confront in their careers and personal lives. In other words, students need to be aware of and sensitive to managerial and organizational unethical acts and practices.

When it comes to ethics, clear answers or frameworks to guide decision-making and actions do not always exist. Why is this so? Questions of ethics and one's understanding of ethical conduct can and does change over time, and reflects the contextual environment in which business takes place. Hoyk and Hersey (2008) identify 45 ethics traps to which we fall prey. Ethics traps can distort one's perceptions of right and wrong. What traps might have led VW CEOs and some Board members to actually believe their unethical behaviors were justified? Was it really a misinterpretation of the law, time pressure, and the superordinate goal of profit maximization? Or was it simply claims of ignorance that led to VW's justification for upper management's unethical behavior? Ethical challenges can also arise due to multiple stakeholders making conflicting demands on the firm. As presented in the VW case, the range and quantity of ethical challenges can reflect profit-maximizing behavior and attempts to balance the competing demands of numerous stakeholders. These stakeholders include: customers, management, family-led boards, labor, governmental entities, suppliers, media, and activists.

The case offers instructors an opportunity to introduce two competing models of the firm: classical single-sovereign model and multi-sovereign or stakeholder model. The single sovereign model argues that management should always act in ways that maximize profits for stockholders, just as long as its actions do not break the law. In this case, VW senior managers and certain Board members did not play fairly by the rules, and consequentially broke the law. So why did management and the Board knowingly violate the law? The stakeholder model explains that, at any point in time, some stakeholders are powerful and active and their actions can negatively (or positively) impact the firm. It appears that the drive for profit maximization and the VW culture (System) put added pressure on management in its attempt to balance the demands of powerful and influential stakeholders.

Instructors might ask students whether senior managers are the agents of the shareholders or the stewards of the firm's resources. Who must act in the best interests of multiple stakeholders (enlightened self-interest doctrine)? The enlightened self-interest philosophy in business ethics holds the belief that strategic managers will act to further the interests of others because to do so furthers their own self-interest and the self-interests of the firm. It has often been simply expressed by the belief that an individual, group, or commercial entity will "do well by doing good." Both agency and stewardship theorists hold the belief that the managers' function as impartial coordinators who owe allegiance to the firm is an ongoing concern. In either case, it is clear that VW's senior managers and some board member did not act in the best interests of the firm and might have destroyed the very thing they were entrusted to protect – the VW Brand. In short, this case provides students with a real-life example of bad corporate behavior and raises for them several real-life questions. These questions include: what would they do if they worked for VW and knew of, or were asked to, engage in such unethical behaviors? What if their

livelihood and careers were at stake? Finally, the case offers a vehicle for students to better understand what is required to manage oneself, act strategically, and think critically when it comes to questions of ethics and questionable business practices.

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