REFLECTIONS ON THE VOLKSWAGEN EMISSIONS SCANDAL

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The crisis hits

On 18 September 2015, the US Environmental Protection Agency (EPA) issued a notice of violation to Volkswagen (VW) for using a ‘defeat device in cars to evade clean air standards’. The defeat device was a software patch in certain diesel engines that could detect when the engine was being tested in a controlled environment and therefore change the engine’s performance by switching on emissions controls to ensure tests were passed. The EPA’s findings covered 482,000 cars in the US and was specifically concerned with Nitrous Oxide (NOx) emissions. Although it took two days for VW to respond to the EPA’s announcement, it soon admitted that its 2.0L diesel cars in the US were indeed fitted with a defeat device, as were approximately 11 million of the company’s cars worldwide, mostly in Europe.

What followed was a familiar pattern of a ‘performance crisis’: high scrutiny and pressure on the company, outrage at the ‘cheating’, apologies, a senior resignation, congressional and parliamentary hearings, speculation about how far this could spread in the industry and the possible cost to VW, a tumbling share price, internal inquiries, law firms searching for ‘victims’ to sue the company, calls for structural and cultural change at the company and so on.

The crisis took a new turn on 3 November, when VW announced it had also discovered ‘irregularities’ in carbon dioxide emissions testing, which at the time was reported to affect up to 800,000 cars in Europe. This affected fuel economy claims and customers’ perceived performance of their vehicles, potentially opening up the company to lawsuits. This new admission, however, didn’t receive the same amount of media attention or add to the public outcry. Perhaps there was a sense that this was just another example of the same deceit: there is only so low you can go, after all.

While there are many months and indeed years of reputation recovery to come, there are some clear lessons to be drawn from the scandal and VW’s response to date. For the purposes of this thought piece, I focus on six.

Scandals are the hardest crises to manage

Crisis can come from anywhere: incidents such as industrial accidents, terror attacks and weather events, and issues such as performance problems, policy change and so on. Organisations mature in crisis preparedness should be ‘ready for anything’, from the familiar to the unimaginable. But perhaps the hardest crisis to manage is the corporate scandal.

Scandals – deliberate wrongdoing, unethical behaviour, criminal acts – tell customers, regulators, employees and others that their trust was misplaced. Scandals provoke outrage, immediately positioning the organisation as a villain. And unlike a physical incident, there is no period where the focus of attention is on human impacts. When you are battling a blaze and saving lives,
“There is something about cheating or bad behaviour that undermines trust more than a safety or security incident.”

Onlookers are normally ‘on your side’ while the incident is ongoing. With a corporate scandal, the recriminations and allegations start immediately. The crisis narrative was established very early – VW had set out to bypass regulations for competitive positioning, increased sales and financial gain. The company’s reputation was perhaps already deeply damaged before the crisis management team met for the first time. And what compounded this was that the scandal hit at the heart of everything that the company was perceived to stand for: quality, reliability, engineering excellence and so on. If a crisis strikes at the heart of what you stand for as an organisation, the route to reputation recovery seems longer and tougher.

Organisations that have successfully demerged strategic crisis management from incident management have recognised that issue-driven crises are in many ways more likely to cause long term reputation damage than incident-driven crises. There is something about cheating or bad behaviour that undermines trust more than a safety or security incident. Preparing for issue-driven crises is just as important as preparing to manage a physical incident.

Slow and opaque communication compounds perceptions of defensiveness

The organisation at the centre of a crisis is under an intense spotlight. Every action, word and sentiment is scrutinised and analysed by sceptical stakeholders and, in the case of a scandal, an outraged public. We all make assumptions about an organisation and how it is likely to behave in a crisis, often turning positive aspects of its reputation into flaws. Attributes such as solid, steady and Germanic are flipped into flaws such as cold, uncommunicative and slow-moving.

VW’s crisis communication job was to confound these negative perceptions by being swift, transparent and accessible. But as yet it has not succeeded: VW’s communication has been criticised as being slow, opaque, defensive, corporate and secretive. It has also been strange in its tone (a statement by new CEO Matthias Müller which announced the company’s next steps was written in the third person) and therefore ineffective. And this despite the fact that much of VW’s messaging was sound: apologise, focus on customers, investigate, promise change and improvement to ensure this can never happen again.

The lesson here is that all organisations should understand their reputations and therefore how they will be perceived in a crisis. They need to plan and practise hard to ensure that they are in a position to accentuate the positives of the reputation and eliminate the negatives. This means working on tone, style and speed of communications as well as content.

Share price is only one indicator of damage

A crisis on the scale of VW’s has reputational, organisational, strategic and financial impacts. The VW share price fell by 40 per cent in the two months after the crisis broke, with investors pricing in the likely primary costs such as fines, recalls and repairs, secondary costs such as legal fees and damages and the costs of reputation and brand damage such as decreased sales.

VW said it was setting aside €6.7bn (£4.8bn) to cover costs, which resulted in the company posting its first quarterly loss for 15 years in October 2015. It warned of a further €2bn hit after the scandal extended to carbon dioxide emissions ‘irregularities’. But, with the US Government filing a law suit for violating clean air laws, threatening to cost tens of billions of dollars, and more than 500 private lawsuits already filed against the automaker for its deception, analysts and commentators have been speculating that the total financial cost to the company could be much larger. To the agitation of investors, VW seemed unable to contain this
speculation (see more on containment in lesson four below).

There are always commentators who explain that the share price will ‘bounce back’ and that the company in question has underlying strengths and qualities to successfully overcome the financial hit. But the idea that the share price will ultimately recover and therefore everything will be OK is simply wrong, as anyone who has been through a major crisis with a global company will tell you. The share price is of course a headline indicator that CEOs and CFOs care about, but the less visible impacts are damaging too. A crisis eats away at a company’s confidence and strategy as well as its finances. Investment is cut, R&D budgets slashed, advertising campaigns shelved, contracts are harder to come by, influence is diminished in the corridors of power and every difficult stakeholder meeting starts with ‘why should we believe a word you say?’.

Perhaps most importantly, graduates go elsewhere, talent leaves and morale saps. And, of course, there will be regulatory change. The focus on efficiency, engines and diesel in particular will pour pressure on the wider industry and its new poster child, VW. The Executive Secretary of the UN Framework Convention on Climate Change, Christiana Figueres knows how these things work: she confessed to being delighted by the scandal as it will force change and a move to electric and hybrid cars.

It is important to remember no-one has died (directly at least – there are some who are trying to link the emissions scandal to pollution-related death rates). No one has been injured. The affected cars are safe to drive. And yet some estimates have put the total costs to VW on a par with those borne by BP after the Deepwater Horizon disaster. The financial and reputational costs will be enormous, and the share price is just one indicator.

Containment is key. Or else stakeholders assume the worst

Many crises are almost exclusively about impact management. Something has happened, it is clear what has happened and the focus is on managing the fall-out. These crises – an explosion at one factory in one country affecting one community and one product line, for example – are at least containable. VW’s problem was made much worse because the crisis remained uncontained for a long period. When speculation mounted about the number of cars and VW brands that could be affected, the likely cost of the recall, the remedial work required to fix the problem and the financial consequences for the business, VW needed to contain the issue, but was unable to. This was partly, I imagine, because it didn’t understand the scale of the problem itself, and partly because it did not find the right communication to limit the speculation with the technical knowledge it did have. The company did not appear to be in control.

As investigations progressed, Volkswagen was able to provide facts about the extent and scale of the scandal including clarifying engine types known not to be affected. But this was weeks into the crisis.

No crisis management team has all the information – technical or otherwise – it would like. Crises are managed with imperfect and incomplete information. In the absence of certainty, organisations in crisis have to find other ways to communicate messages of reassurance and control to a sceptical public.

Crisis recovery is about real change

The authors of BS 11200, the 2014 British Standard for crisis management, noted that the ‘essence of recovery [after a crisis] is not necessarily a return to previous normality. It may mean moving forward towards a model of business and organisational structures that represent a new normality’. Crises can sometimes be an opportunity to effect change that might otherwise never happen. While
no leader would wish a crisis on his or her organisation, and while it is not easy to think positively when the pressures and scrutiny are at their height, those who find themselves in a crisis should always consider it – at least in part – an opportunity as well as a threat.

Most major crises bring major change. Scandal crises certainly do. If something goes so terribly wrong in an organisation, it needs to be fixed and be seen to be fixed. After the Shell reserves crisis of 2004, the oil giant fundamentally overhauled its board and management structure and embarked on a new internal change programme called ‘enterprise first’ which encouraged employees to always think of the wider Shell business (rather than their own divisions). After the phone hacking scandal, News International changed its structure, separating it into two entities – News Corporation and Fox Corporation; its name, it became News UK in the United Kingdom; and closed the News of the World, accepting the title was toxic.

VW never tried to downplay the scandal or what it meant for the company. Clearly there was going to be significant change to ensure something like this would ‘never happen again’. This change would be in personnel (see lesson 6 on leadership), structure and culture. In a statement on 28 October, VW announced that new CEO Matthias Müller had proposed changes to structure, process and operations. This, of course, was on the back of commentators and industry experts queuing up to explain that VW’s business model was flawed, its unions too powerful, its senior team too entrenched and its operations too secretive. Ratings agency Fitch downgraded VW’s debt, a decision driven by ‘corporate governance, management and internal control issues’.

And there are plenty of people lining up to tell you how to change in the aftermath of a crisis, as proposals from Elon Musk, CEO of electric car manufacturer Tesla, and 43 other technology company leaders demonstrate: instead of focusing on fixing diesel cars, they wrote in an open letter to the California Air Resources Board that VW should change its business model entirely and put its resources toward becoming a zero-emissions car company.

Accepting things are going to change, even when the scale and scope of the crisis has yet to be determined, is an early requirement of managing scandal crises. Change comes, whether it is designed internally or whether it is led by politicians and regulators. It is better to get on the front foot, and drive change from within rather than having it imposed upon the organisation.

6. Crises are the ultimate test of leadership
Scandals hit leaders hard. The crises mentioned in lesson five both ended the tenure of the CEOs involved. VW was no different, but the very swift resignation of CEO Martin Winterkorn raises an interesting crisis question. When is the right time for a leader to step down?

Winterkorn announced his resignation on 23 September, only five days into the crisis. He said he was ‘doing this in the interests of my company even though I am not aware of any wrong doing on my part.’ Leaders must ultimately be accountable, whether or not they knew of the problem.

The ultimate act of leadership might be to know when it is time to go. Crisis commentators often suggest that leaders cling to office too long, and it is true that a resignation can serve as the punishment and gesture that pushes the organisation over the peak of the crisis and towards a sense of rebuilding. Certainly Tony Hayward of BP was seen by many to have become a lame duck CEO long before he announced his resignation three months after the crisis in the Gulf of Mexico first struck.

But with Martin Winterkorn resigning after five days, Matthias Müller came to the CEO role knowing the situation was still fluid and could get much worse. It
was – and remains – extremely difficult for him to be the ‘new broom’ when the extent of the mess he has inherited is still unknown and uncontained. Would it perhaps have been more effective had Winterkorn stood down once the investigation had reached a critical stage and the recovery was in sight? This would have provided the incoming CEO with the opportunity to present a fresh start. Instead, there are allegations of ‘out with the old and in with the old’ as one long time VW senior executive replaces another, and suggestions that an outsider would present a better opportunity for the company to turn around its fortunes. In this respect, perhaps BP managed this aspect of its crisis response better. Tony Hayward remained in post as the lightning rod for criticism and the personification of the problem; allowing Bob Dudley to come into the role able to focus more on the future and be the solution.

Final thoughts
Until this scandal, VW had a reputation for solidity and reliability. Recovering this reputation is likely to be a long process. It won’t be done through words alone, and certainly not through any misguided PR or CSR initiatives, but through demonstrable change and a recommitment to rebuilding trust through good, solid, reliable – and honest – performance.

Change is the watchword for this crisis, as it is for so many, especially those emanating from a scandal. The purpose of change is not to be punished or to make up for wrongdoing, although these are important. It is, rather, to emerge better and stronger; something Matthias Müller has publicly stated. Where there is change there is opportunity: to fundamentally improve direction, purpose, values and strategy. The company’s survival instinct can create better – perhaps industry leading – practices and force changes that might otherwise never have happened.

Get in touch
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