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Volkswagen: A lesson in implicit versus explicit rules and regulations

As uncertainty swirls around what Volkswagen executives knew or did not know about the company's emissions cheating, this much seems certain: To achieve accountability going forward, Volkswagen executives must commit to creating a corporate culture in which employees feel comfortable raising concerns and are protected from retaliation if they do so.

According to reports out of Germany, Volkswagen's own internal investigation found that a main factor in the scheme to develop a software algorithm enabling cars to circumvent emissions controls was the company's pervasive "achieve goals at all costs" culture. No one within the organization wanted to break the news to senior management that VW's goal for "clean diesel" cars in the U.S. was unachievable if they were also to meet strict U.S. emissions standards. The result? One of the largest corporate environmental scandals in history."

Volkswagen is not alone in ignoring the incredible risk created by a can-do-at-any-cost culture. Goldman Sachs, one of the biggest corporate bad actors in decades, agreed last month to pay \$5.1 billion in U.S. federal fines for the massive underwriting of bad mortgages that contributed mightily to the 2008 recession. And last October, a federal probe revealed that Walmart systematically paid bribes to elected officials in Mexico and India, in exchange for help circumventing regulations and getting into those markets by any means necessary.

One defining feature of these three cases is a clash of the explicit and implicit rules governing employee behavior. Explicit rules include written, accessible regulations, laws, and internal policies, such as codes of conduct. Implicit rules emanate from a corporate culture molded largely by management behavior. They are unwritten and decipherable primarily by observing what type of behavior is rewarded or punished within an organization.

Employees may be tempted to prioritize implicit rules over explicit rules if they sense doing so advances their careers. When employees also believe their actions will not expose them or their companies to high risks, the chances of misconduct are even higher. Often, this is how internal fraud begins—the downward spiral of a loyal employee wanting to "fix the books" this quarter, convinced he or she can make everything right next quarter. This is always a slippery slope ending in disaster.

The problem compounds when, instead of serving as role models for ethical behavior—doing the right thing not because you must (compliance), but because you should (ethics)—leaders rule by intimidation and fear. Managers come to realize that they must use any means necessary to meet business objectives in order to advance their careers. In situations where priorities defined by senior management implicitly or explicitly collide with external laws or regulations, they find themselves between a rock and a hard place: adhere strictly to external regulations, and you risk the consequences of going against your boss. Comply with questionable executive mandates or pressures, and you risk regulatory investigation—and its consequences. Such appears to be the story at Volkswagen.

Volkswagen will no doubt fix its emissions software—and it might, based on an internal investigation, tighten its compliance standards. But it will not extract the greatest possible long-term benefit from this scandal unless it changes its corporate culture. This should involve instituting independent oversight of executives and making sure that the tone from the top is backed by visible action. Executives also must practice consequential ethical management—recognizing people throughout their organizations who stand up for integrity while disciplining even high performers who act illegally or unethically.

Management must also make clear to future leaders that how people achieve objectives is as important as what they achieve. To show it is serious, Volkswagen should provide ongoing, targeted ethics and compliance training and communications. While employees at all levels must understand the risks of noncompliant activity, managers on the fast track to leadership must realize that acting with integrity is linked inextricably to continued upward mobility. Regulatory scrutiny is increasing in all industries. Now, more than ever, companies need to understand that written rules and regulations are not the only factors affecting employee behavior. Implicit rules can have an even greater effect. It is time for organizations, like Volkswagen, to put culture in the driver's seat of change.

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