

# Social Responsibility: Does it Matter? Case study on Emission Scandals of Volkswagen and Mitsubishi

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## Abstract

*Due to the huge social and environmental issues faced by the world during the last couple of decades the concept of Corporate Social Responsibility (CSR) has taken front stage in the business world by becoming the key element of sustainable competitive advantage that benefits the company, society, and environment*

*The purpose of this paper is to analyze whether the concept of CSR take as a tool only for maximizing the shareholders' wealth by the investors (principals) as well as managers (agents) of the company by analyzing the two prominent CSR related scandals happened in the auto industry. It uses the agency theory model to analyze these cases and understand whether this model is overshadowing the stakeholder model of CSR concept. The preliminary studies carried out by comparing CSR reported by these two companies and the facts, effects, and reactions to the emission scandals indicate that although firms indicate that they follow a stakeholder model for their CSR initiatives and reports based on it, in reality, they follow agency model and CSR appears to do not really matter. This study also implies that manager needs to have a proper strategy that is followed and reported along with proper monitoring and control measure for a successful implementation of CSR. Due to many complexities, this it is too early to generalize 'CSR does not matter ' view either to the entire corporate world nor the auto industry. Therefore, future studies are encouraged to include more companies in the auto industry and expand it to other industries as well.*

**Key Words:** Emission Scandal, CSR, Agency Theory, Volkswagen, Mitsubishi

## Introduction

"If we're not going to live by it, let's tear it off the wall" said James Burke, then chief executive of Johnson & Johnson after summoning more than 20 of his key people into a room, referring to the document entitled "Our Credo," that list the principles of the company and had been a fixture on James Burke's statement. It seemed to be applicable when CEO of Volkswagen (VW) Martin Winterkorn issued a statement on emission scandal saying, "deeply sorry that we have broken the trust of our customers and the public," and added "we do not and will not tolerate violations of any our internal rules or the law,". (Isidore & Valdes-Dapena, 2015), It also appears to be applicable when President of Mitsubishi

Corporation (MC) Tetsuro Aikawa said that the mishandling of the test data was “intentional,” and bowed in apology before a briefing in Tokyo. (Ma & Hagiwara, 2016)

These two apologies came as a shock to the corporate world because of the CSR record held by both of these companies. Volkswagen is considered in the top tier of the responsible business list and listed as the most sustainable automaker in the Dow Jones Sustainability Index. The company even listed environmental and climate protection as one of its top three most material topics. Similarly, Mitsubishi Motors dedicated more than 25% of its 2015 Corporate Social Responsibility report to discussing its commitment to environmentally friendly products and initiatives. If these seemingly responsible companies are caught up in this scandal, critics say it undermines trust in any business claiming to create long-term value for its stakeholders. Without a lie detector test accompanying every report, can stakeholders ever have absolute confidence that companies are executing their corporate responsibility strategies as they say? (Texin, 2016)

Moreover, is CSR is just part of a profit making for the shareholders by storytelling to the stakeholders, or it does with real stakeholder focus? These questions can answer by looking at two different companies with two different levels where the Volkswagen had a stronger market and financial position and Mitsubishi Motors were already struggling for the market share and had come under the target of Nissan. Finally, it is also important to notice that the reaction of the investors to the scandals whether it supports the stakeholder view of CSR or else as long as the shareholder values create to the satisfactory scandals can tolerate.

### **What is CSR?**

Before the discussion about the emission scandals, its impact, and CSR, it is important to answer the question what is CSR.

There are hundreds of definitions for CSR. The one we think says it the best comes from the International Organization for Standardization’s Guidance Standard on Social Responsibility, ISO 26000, published in 2010. It says:

“Social responsibility is the responsibility of an organization for the impacts of its decisions and activities on society and the environment, through transparent and ethical behavior that:

- Contributes to sustainable development, including the health and the welfare of society
- Takes into account the expectations of stakeholders
- Complies with applicable law and consistent with international norms of behavior, and
- Is integrated throughout the organization and practiced in its relationships.”

(The Australian Centre for Corporate Social Responsibility (ACCSR), n.d.)

Converse to the definition above that calls for company’s decisions to have a positive impact on society and environment openly, these couple of cases take us behind few steps and remind us an old statement “if you cannot do good at least do not do bad.”

### *The Company and Its CSR*

Before going into the details of scandals let us understand a brief about the two companies under investigation for emission, fuel efficiency scandals and see their CSR commitments made to the stakeholders via annual reports.

Instead of analyzing the latest CSR reports where it is expected to see a lot of remedy plans and actions filled with the scandals happened, to have a better comparison between CSR in reports and reality, the CSR reported in the latest annual reports just before the scandals for both VW and MC detailed in this study.

### *Volkswagen AG*

The second largest car maker

Volkswagen is the largest carmaker in the world, after Toyota. It's 590,000 employees produce nearly 41,000 vehicles daily. It currently owns 12 subsidiaries including Volkswagen Passenger Cars, Audi, Seat, and Skoda, luxury brands such as Bentley, Bugatti, Lamborghini, Porsche and Ducati - as well as Volkswagen Commercial Vehicles, Scania and Man. (Bowler, 2015)

German cars deemed more strong, safe and environmentally friendly than the Japanese cars. In this background, VW can be seen as the dominating carmaker in the world.

### Is VW – The Sustainability golden child?

Before the scandal, VW is considered to be the most responsible business to the sustainable world and claiming the top spot in the Dow Jones Sustainability Index.

VW did not disappoint the reader of latest the annual report on highlighting itself as a most sustainable business where it started with the below statement from Prof. Dr. Martin Winterkorn, then Chairman of the Board of Management.

“Our pursuit of innovation and perfection and our responsible approach will help to make us the world’s leading automaker by 2018 – both economically and ecologically.” (Volkswagen, 2014)

This glamorous statement of the chairperson was followed up with Sustainable Value Enhancement section of the report for more than 30 pages started with a similar beautiful statement saying:

“We run our business responsibly and with a long-term perspective along the entire value chain. Everyone should benefit from this – our customers, our employees, the environment, and society.”

VW did not stop only with mere statements, but in its sustainable value enhancement report, it also presented detailed action plans in the areas of environment, society and governance as depicted in Figure 1. As for environment, focus is appeared to be on new environmental imitative such as electronic cars not on auditing the existing systems for enhancement of environmental friendliness and to confirm the claims the company makes for its environmental achievements

VOLKSWAGEN GROUP'S KEY ACTION AREAS



Figure 1: VW group’s Key Action Areas (*Volkswagen, 2014*)

In general, is the company’s ecological leadership in 2018 a myth or reality? Is business running responsibly to its society and environment? These are the two important questions to be answered by VW’s management after the scandal. However, from the outset, it appears that the company had to make more inroads towards ecological leadership with more transparency and responsibility in its action rather than statements.

VW’s environmental Strategy is a mere compliance tool

As part of the action plan, The Volkswagen Group has published an environmental strategy to become the ecological leader in the automotive industry by 2018 concentrating in four environmental related areas as shown in Figure 2. However, detailed plans of this strategy lack monitoring and control measures. As we all know, what monitored and measured is done and improved.

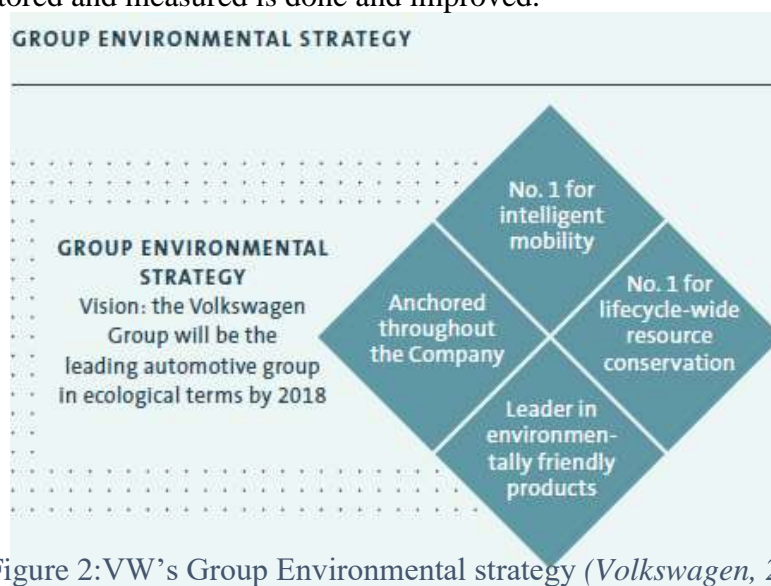


Figure 2:VW’s Group Environmental strategy (*Volkswagen, 2014*)

Further, the company also talks at length about its plan to cut carbon emission to reduce from current 126 grams per Kilometer to 120 by 2015. The chart showing the progress of cutting carbon emission is extracted from the annual report and shown in the annexure 1.3. Despite the improvements in cutting the carbon emission, the commentary of the section indicates that the company is only concerned that they can comply with the European standard carbon emission requirements than the positive impact it can bring to the environment by doing so. Moreover, due to the recent scandal, these statistics can be viewed with a reasonable doubt whether it is a real reduction in the CO2 emission of another mere technical adjustment to show it to comply with the requirements.

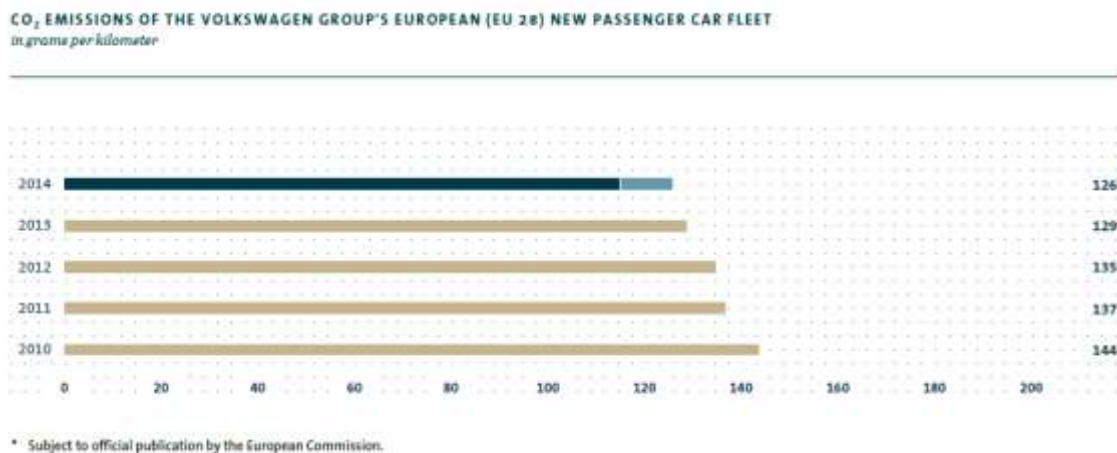


Figure 3: CO2 emission of VW group’s European fleet (Volkswagen, 2014)

### Mitsubishi Motors

#### The Three Diamonds

On the other hand, Mitsubishi Motors is part of the Mitsubishi Group, which includes about 40 individual companies. The group was established in 1870 as a shipping company, and its name roughly translates to "three diamonds" - hence its logo.

The main divisions are the Mitsubishi UFJ Financial Group; Mitsubishi Corporation - Japan's largest general trading company; and Mitsubishi Heavy Industries - which includes atomic, chemical and power systems divisions as well as the carmaker. (bbc.com, 2016)

#### Is Mitsubishi the Shoki Hoko (Corporate Responsible to Society) Company?

At a group level, Mitsubishi Corporation (MC) followed Global Reporting Initiative (GRI) to report its annual report in the name integrated reporting. The report starts with talking about CSR:

“Mitsubishi Corporation (MC) is pushing ahead with a strategy for generating sustainable corporate value by pursuing Sustainable Economic Value, along with Sustainable Social value and Environmental value.”



Figure 4: Mitsubishi’s Corporate Sustainable Value Principles. (*Mitsubishi Corporation, 2015*)

As it is clear from the three pillars by which the company is pursuing sustainable corporate value (Figure 4) two third of the emphasis is given to the social and environmental sustainable value combined. Despite the fact that recently discovered scandal has little impact on environmental issues it has a huge importance on the “trust “one of the primary aspects of social sustainability.

Further, MC also boasted in its integrated report that it had gained the entry into Dow Jones Sustainability index that includes only Socially Responsible Indices (SRI) based on its CSR and environmental initiatives and transparency in disclosure of information. Most importantly the group including the Mitsubishi Motors Corporation (MMC) follow a corporate philosophy with three principles (refer Figure 5) and the first one is CSR named in Japanese “Shoki Hoko” transliterate into that strives to enrich society, both materially and spiritually while contributing towards the preservation of the global environment. However, the scandal raised the questions whether MC is trying to enrich the society when the company within itself failed to uphold basic ethical values.



Figure 5: Mitsubishi’s Three Corporate Principles. (*Mitsubishi Corporation, 2015*)

### MMC’s CSR Following Footstep of the Parent

In line with the group, Mitsubishi Motors as well had given extensive coverage to the CSR through its separate CSR reporting Corporate Social Responsibility Report 2015. It highlighted its approach as below:

“We will continually contribute to both society and the environment by winning trust in Mitsubishi Motors through the fulfillment of the expectations and demands of stakeholders through the implementation of our Corporate Philosophy.” (Mitsubishi Motors, 2015)

Comparing to the VW scandal, Mitsubishi scandal has almost no direct link to the environmental issues. However, if we consider from a social point of view, it has the biggest impact breaching customers trust. Moreover, if we analyze the “Environmental Vision 2020” formulated by Mitsubishi Motors Corporation based on its “Environmental Policy” in fiscal 2009, it only aims to achieve environmental sustainability through new technology initiatives such as electronic cars. However, it is important to focus on the current operations to improve environmental and social friendly before investing in new ventures. At least both need to go hand in hand to realize the sustainable CSR.

### The Emission Scandal Facts & Effects

As opposed to the CSR reporting we had seen by both Volkswagen and Mitsubishi so far in this study, the facts unfolded about the scandals by these companies are very disturbing. As both of these entities are from two countries where stakeholders other than the shareholders supposedly have more power in the corporates than rest of the world, the hope for a real CSR from stakeholder’s view is fading.

#### Volkswagen Emission Scandal

How was the VW emission scandal structured?

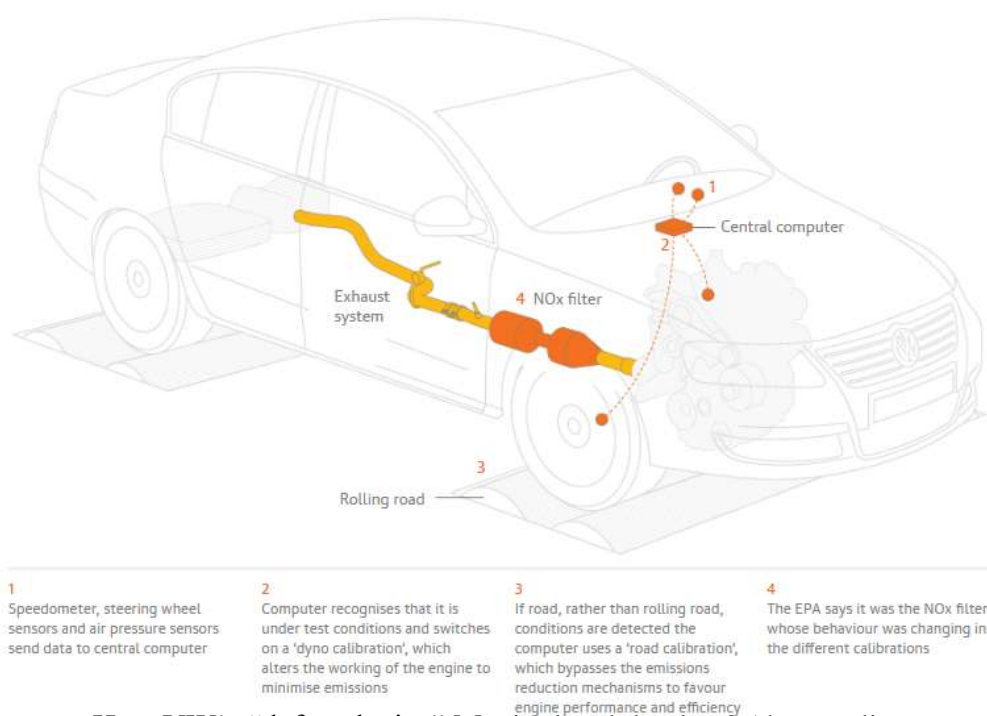


Figure 6:: How VW’s “defeat device” Manipulated the data? (theguardian.com, 2015)

Briefly, the VW emission scandal is all about a cheat software that manipulated the data indicating very low emission and excellent fuel economy. The software attached to the control device concealed the true amount of nitrogen oxide Volkswagen's diesel engines were producing especially when it was tested in the lab to certify the vehicles for the road use. The info graphic is showing how the defeat device was functioning provided in Figure 6. As per the findings, in the real driving conditions, the discharge of emission reached up to 40 times more than the allowed legal limit.

**How the Scandal discovered**

This scandal was discovered by an NGO the International Council on Clean Transportation (ICCT). When ICCT tested emission results of VW Jetta and Passat compared to BMW X5 under various conditions performed showed an unbelievable amount of additional diesel emission from VW models. (Charts showing the comparison of different level of emission are depicted in Figure 7) This result prompted them to contact EPA (The Environmental Protection Agency) who confirmed the findings that eventually lead VW to accept the fraud by September 2015.

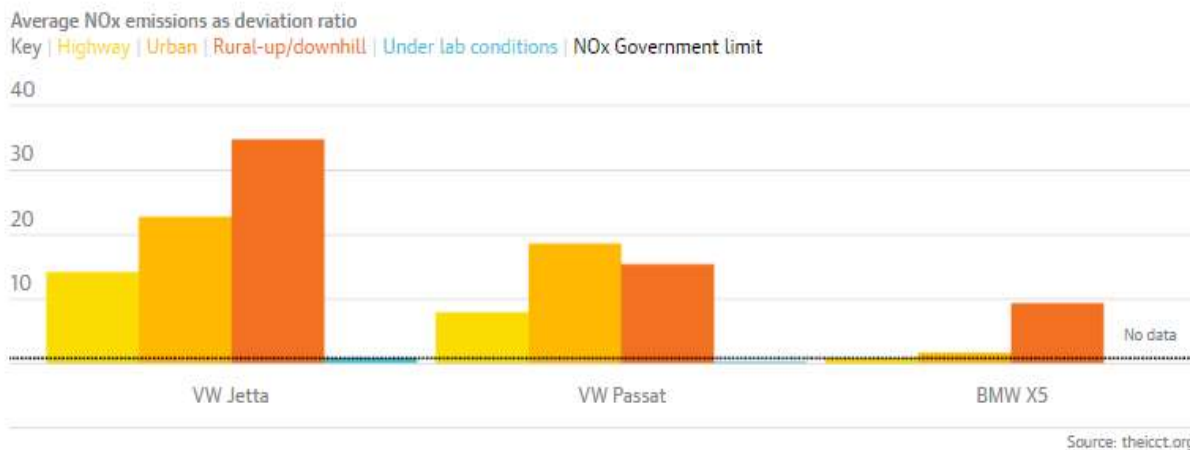


Figure 7: Average NOx emission Comparison? (*theguardian.com, 2015*)

**Effects of VW’s Scandal**

VW diesel vehicles in the USA, specifically VW-manufactured Audi A3, VW brands Jetta, Beetle, Golf, and Passat are all implicated by this device to manipulate the emission data. (*autofuelfix.com, 2016*)

Initially, EPA discovered around 482 thousand VW diesel cars in America was affected by this scandal. However, the total cheat estimated to have affected 11 Million cars across the globe.

As for the harm, from an environmental point of view, the amount of harmful NOx emitted by the vehicles by manipulating the data is staggering. Assuming the similar mileage of US cars the effect of the harmful NOx emission estimated to be between 237 tons and 949 tons each year. The hidden damage from these VW vehicles could equate to all of the UK’s NOx emissions from all power stations, vehicles, industry, and agriculture. (*theguardian.com, 2015*)

If we look at the impact on the human health, the fumes can cause inflammation of the airways and worsen breathing. NOx emissions can also react with other compounds to cause serious respiratory conditions and



aggravate heart problems. Long-term exposure to the pollution hastens death: research this year linked high levels of NO<sub>x</sub> to 9,500 premature deaths annually in London alone. (theguardian.com, 2015)

Therefore, these effects alone appear to be sufficient to wipe out all the CSR projects and activities carried out by the VW group until date.

### *Mitsubishi Fuel Efficiency Scandal*

In comparison with VW scandal, Mitsubishi scandal can be considered as minimal about the effect on some vehicle and environmental consequences. However, if we compare the period, it is estimated while VW scandal dates back to 7 years, Mitsubishi cheating was continuing for more than 20 years playing with consumer trust.

#### How the Fuel Efficiency Scandal performed?

MC tampered with the tire rolling resistance and aerodynamic drag data it provided to the transport ministry for government tests to certify the fuel efficiency of its four models of minicar category eK Wagon, eK Space, and Nissan's Dayz and Dayz Rook. This made the affected 625 thousand cars look 5-10 percent more fuel-efficient than they can achieve. (Japantimes, 2016)

#### How the MMC's Scandal was discovered

Interestingly MMC's fuel efficiency scandal was discovered by Nissan Motors, another Japanese carmaker, and a competitor.

The story unveils that Mitsubishi manufactures the UK and sells it at dealerships in Japan. However, it also supplies versions of the car to Nissan, which markets them under a different name, the Dayz. Nissan. However, just the year before the scandal Nissan took over development and design work in the UK and Dayz. The Nissan's engineers noticed the discrepancy in the published fuel rating — apparently, an impressive 25 to 30 kilometers per liter, or 60 to 70 miles per gallon, depending on the version — and confronted Mitsubishi. (nytimes.com, 2016)

Then the company acknowledged that its engineers had intentionally manipulated evaluations.

#### Effects of MMC's Scandal

The cheating affected about 620,000 cars sold in the Japanese market starting in 2013, an info graphic detailing the effects are given in Figure 8 for further references.

More than an environmental impact, this scandal has more to do with trust, due to inflated fuel mileage figures there won't be any safety or concerning environmental issues. However, the fact that MC was tampering the figures to outperform the competitors and deceiving its customers raises questions whether the other products of the company also might have cheatings to promote the products.

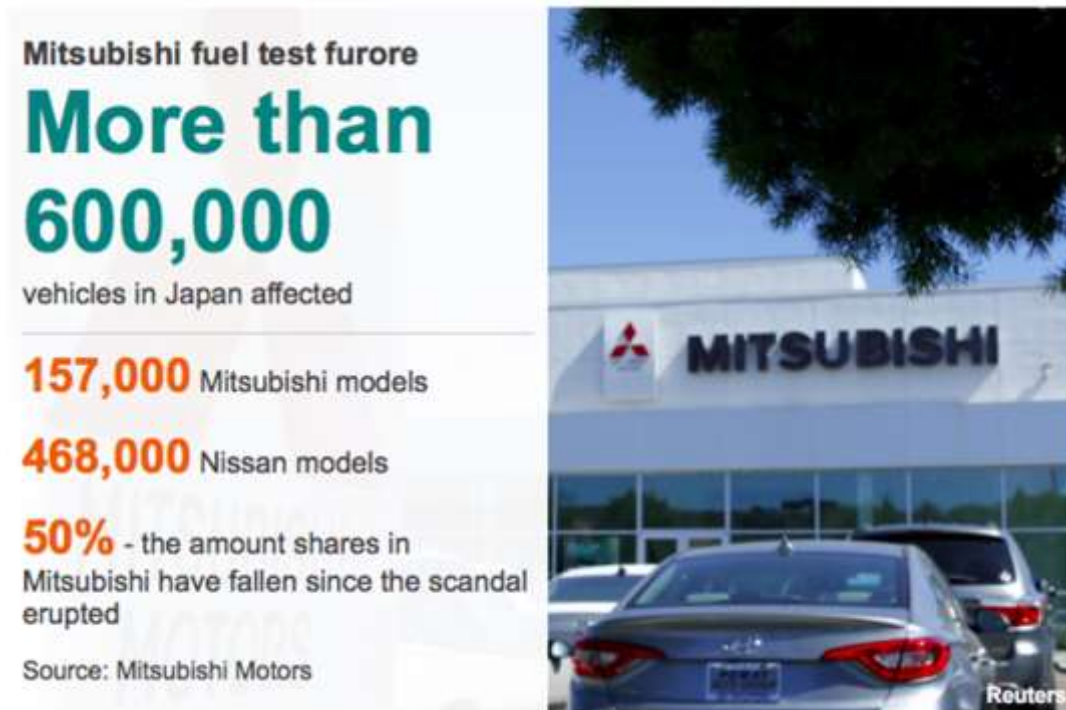


Figure 8: Effects Summary of Mitsubishi Fuel Efficiency Scandal (bbc.com, 2016)

### Facts vs. Reality

From the above sections about the both companies and its CSR publication and the scale of the effect of scandals show us the vast gap between the published statements and figures and what had been going on for such a long period in reality.

Further, these comparisons also have raised the question whether CSR matters as the defined CSR or just part of a profit making marketing tool. These also rekindle the debate on definition where it is argued that the primary reason for not to have a uniform CSR definition is the differences in motivation for CSR – doing it because it is morally correct or doing it because it makes good business sense as one of the main reasons. (The Australian Centre for Corporate Social Responsibility (ACCSR), n.d.) These scandals are proving that the companies are focusing on CSR as its make good business sense to promote it products and indicating that there is evidence that CSR may be carried out only by pure business motivation. However, it is important to understand the strategies available for a firm on the CSR matter before deciding on the model followed by them.

### Theories dominating CSR Strategies of a firm

The Agency theory and the stakeholder theory are two primary theories put forward on managing CSR strategies of an organization.

Agency Theory, in a simplified manner, can be seen as a relationship theory that explains the relationship between one or more individuals (Principal) who appoint one or more individuals (agents) to do some responsibilities on his behalf. From a corporate world point of view, it is the Shareholders of the company (Principals) appointing managers of the company (agents) to maximize their wealth. (Bouckova, 2015).

In 1976 Jensen and Meckling in their study titled *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure* laid the foundation for the Agency theory with an explanation of the agency cost. Since then there are hundreds of studies performed using this theory primarily focusing on corporate governance and controls (JENSEN & MECKLING, 1976) for instance, Mohammed Namazi used in his study to explain how agency theory can be used as a framework to implement management control system. (Namazi, 2012)

Agency theory applied to CSR means improper spending (abuse) of corporate resources that can be used better to add value to the implementation of internal projects or return to shareholders. It also presumes that CSR is a willingness on the part of executives to use CSR for career development or other personal gains. (Slavova, 2013). Therefore, agency theory can be seen as an unfriendly theory for the CSR.

It is mentioned in a study that links CSR reporting to the corporate governance mechanism of the company call for a corporate governance mechanism to move from the shareholder focused agency theory that represents the interest of the shareholders to a broader representation of the stakeholders. Unless this is reached, it will be difficult to have corporates accountable for all the stakeholders. (Nwagbara & Ugwoji, 2015)

The above concern was addressed by the second theory available for a firm to align their CSR strategy, the stakeholder theory. This theory takes a wider view on the responsibility of an organization. (Freeman 1984 as cited by (Slavova, 2013) argues that managers must satisfy different groups (e.g. workers, customers, suppliers, local community organizations) who can influence firm outcomes. According to this view, managers are not allowed to exclusively focus on the needs of shareholders or the corporate owners. The stakeholder theory suggests that it can be beneficial for the firm to engage in certain CSR initiatives that non-financial stakeholders see as important because otherwise, these groups might withdraw their support for the firm. Therefore, this theory can be seen as a CSR friendly theory and many organizations indicate that they have adopted this theory. However, the question is whether the company follows which model in practice, agency or stakeholder.

### **Is Shareholders primacy Agency Theory a reason for these scandals?**

The facts and reality of the scandals and two theories available for a firm to address its CSR obligations have brought out an important question that whether these scandals can be linked to a CSR only based on profit maximization objective of the shareholders.

In the last decades, the agency model has gained acceptance among corporate governance (CG) scholars and practitioners. The agency model does not acknowledge any basic responsibility of managers or directors towards any stakeholder beyond shareholders. It is based on shareholder's primacy. Corporate social responsibility (CSR), however, involves at least some corporate responsibility towards stakeholders other than shareholders. Not surprisingly, the agency model of CG does not reserve any major role to CSR within CG, even though it does not exclude an instrumental use of CSR as far as it may function as a tool practical to shareholder value maximization. (Sacconi, 2012)

However, the concept of corporate only exists to maximize shareholder wealth and not to engage in CSR was stated by Friedman. He (Friedman 1970, as cited by Slavova, 2013) draws on agency theory in his

criticism of CSR, explaining that managers as the agents of company owners have a responsibility to maximize the corporation's profits. Spending money on something else is an abuse of the relationship. Corporations exist to generate revenue, say the firm CSR opponents, and they do not solve social problems. They live to optimize the outcome for themselves (shareholders, managers, employees, etc.), and not for others around them.

Further, it is interesting to note that as per the worldview in Germany and Japan, the fundamental premise behind a corporation is not the notion of a promise to maximize value for shareholders. Instead, the fundamental corporate promise is that the corporation is a creation of the state whose goals are to serve myriad and often conflicting societal interests. (Macey 2008, as cited by Sacconi, 2012)

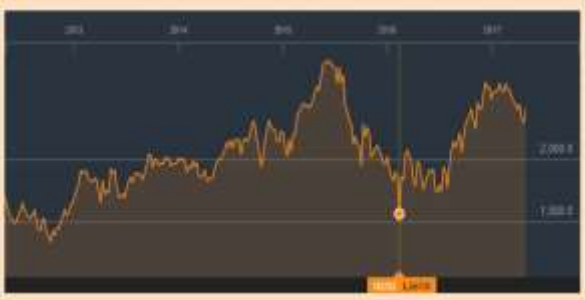
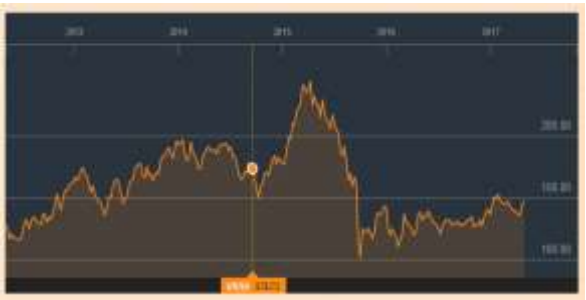
However, it appears that despite the different agency view in Germany and Japan that gives more prominent to society and despite CSR strategies and policies both VW and MC put in place, both of the companies are displaying through the scandals that they are following a pure Agency model focusing only on maximizing the shareholders' wealth. The all the CSR initiatives are appeared to be a mere tool to attract customers and stakeholders who are concerned about environment and society.

The view of profit maximization dominating the entities can be seen clearly through the reactions of the shareholders and investors of these two companies post scandals.

### **Is Investors Reaction to Emission Scandal in support to the agency model?**

From an Investors point of view, it appeared that as long as the company had strong financials and they had an indication that the company can bear the penalties that may arise from the scandal, it did not have much impact. However, if the investors see company already struggling with other financial issues, then it had a greater impact.

This can be illustrated by looking at the share price impact immediately after the announcement of Emission scandal of VW and Mitsubishi. Despite VW's scandal is much larger (with a provision of EUR 18.2 Billion for damages) and affected more vehicle the shareholder reactions were many minutes. In the meantime, Mitsubishi's scandal is with a lower impact with only around EUR 500 Million affecting lesser vehicles mainly in Japan had much bigger impact. This is illustrated in the annexure 1.9 we can see immediately after the scandal the share prices of VW fell only 23% while Mitsubishi's share prices fell more than 35% within two days triggering a temporary suspension of share trading that threatened to wipe out one-third of the company value.

<b>Mitsubishi share price movement</b> (line indicating the immediate reaction to scandal)	<b>Volkswagen share price movement</b> (line indicating the immediate reaction to scandal)
	
Source: (bloomberg.com, 2017)	Source: (bloomberg.com, 2017)

*Figure 9: Share Price Effects after scandal Mitsubishi Vs Volkswagen*

Further, it also can be noted that within the short period the share prices started moving upwards purely based on the financial outcome of the company without much concern for the CSR issues just the company manipulated.

**Conclusion**

This study looked into the recent scandals of two prominent companies in the auto industry Volkswagen and Mitsubishi from a CSR perspective. It initially detailed the facts reported by the companies where it found out that despite both the companies having detailed strategies and plans related to the CSR it did not have proper monitoring and controlling mechanism for it. However, when the facts and effects of the scandals were detailed out more than mere lack monitoring and controlling the real concern whether these companies follow a proper CSR strategy to support its reported stakeholder model, or it is only to satisfy the reputation of the company and its customers. Based on the facts this study concludes that both the companies are following its CSR strategy based on agency model not based on the stakeholder model as reported. This conclusion was supported by the reaction of the investors in the stock market immediately after the scandals.

Managerial implications of these studies are twofold. One is that the company need to be transparent and honest in the strategy as follows for its CSR. Second is that the company should deploy a proper monitoring and controlling system for all of its CSR initiatives.

This study recommends carrying out further studies focusing on reported and practiced CSR with more companies of the auto industry to generalize whether CSR does it matter to the industry. In the meantime, this study can also be expanded to other industries such as apparel, pharmaceutical and consumer goods where scandals are unveiled very often.

Finally, if we need the corporate world to give attention to CSR related matters and adopt a broader stakeholder view on paper and practice, there should be many studies performed critically by asking the question CSR does it matter.

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