

How VW Lost the Public's Trust

MAY 2016

An analysis of Volkswagen's emission scandal alongside Reputation Institute's (RI) data shows that Volkswagen is not doing enough to gain back its stakeholders' trust due to the fact that it is not implementing the correct steps in reputation risk management. According to RI research Volkswagen must start focusing on those who for so long believed in the automaker and the quality of its cars.

On September 18 2015, the US Environmental Protection Agency (EPA) announced that Volkswagen, the company that coined the term "clean diesel," has been installing sophisticated software to cheat diesel emission tests. As a result, its cars produced up to 40 times more pollution than allowed by US standards - Volkswagen's cars were environmentally friendly no more. Reputation Institute's research shows that with the EPA announcement, the general public's trust in the automaker was highly damaged in the US as well as globally.

Volkswagen's Reputation Pre-EPA announcement

In Reputation Institute's 2015 annual reputation research studies (conducted in Q1), Volkswagen was always at the top of the list. In the 2015 Global RepTrak® 100 – a list of the world's most reputable companies measured across 15 countries – Volkswagen ranked 14th with a strong RepTrak® Pulse score of 75.0. That score was 4 points higher than the global average for the year – a statistically significant lead. Beyond its overall reputation, Volkswagen was recognized in the 2015 Global Corporate Social Responsibility (CSR) RepTrak® 100 study where the automaker ranked 11th right behind competitors BMW and Daimler. The CSR RepTrak® ranking assesses the general public's perception of the companies based on three dimensions of reputation – Workplace, Governance and Citizenship. Volkswagen's efforts and commitment to become the most sustainable company in its industry (as outlined in the 2015 VW CSR Report) was acknowledged by the Dow Jones Sustainability Index (DJSI). Only a week before the EPA announcement, DJSI declared Volkswagen as the world's most sustainable automaker.

The RepTrak® Pulse is a single score that measures the emotional bond with a company by capturing the respondent's trust, admiration, esteem and good feeling.

Volkswagen's Reputation Post-Scandal

Reputation Institute measures companies in over 15 countries on a continuous basis. RI's continuous reputation measurement service – *The National Tracker* – allows companies to see the immediate impact of issues as they occur anywhere in the world. One of the most important tools any company has to manage reputation risk is continuous measurement. Continuously measuring reputation is important because it enables early problem detection and mitigating any potential adverse impacts of reputation risk events on company's business results.

One month after the Volkswagen emissions scandal broke out, the drop in reputation was drastic. In October 2015, Volkswagen's reputation saw an initial large drop of 22 points in its home country of Germany, while in the US there was a lower drop of 11 points (both drops statistically significant). The trend of decline did not stop there and then; it

continued throughout the last quarter of 2015. At the beginning of last year, Volkswagen enjoyed an excellent reputation in

Germany and the U.K., a strong reputation in Spain, France, and Italy, and a borderline strong reputation in the US (RepTrak® Pulse reputation scores are classified as either poor, weak, average, strong or excellent using RI's research-based normative scale).

As shown in Table 1, by the end of the year Volkswagen's reputation dropped by a staggering 20+ points in the European countries and 9 points in the US.

Table 1: VW RepTrak® Pulse in Q1 2015 and Q4 2015 across six markets

Country	Q1 RepTrak® Pulse	Q4 RepTrak® Pulse	Δ RepTrak® Pulse
UK	82.7	52.8	-29.9
SPAIN	74.8	47.1	-27.7
ITALY	77.9	52.2	-25.7
FRANCE	76.1	51.3	-24.8
GERMANY	80.6	57.1	-23.5
US	69.7	61.0	-8.7

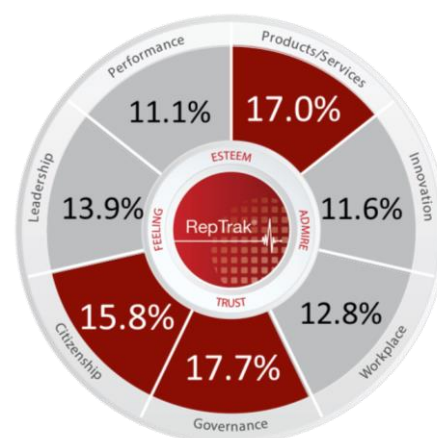
Source: Reputation Institute, March 2016

The Most Important Dimensions of Volkswagen's Reputation

Volkswagen's reputation is very much driven by the company's ability to deliver tangible results (please see "About the RepTrak® Model" section at the end of this document for an explanation of RI's methodology). The most important dimensions for Volkswagen's reputation and what the general public cares about the most are the automaker's corporate governance, products and citizenship. Statistically, these three dimensions have the strongest impact on Volkswagen's overall reputation score. In fact, more than 50% of Volkswagen's reputation is driven by its ability to be a responsibly-run company, have high quality products and be a good corporate citizen.

These three dimensions are even more important since they are the dimensions most affected by the Volkswagen's diesel emissions scandal. Firstly, the insider-job aspect and secrecy of the scandal exposed Volkswagen's poor governance model, lack of ethical behavior and transparency. Secondly, Volkswagen's cars were tampered with a "defeat device" with the purpose of changing the emission levels to fit the US standards in a testing environment, directly compromising the quality of its products. Thirdly, the seemingly environmentally friendly diesel vehicles were no longer safe for the environment – the engines emitted nitrogen oxide pollutants that were up to 40 times the allowed levels in the US, hitting VW is the Citizenship dimension. Failing to address the needs of stakeholders in these specific dimensions has led to a dramatic decline in Volkswagen's governance, citizenship and products scores.

Figure 1: Drivers of Reputation for Volkswagen



Source: Reputation Institute, April 2016

The Consequences

When an emotional bond is broken and a company fails to deliver on the rational dimensions of reputation, stakeholder support for the company drops as well. This, in turn, affects the business outcomes, in a negative way. With the drop in reputation, Volkswagen's decline in support followed.

When asked if they would give the benefit of the doubt to Volkswagen if the company was facing a crisis, 1 in 2 respondents from the U.K. and Italy strongly agreed in the beginning of 2015. By the end of 2015, however, only 1 in 5 strongly agreed that they would give Volkswagen the benefit of the doubt in a time of crisis. Along with the decline in trust, the general public's willingness to buy products from the company dropped as well. *Volkswagen has to address the breach in trust with customers in order to regain their product leadership.*

Table 2: Percentage of respondents who strongly agree that they would be willing to give the benefit of the doubt to or would buy VW's products (Q1 vs Q4 2015)

Supportive Behavior	UK			ITALY			GERMANY			SPAIN			US			FRANCE		
Willingness to buy products	Q1	Δ	Q4	Q1	Δ	Q4	Q1	Δ	Q4	Q1	Δ	Q4	Q1	Δ	Q4	Q1	Δ	Q4
	58%	-31%	27%	69%	-38%	31%	52%	-24%	28%	52%	-24%	28%	48%	-8%	40%	48%	-21%	27%
Give benefit of doubt	Q1	Δ	Q4	Q1	Δ	Q4	Q1	Δ	Q4	Q1	Δ	Q4	Q1	Δ	Q4	Q1	Δ	Q4
	53%	-34%	19%	52%	-28%	24%	37%	-15%	22%	38%	-12%	26%	44%	-7%	37%	44%	-28%	16%

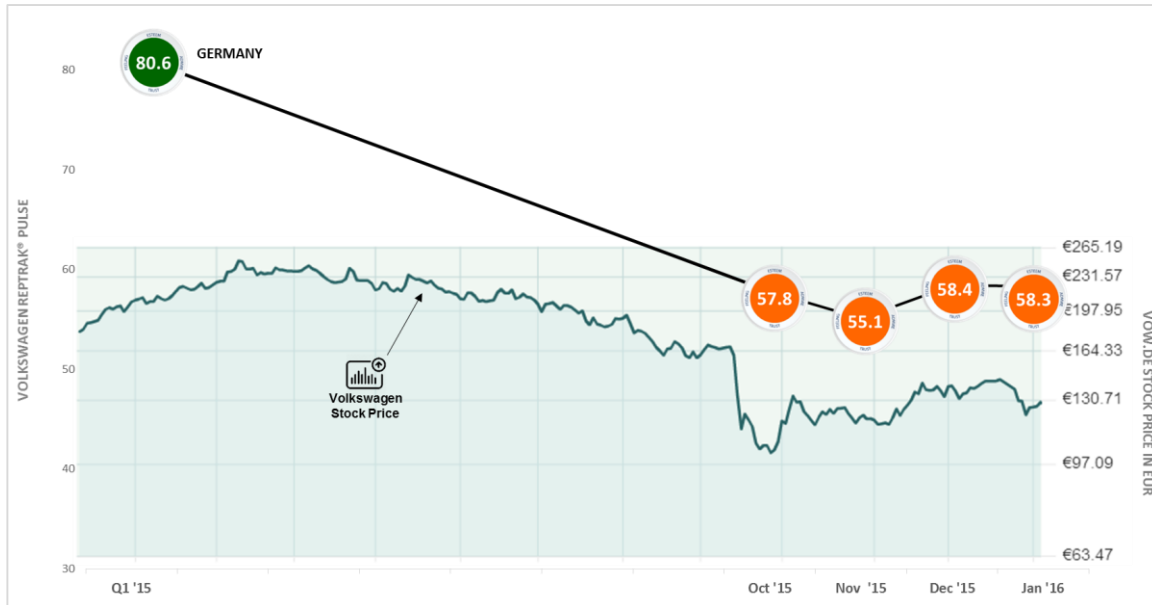
Source: Reputation Institute, April 2016

Financial Impact

The loss in support has had an impact on financial results. Volkswagen had to set aside €6.7 billion to pay for recalling and fixing affected vehicles (Business Insider) and received a lawsuit from the US Department of Justice for up to \$46 billion under the Clean Air act. In February 2016, The New York Times reported that Volkswagen "would delay reporting its annual earnings and move back the date of its annual shareholders' meeting because of uncertainty about the cost of its diesel emissions scandal."

One of the most visible impacts on Volkswagen's business is the drop in stock price. When compared to the RepTrak® Pulse, Reputation Institute's analysis shows strong correlation of 0.93 for Germany as well as correlations above 0.9 for the US, U.K., and Italy. The analysis confirms the relationship between VW's reputation and its stock performance. Reputation Institute continues to monitor the relationship between reputation and financial variables.

Figure 2: VW RepTrak® Pulse in Germany and VOW.DE Stock Price: Q1 2015 through January 2016



Source: Reputation Institute, April 2016

Regaining Stakeholder Trust after a Reputation Crisis

It is now seven months after the EPA's public announcement and Volkswagen's diesel emission crisis is far from being resolved. In order to regain the trust and rebuild its reputation, Volkswagen must learn from reputation crisis best practices. Reputation Institute's research shows that companies that are the most successful in reputation crisis management, have the following actions in common:

- Immediate response and action to remedy the situation and make it better
- Prominent leadership taking responsibility
- Continuous and transparent communication

By delivering on the aforementioned actions, companies gain a control over the crisis and practice good stakeholder communication. The only way in which a company can deliver and apply best practices, is through an internally established crisis management framework.

In Volkswagen's case, there is a steep learning curve in proper crisis management. As reported by the EPA, the organization reached out to Volkswagen as early as December of 2014. Volkswagen only admitted to its wrongdoings in September of the following year when the EPA made the issue public. Even though they admitted to cheating, Volkswagen's leadership did not take the full accountability. Dr. Wiinterkorn's (Volkswagen's former CEO) official statement, asserted that he was "not aware of any wrong doing on [his] part." Moreover, throughout the last year and a half, Volkswagen's leadership has not been sufficiently consistent and transparent in communicating with its

stakeholders about the crisis. For Volkswagen to regain the trust of the public and restore its reputation, the company needs to address the underlying problems, while at the same time improving its communication about what it is doing to make things right.

About the RepTrak® Model

Reputation Institute's RepTrak® model for reputation measurement is structured around four core themes and seven dimensions of reputation. Together, these elements explain a company's reputation:

1. Corporate Reputation

RepTrak® Pulse is the core of a company's reputation. It measures the strength of the emotional bond between the company and the public.

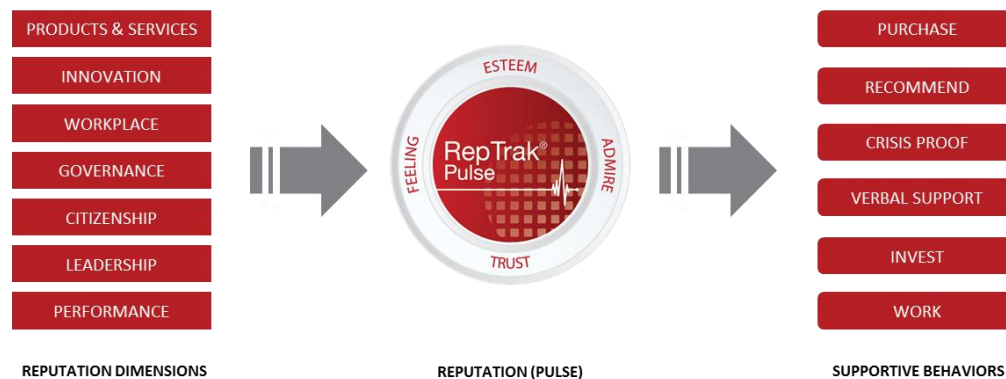
2. Seven Dimensions of Reputation

Reputation Institute evaluates stakeholders' perceptions of company performance across seven reputation dimensions: Products and Services, Innovation, Workplace, Governance, Citizenship, Leadership and Performance. The individual dimensions have varying weighted importance in different industries.

The RepTrak® Model Summary

The RepTrak® System measures a company's ability to deliver on stakeholder expectations on the **7 key rational dimensions of Reputation**

A company that delivers on expectations in the 7 domains will earn **support from its stakeholders**



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