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HARD LESSONS FOR SOFT FACTORS

What Volkswagen's value collapse says about knowledge worker behaviour, productivity and control.

By *Andros Payne*

Volkswagen's 37 per cent value collapse not only punched a hole in institutional portfolios, it also provides instructive lessons about new risks in the knowledge economy for private equity sponsors and portfolio company executives alike. €25bn was wiped out in three days of trading – €42,000 for every Volkswagen employee.

Who is responsible, and what should be done to avoid such corporate malfeasance in the future?

Like Volkswagen, most portfolio companies are under intense competitive pressure. In a day and age of ubiquitous information, customers are taking apart a firm's offer and arbitraging out its unique value proposition faster than ever before. And, with shrinking private equity returns, portfolio company managers and employees are under added pressure to deliver results – increasing the chance that someone, or a few, will cut corners. In the case of Volkswagen, emission standards was the differentiating factor, and it was cut.

At some point, a few Volkswagen design engineers were confronted with difficult choices. With poor judgement, they made the wrong ones. The problem is, in large and complex corporations there may actually be no identifiable person or group who maliciously understood the problem end-to-end and can therefore be held accountable. Each may have been doing what they genuinely believed was right in their context, but the final result was clearly wrong. Multiple parties collectively failed to connect the dots and make the right choices. Organisational and management processes failed.

The concerning thing for investors is that this could happen to any company, in any business, if just a few knowledgeable employees make wrong decisions. The answer for most firms is more controls, policies, procedures – more governance. But this is not a viable long-term solution as more controls choke the ability of the organisation to quickly make and execute decisions, to adapt, and therefore drive value growth in dynamic markets.

Unfortunately, the behaviour of knowledgeable and creative employees is more difficult to control than that of their factory labour brethren from days past. Old school authoritarian control doesn't work with Generation Y Millennials. However, other, more subtle, levers of behavioural control do work, and will surely be a focus of Volkswagen's introspective review.

A guiding purpose, beyond the firm's immediate products or service, is an increasingly important driver of employee identification and intrinsic motivation. Clearly articulated values also provide behavioural guideposts that help leaders and employees make the right choices when confronted with difficult options. Finally, leadership principles, based on a clear purpose and values, give pragmatic guidelines to enable better management and judgement. But all these measures to get voluntary compliance only work if they are deeply communicated, well understood, and lived.

Portfolio company executives are well advised to heed Volkswagen's learnings for risk management in their transformation projects. Otherwise, like Martin Winterkorn, the company's famously autocratic boss, they might find themselves thinking about hard lessons on the soft factors during an unexpected early retirement.

37%

value collapse suffered by Volkswagen following the emissions scandal

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