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# Learning points from the Volkswagen scandal

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**Volkswagen: the largest German car manufacturer. The Porsches: the wealthiest family of Austria. Ferdinand Porsche, the engineering genius who would build the cars that ultimately dominated the German autobahn after Hitler's war. VW is a part of (industrial) history.**

But recently, Volkswagen has also written a different sort of history: do you remember José Ignacio López de Arriortúa, who was accused of having misappropriated trade secrets when he left his post as Head of Purchasing with VW and took a position with GM, and who was also the eponym of the López effect? Do you remember the sex scandal where prostitutes had been paid for and flown in from Brazil by the company specifically to "convince" the shop stewards committee of the proposals put forth by management? Do you remember the takeover battle between Porsche and VW and the rollercoaster ride it caused on the stock exchange? Do you remember the headlines about the fight for power between the Supervisory Board president Piech and the CEO Winterkorn. A multi-billion euro company with hundreds of thousands of employees had been temporarily reduced to the pawn of two alpha males.

For the sustainability industry Volkswagen (VW) is a highly interesting case. On the one hand VW proves yet again the fact that basic rationale that the costs of bad governance ultimately exceed the benefits is correct. Whoever does not want to believe this just has to take a look at the VW share price over the past couple of days. An image says more than a thousand words.

On the other hand, as sustainable investment manager who had VW in their universe and portfolio one has to ask oneself (or accept to be asked) what sustainable funds are for if this situation slipped everyone's attention. Given this history it seems obvious that something had to happen.

**I can think of several answers to this question.**

**The first one is simple: we have to improve!** Obviously we have to dig in our heels, stick with it, ask more persistent questions, and second-guess responses more critically. Whenever companies with a certain reputation ostentatiously shout "We have understood!", it is important to look very closely whether words are followed by actions. Bad governance is no "technical malfunction" but usually the result of a specific corporate culture, which is difficult to change, let alone in the short term. We have had this internal discussion many times, of whether it would not be better to quickly re-admit for investment companies that have been convicted of bad governance (corruption, fraud etc). After all, these companies should have the incentive to do everything in their power to avoid getting into that sort of trouble again. But obviously that argument is not convincing enough. It seems that we, as investors, have no alternative but to pay more attention to corporate culture, and to the main representatives of that culture, i.e. management. The rot starts at the top, as they say.

**Second**. This case highlights better than many others and than many arguments could that **our approach to take bad governance seriously and to penalise violations is right**. The VW share price proves it, even though we did not benefit from it, and many examples where we managed to generate a profit or avoid risk (Petrobras, Enron) on the back of this approach prove it as well. VW has committed fraud, and fraud has to be discovered first. To build the systematic, accusatory argument from this inability to discover fraud that it is generally not right to pay attention to corporate governance does not seem logical to me. Not every crime is disclosed, and not every disclosed crime is solved. To derive from that the idea that we do not need laws or the police is simply wrong.

**Thirdly we as company and as sector have to do more to manage these risks** . VW has realised that the prefix "eco" works. What should be a positive development for a sustainable asset manager has turned into a perversion, given that we were ready to be defrauded. Apparently we need other, better forms of scrutiny in order to identify this risk. This is of course difficult, but not impossible. (It would only be impossible if one were not to ask oneself the question.) The culture of a company facilitates conclusions about how these issues tend to be handled. Statistical techniques can be used to establish whether data may have been manipulated. NGOs represent a critical public that can gather information and challenge companies on various levels. (Sustainable) rating agencies have the know-how and tools in order to be taken seriously by the large companies. Internal reporting systems make it increasingly possible to deal with such attempts of fraud within the company. As a rule, fraud of this magnitude requires more people than there are fraudsters.

**The sustainable asset management industry in particular can be a spearhead also for traditional managers because it has learnt to ask the right questions and to work with this form of largely "soft" data.**

***Personally I think that the learning point of Volkswagen has to be not to pay less, but to pay more attention to corporate governance. The hypothesis "bad governance creates costs" is correct. But we have to develop better tools in order to identify cases like VW earlier and more often.***

## Legal disclaimer



## Gerold Permoser

Gerold Permoser has been Chief Investment Officer at Erste Asset Management since early April 2013. He is responsible for all asset management activities and investment strategies for all investment funds held by the Erste Asset Management Group in Austria, Germany, Croatia, Romania, Slovakia, the Czech Republic, and Hungary. Before joining the company, he served this function at Macquarie Investment Management Austria KAG. Permoser has gathered experience in investments since 1997.

He began his career as a fixed-income analyst at the Creditanstalt in Vienna. He moved to asset management at Innovest KAG in 2000. He made significant contributions in the investment field there and advanced to CIO (director of asset allocation and research). Gerold Permoser studied at the University of Innsbruck and is a CFA charter holder. He offers training at the University of Vienna and at various post-graduate institutions for analysts and portfolio managers (i.e., at VÖIG, the Association of Austrian Investment Fund Companies).