Paying the Price: Lessons from the Volkswagen Emissions Scandal for Moral Leadership

付出代价；大众汽车排放丑闻所揭示的道德领导力教训

Gerhold K. Becker 百里浩

Abstract

All signs indicate that the VW emission scandal currently unfolding represents a colossal failure in moral leadership at managerial levels reaching all the way to the top. As more and more data become available the analysis suggests that senior managers not only ignored their own company codes but also broke fundamental moral and legal standards that they saw as hindrances on the way to quick profi t. In the end they incurred billions of dollars in fi nes, are personally embroiled in lawsuits and claims for compensation, ruined the company's reputation, caused a sharp decline in car sales that resulted in workers' lay-off s, and risked the company's very existence.

T us t h he VW emission scandal seems to have all the ingredients for becoming a test case in moral leadership studies. By starting off with its ethical analysis, major dimensions of moral leadership will reveal themselves even if only ex negativo. In the main part of the paper I will be claiming that genuine leadership in business cannot merely be derived from organizational authority and legal stipulations but is only sound when it is grounded in moral commitments and values rooted in universal moral and spiritual traditions. Its moral legitimacy extends beyond self-interest, and its commitment to ethics must not have merely instrumental, but intrinsic value. It is its moral dimension that gives leadership

authenticity and companies true value.

The cause of the Volkswagen emissions scandal

On September 25, 2015, Volkswagen's CEO Martin Winterkorn suddenly resigned and was replaced by Matthias Müller. Müller wrote in a letter "To Our Shareholders" that prefaced the Company's *Annual Report 2015*: "On behalf of the Volkswagen Group I would like to apologise to you, our shareholders, that the trust you placed in Volkswagen has been broken." And Volkswagen America boss Michael Horn put it bluntly: "We've totally screwed up" (Ruddick, 2015).

What caused this turn of events? It was the diesel emissions scandal that shocked even hardened cynics, when Volkswagen finally had to admit in September 2015 that it had cheated on its promise to produce environmentally friendly diesel engines that would meet the strict US emissions standards. There had long been suspicions about apparent discrepancies between emissions test results and actual emissions for which no good explanations could be provided. Yet Volkswagen denied any wrong-doing and referred to unspecified technical problems as the cause. Volkswagen management seems to have believed for a long time that when caught they would get away with some fine that would quickly bury the issue without much publicity. But they were wrong.

According to press reports American regulators first began asking Volkswagen questions about suspicious emissions data in mid-2014. The answers Volkswagen provided did not satisfy the authorities and on September 18, 2015 the US Environmental Protection Agency (EPA) issued a *Notice of Violation* of the Clean Air Act to Volkswagen, citing problems with its 2.0 litre diesel cars. A second *Notice of Violation* was later issued for its 3.0 litre diesel cars. For the EPA the cause for the huge discrepancies reported between their test results and those certified by Volkswagen is a "defeat device" that the Clean Air Act defines as a "device that bypasses, defeats, or renders inoperative a required element of the vehicle's emissions control system."

Seeing itself cornered, Volkswagen finally conceded that there was indeed an "emissions issue" that involved "process deficiencies on the technical side in addition to misconduct on the part of individuals" (Volkswagen, 2015, p.51). But what the EPA had discovered was that a device had been installed in each car to defeat emissions control systems. The device was designed to detect whether the vehicle was undergoing an emissions test situation. Full emissions controls were turned on only during the test but reduced during normal operation. This enabled cars that were fitted with the device to meet emissions standards in the laboratory or testing station but during normal operation emit nitrogen oxides at levels high above the permitted EPA standard. In other words, the problem is not only that emissions standards were bypassed but also that Volkswagen developed its device with deceptive intent. The number of manipulated cars was staggering. EPA's findings cover 482,000 cars in the US, but Volkswagen admitted that worldwide about 11 million cars, including eight million in Europe had been sold with the cheating software.

> The widespread conclusion is that the emissions scandal was the result of a colossal failure in leadership at the highest levels of Volkswagen management.

In response to the public outcry, the prospect of exorbitant fines, and criminal investigations, the company adopted a strategy that seems hardly in line with provisions in its own *Code of Conduct*. Instead of providing "reports, records, and statements [that] are accurate, timely, comprehensible, comprehensive, and true", the Company tried to conceal relevant facts about its cars from consumers and governments and withheld information from investors in contravention of securities laws. The purpose of all this seems obvious; Volkswagen was seeking to minimise the financial fall-out from the scandal and to protect management from litigation as much and as long as possible. In its *Annual Report 2015*, Volkswagen blamed a small group of middle managers and "rogue engineers". This line of argument, however, received a severe blow when U.S. prosecutors in Detroit "won a guilty plea from a long-time Volkswagen engineer for his participation in Volkswagen's efforts to cheat emissions tests of its diesel engines" (Kiley, 2016).

As more details come to light, it seems clear that Volkswagen's top management had a choice. BMW and Mercedes, Volkswagen's competitors in selling diesel cars into the US market, had developed a technology for cleansing diesel fumes. Yet the technology was costly and apparently more expensive than designing a defeat device. By deciding to save the estimated $4.8 billion that licensing this technology would have cost them, Volkswagen grossly miscalculated the amount they would finally have to pay in penalties, legal costs, recalls, compensations, and above all in the loss of trust, reputation, and consumer confidence. The provisional price tag Volkswagen anticipated in its *2015 Annual Report* totalled $18.4 billion for the clean-up and legal costs, including $8 billion for "legal risks" and a further $1.2 billion for contingent liabilities. Yet even these estimates now seem rather low. Some analysts expect the final cost will be close to $30 billion, once settlements have been agreed in other major markets.

On July 19, 2016, three attorneys general from New York, Massachusetts, and Maryland directly challenged Volkswagen's defence over its emissions deception, calling it an orchestrated fraud that lasted more than a decade, involved dozens of engineers and managers and reached deep into the company's boardroom (Ewing & Tabuchijuly, 2016). Should their case be proven, the scandal over the diesel emissions reaches to the top of Volkswagen's current leadership. The fraud would have been the result of strategic decision-making that put short-term profit before integrity and compliance with legal and moral norms. The implications would be that Volkswagen violated the major norms of good company practice: legality, honesty, the prohibition to cause harm, and the rules of fairness. By cheating on the emissions standards with criminal intent the people in charge knew that they would violate laws and act with dishonesty. By accepting higher than declared toxic emissions that would result in higher pollution levels of more than 11 million cars they were aware that they would cause considerable health risks to people and damage the environment. In the end this could increase pressure by the general public on politicians and legislators to impose more controls and regulations on business that would narrow its operational space and stifle its activities. In this regard the Volkswagen strategy would have been self-defeating as car companies have all along championed for lower emissions standards.

> For too long ethics has been seen as a useful factor in marketing and a popular sales strategy rather than the foundation of the good life for which business and society are striving. Yet underrating the importance of ethics for business and business leadership turned out to be a damaging and costly experience for companies like Volkswagen.

A failure in leadership

The widespread conclusion is that the emissions scandal was the result of a colossal failure in leadership at the highest levels of Volkswagen management. The problems are, of course, not those of Volkswagen alone. Other large companies the world over—notably Enron, Siemens, and the Wall Street financial institutions involved in the mortgage market collapse of 2008—have been plagued by similar failures in leadership, apparently ignoring its intrinsic relationship to ethics.

Conventional leadership studies and management education have been criticised for too narrowly focusing on the mechanism that "gets people to do something" (Ciulla, 1998). Central to all such leadership theories is the question of efficiency: what is the most successful method to achieve the best results for the company? Thus leadership theories range from emphasising strict *controls* over subordinates through rewards and punishments, to *inspiring* them for common goals or *empowering* them to pursue, within certain limits, their own ideas. Leadership was (in James MacGregor Burns' terminology) either

> Good business never lacks moral background institutions and internalised normative standards; it simply cannot operate effectively without them. Business people, leaders and subordinates, employers and employees, CEOs and workers, depend like all of us on norms of trust, honesty, and fairness.

transactional by exclusively focusing on results or *transformational* by engaging "the full person of the follower" (Burns, 1979). Regardless of their specific emphases leadership theories paid little attention to ethics, and where they did, tended to attribute to it more instrumental than intrinsic value. For too long ethics has been seen as a useful factor in marketing and a popular sales strategy rather than the foundation of the good life for which business and society are striving. Yet underrating the importance of ethics for business and business leadership turned out to be a damaging and costly experience for companies like Volkswagen.

In hindsight it seems clear that serious flaws at the individual and the organisational levels caused the dramatic break-down of corporate culture and values for which companies have pay dearly. Managers and business leaders behaved as if they were living in an ethics-free zone where lip service to moral values would do and all they had to be concerned about was to avoid being caught by the police. They seemed to have forgotten that business is not exclusively defined by the economic parameters of profit and loss or by legal standards and regulations. Economic systems and those who become key players in them depend, like everyone else, on the common ethos and the moral values and norms on which human flourishing and social life are built.

Business leaders in particular are not merely role-bearers and functionaries of economic systems but also social beings and citizens whose wellbeing depends on shared values and norms. As social beings, we can only expect to further our self-interest when we reciprocally recognise the interests and needs of others. The rules of effective cooperation are not only the result of rational behaviour, self-interest, and economic prudence but derive their force from a common interest in 'the good'. In this sense good business never lacks moral background institutions and internalised normative standards; it simply cannot operate effectively without them. Business people, leaders and subordinates, employers and employees, CEOs and workers, depend like all of us on norms of trust, honesty, and fairness. Normally we take it for granted that we can trust each other, that others speak the truth, that they will keep their promise, and that none of us is completely without any sense of compassion, sympathy, or justice. Thus a truly amoral economic system, should it be feasible, would have to be parasitic on the socially embedded ethical norms to which everyone can typically be expected to adhere.

If this is true, moral leadership should be possible even within the hard conditions in which business has to operate. And that is exactly what society and the general public expect. Only these expectations can explain the shock that those business scandals caused and the public outcry that followed. It is precisely because they have seen so many business leaders who failed miserably in moral leadership that people have begun to observe them closely and demand ever stricter standards. Companies should not only fear the steep fines and huge penalties for breaking laws, but the loss of their moral reputation. If consumers have lost trust in a company and its products, they will not buy them but look for alternatives. When people think they are buying something helpful to the planet and it ends up that they were doing the opposite, they feel betrayed and are hurt (Orts & Paul MacDuffie, 2016). And it will be a very long way for a company to win back moral territory that was lost.

> Without a good foundation in morality and ethics business people, like everyone else, would regard legal stipulations as mere obstacles on their way to profit and success and consequently look for loopholes to circumvent them even to the detriment of consumers and the general public.

All this confirms that moral leadership is not a luxury and that companies should be careful not to ignore it. Most of them may, however, think that installing compliance systems is enough and will prevent breaches of the law and of professional regulations. In 2011, Volkswagen appointed a Group Chief Compliance Officer (CCO) as head of the newly created *Governance, Risk and Compliance* department. Though the CCO's office had a staff of 14, they neither prevented the emissions scandal nor did they uncover it. After the scandal broke, Volkswagen was quick to announce that from now on compliance would be a matter of the highest importance. As a consequence Volkswagen have created the new position of *Integrity and Legal Affairs* at Board of Management level and appointed a highly respected former judge from Germany's constitutional court, Christine Hohmann-Dennhardt, effective since January 1, 2016.

Compliance systems are useful tools in preventing legal transgressions and in fostering a sense of respect for the law across the company. Yet ensuring the legality of activities is simply the bare minimum society and consumers expect of companies. Good companies are those whose people in charge act not merely in accordance with the law but also out of respect for the law, as Kant put it. Thus they uphold *legal* laws because they know that without respect for the *moral* law legality would be hollow and short-lived. Without a good foundation in morality and ethics business people, like everyone else, would regard legal stipulations as mere obstacles on their way to profit and success and consequently look for loopholes to circumvent them even to the detriment of consumers and the general public. As long as they have reason to believe they can get away with it, nothing will prevent them from engaging in dubious activities that promise greater profit and Volkswagen is a case in point. Unless you already believe in the value of morality and thus set limits to your own actions, you would have no good reason *not* to act like Gyges in Plato's famous parable about a man with a magical ring that made him invisible and thus unaccountable for whatever he did.

The foundation of good leadership in business as elsewhere is not merely legality and compliance but above all morality. It is not sufficient to instil in employees and managers a sense of legality and raise legal awareness through training and compliance protocols. Companies are expected to promote a culture of moral sensitivity and a commitment to individual and organisational ethics. Their leaders are required to make it clear that a commitment to ethics is not window-dressing, merely intended to lure consumers into believing in ethical operations throughout the company; instead, they should be trustworthy in their statements as in their actions. Only then can they expect their employees to be similarly committed. It has been argued that many ethics violations by mid-level managers in fact signal conflicts of loyalty resulting from their leaders' inconclusive, ambiguous, or outright misleading value statements and personal behaviour. Morally committed leaders will therefore take measures to assure the development of moral awareness and morally sound judgment in their subordinates and throughout the company. They will see to it that the moral point of view becomes an integral part of company performance and strategy.

In view of the huge damage the emissions scandal has done to Volkswagen, its new chairman of the board Matthias Müller (Volkswagen 2015, p. 64) finally acknowledged that: "Our key currency is not unit figures or the operating result. Our key currency is credibility and trust in our brands, our products and the people who work for our Company." Credibility and trust, however, can only be realised through personal commitment to moral leadership. Moral leaders will therefore be aware of the tie between the core values of their company and their personal morality. In adopting the moral point of view in all their actions, they develop moral character and become role models for their subordinates. This insight is shared across cultures and ages. Confucius, for example, made it the cornerstone of his political philosophy and summed it up in this well-known statement: "When a prince's personal conduct is correct, his government is effective without issuing orders. If his personal conduct is not correct, he may issue orders, but they will not be followed" (Waley, 2005, XIII, vi).

This is echoed in contemporary views that directly link a company's standing to the integrity of its leadership:

> "Managers who lack integrity place themselves and their organisations at risk. When they transgress norms of integrity, they risk losing the trust, loyalty, and commitment of employees, suppliers and customers. The best strategy for compliance is for organisations to define the moral standards expected of everyone and to develop programs that reinforce these standards." (Zauderer, 1992)

Integrity reflects the conscience and character of a moral person and provides the focal point for his or her action. It represents the moral ideal that grounds the vision of the good and its embodiment in personal and social life. Thus it transcends codification and consists primarily in the consistency between one's personal principles and the moral respect for persons (Becker, 2009a).

The foundation of good leadership in business as elsewhere is not merely legality and compliance but above all morality.

As I have argued elsewhere in more detail, the values that make up moral leadership at the individual level include integrity, honesty, trust, moral courage, justice and fairness and authenticity (Becker, 2009b). Their meaning for business leaders is well summarised in the Hong Kong ICAC's *Guidelines for Directors' Ethics*:

> *"A tree greens from the top while a rotten apple spoils the barrel.* Company directors, being strategic decision makers at the top, should serve as a role model for their fellow board members and all staff to follow. They should lead by example and stay vigilant against corruption, fraud, malpractice and other unethical acts. It is equally essential for them to demonstrate the moral courage to speak up and report any illegal acts or irregularities unveiled. Failure to do so will send a wrong message to staff members, investors and the reputation of the (…) company will be damaged and investors' confidence weakened." (ICAC, 2009)

Nevertheless, personal qualities of moral leadership are useless unless they are embedded in a supportive company structure. That is to say, moral leadership not only interacts with internal environments, corporate cultures, and hierarchical structures, it also influences their development. While leaders may be the most visible representatives of an enterprise, companies, particularly corporations, are themselves moral agents with their own sets of values and objectives. CEOs come and go, while companies are usually there for the long term[1]. Internally, the company-wide mechanisms that bring moral leadership to bear include codes of ethics, mission or core value statements, ethical training programs and reporting channels for ethical grievance. Although it is not likely that all these mechanisms can be imposed upon a business simultaneously, there may be paths forward that can be studied and implemented progressively. Reidenbach and Robin, for example, have argued that companies, like individuals, can develop morally and move through five stages that range from the (1) amoral organisation, to (2) the legalistic, the (3) responsive, and the (4) emerging ethical, and finally to the (5) ethical organisation (Reidenbach & Robin, 1991). An ethical organisation can only emerge from a common effort that takes all on board and aims at developing a corporate culture that wins moral recognition from all stakeholders.

> Personal qualities of moral leadership are useless unless they are embedded in a supportive company structure.

Merely having a code, even one backed up by a robust compliance department, is not enough, it must also be taken seriously, particularly in rough times. No code can prevent misconduct and unethical activities unless it is embedded in a company culture that is ethically sensitive and accepted by all concerned, particularly the leaders at the top. For this adherence to standards must be built into management systems, into performance evaluation, compensation, audit and control (Paine, 2003). Needless to say such culture takes time to grow as it involves habits of mind and action that are only produced through the continued, sincere encouragement to abide by company values and principles. Yet in the end this will develop into moral standards of good practice the individual employee and manager can hardly ignore.

Learning from Siemens

As things stand now Volkswagen seems fully aware that it will take much effort to win the public's trust again. The steps it has taken so far have some similarity with the actions taken by Siemens to regain its reputation after it became clear that corruption was endemic in the company (Rothlin & McCann, 2016). It admitted the wrongdoings and the lack of oversight, replaced its tarnished top leadership, appointed a new CEO from outside the company. It sued individual managers at the centre of the scandal for compensation, including eleven former top managers together with the former chairman of the supervisory board and the former CEO, and aggressively introduced a variety of measures to rout out corruption. The new CEO Peter Löscher, who is one of the few top managers in German corporations with an MBA, made it absolutely clear throughout the company that corruption prevention would be a priority for the senior management. This was backed up by the appointment of a Chief Compliance Officer (19 September 2007), the institution of a new directorate "Law and Compliance" on the Siemens Managing Board, and the appointment of an independent compliance consultant to advise the Board of Directors and to regularly report to the Chief Compliance Officer. Sanctions were imposed on 500 employees for violation of external regulations or internal policies. The contracts of thirty percent of those employees were terminated and eight percent were punished with salary reductions. The rest received either a reprimand or a warning.

1 Peter A. French has argued that corporations are moral persons on equal footing with natural persons with all the privileges, rights, and duties moral persons normally have (French 1979).

Siemens consolidated all its internal anti-corruption regulations within a single, easy-to-use source, the *Siemens Compliance Guide Anti-Corruption*, and distributed it to every employee throughout the company. It set up a Compliance Help Desk with an "Ask us" function as central contact point for employees with questions related to matters of compliance and corruption. The second function of the Compliance Help Desk is a "Tell us" function that gives employees and all external stakeholders the opportunity to report any indications of possible violations of the Business Conduct Guidelines, on the assurance that reports are neither traced nor registered. Siemens also stepped up its anti-corruption and ethics training program and began ethics training for its employees.

It seems that Siemens took the right steps to regain its reputation of an honest and law-abiding company consumers and the public can trust. When Volkswagen finally settles its lawsuits and its fines, it will be well advised to follow in Siemens' footsteps. Nevertheless both companies should be mindful that such changes in policy will not succeed unless they are strongly supported by moral leadership at the top.

Gerhold K. Becker is Former Chair Professor of Philosophy & Religion and Founding Director of the Centre for Applied Ethics, Hong Kong Baptist University.

References 参考资料

Becker, G. K. (2009a). Integrity as Moral Ideal and Business Benchmark." Journal of International Business Ethics, 2(2), 70-84.

Becker, G. K. (2009b). Moral Leadership in Business. Journal of International Business Ethics, 2(1), 7-21.

Becker, G. K. (2013) The Competitive Edge of Moral Leadership. In Rothlin S. & Haghirian, P. (Eds.) Dimensions of Teaching Business Ethics in Asia (pp. 9-28). Heidelberg: Springer.

Burns, J. M. (1979) Leadership, New York: Harper Torchbooks.

Ciulla, J. B. (1998). Imagination, fantasy, wishful thinking and truth. The Ruffin Series of the Society for Business Ethics, 1, 99-107.

Ewing, J. & H. Tabuchijuly (2016, July 20). Volkswagen Scandal Reaches All the Way to the Top, Lawsuits Say. Retrieved from: https://www.nytimes.com/2016/07/20/business/international/volkswagen-ny-attorney-general-emissions-scandal.html?_r=0

French, P. (1979). The Corporation as a Moral Person. American Philosophical Quarterly, 16(3), 207-215.

Kiley, D. (2016, Sept 9). The First VW Exec Pleads Guilty In Dieselgate; More Sure To Follow. Forbes. Retrieved from: http://www.forbes.com/sites/davidkiley5/2016/09/09/the-first-vw-exec-tumbles-in-dieselgate-with-more-sure-to-follow/#f07cced37228

ICAC. (2009). Ethics - The Core Value of Leadership Toolkit on Directors' Ethics. Retrieved from: www.hkbedc.icac.hk/english/files/news_events/20090205director_ethics.doc

Orts, E. and MacDuffie, J. P. (2015, April 26). Can Volkswagen Move Beyond Its Diesel Emissions Scandal? Knowledge@Wharton. Retrieved from: http://knowledge.wharton.upenn.edu/article/can-volkswagen-move-beyond-its-diesel-emissions-scandal/

Paine, L. S. (2003). Value Shift: Why Companies Must Merge Social and Financial Imperatives to Achieve Superior Performance, New York: McGraw-Hill.

Reidenbach, E. R. & Robin, D. P. (1991). A conceptual model for corporate moral development, Journal of Business Ethics, 4, 273-285.

Rothlin, S., & McCann, D. (2016). International Business Ethics: Focus on China. Berlin Heidelberg: Springer, 297-320.

Ruddick, G. (2015, Sept 22). Volkswagen scandal: US chief says carmaker 'totally screwed up'. Retrieved from: https://www.theguardian.com/business/2015/sep/22/volkswagen-scandal-us-chief-carmaker-totally-screwed-up-michael-horn

Siemens. (2007). The Siemens Compliance Guide Anti-Corruption (November, 2007)/ Retrieved from: http://w3.siemens.no/home/no/no/omsiemens/Documents/sc_upload_file_anticorruption_handbook.pdf

Volkswagen 2015. Volkswagen Annual Report 2015. Retrieved from: https://www.volkswagenag.com/presence/startseite/dokumente/Volkswagen_AG_Ge-schäftsbericht_en.pdf

Waley, A. (2005). The analects of Confucius (Vol. 28). Psychology Press.

Zauderer, D. G. (1992). Integrity: An essential executive quality. Business Forum 17, 4. Los Angeles: California State University, School of Business and Economics, 12-16.