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# How Corporate Culture Can Silence the Whistle

Lessons Learned from Volkswagen's  
Dieselgate (CS 1-5)  
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# What we should know about VW (1/3)

- Volkswagen is based in Wolfsburg, a city with about 123.000 inhabitants, which was founded in 1938 because of Volkswagen.
- A specific law guarantees the German state of Lower Saxony, as Volkswagen's second-largest shareholder specific voting rights.

# What we should know about VW (2/3)

- Volkswagen is well known for a powerful workers' council.
- In 2013 Volkswagen was elected as No.1 employer in Germany.

# What we should know about VW (3/3)

- Volkswagen has a mature compliance system with an external whistle-blower hotline, code of conduct and an internal audit department.

# Corporate Culture (1/3)

- One main element of corporate governance is corporate culture
- Research points out, that culture is important and directly connected to the value of the company.

## Corporate Culture (2/3)

- Corporate culture can be defined as “the mechanism that delivers the values and behaviors that shape conduct and contribute to creating trust in [organizations] and a positive reputation for [organizations] among key stakeholders, both internal and external.” (G30, (2015), p.17).

# Corporate Culture (3/3)

- Employees place a high priority on workplace culture and an interesting, meaningful work.

# Conclusion I (1/2)

- Top ranked employers seem to be seen as organizations with a mature corporate culture.
- These organizations deliver benefit for their employees and increase the value of the job.



# Conclusion I (2/2)

- The higher ranked an employer is, the more difficult it is to get a job there because many people like to work there.

# Internal Audit and Corporate Culture (1/2)

- Internal auditors have to include corporate culture in their audit universe and perform audits on corporate culture.

# Internal Audit and Corporate Culture (2/2)

- Some aspects of the audit can be:
  - employee and customer survey results,
  - comprehensive training programs for employees,
  - protection of whistle-blowers,
  - strong leadership, shared values and
  - trust and openness.

# Four types of fraudsters (1/6)

- Differentiate between a direct/indirect benefit or access to money as one factor.
- Someone has a direct benefit, if he participates without any delay. If a pickpocket steals money from a colleague he can use the stolen money right afterwards: cash in his pocket.

## Four types of fraudsters (2/6)

- A fraudster has indirect benefit, if his fraudulent action leads to a profit for his company and as an effect he gets an additional bonus: cash in the companies pocket and then in his pocket.

## Four types of fraudsters (3/6)

- The second factor is the sort of contract in connection to the fraudulent act. If a fraudster agrees willingly to a fraudulent act, he signs an active contract.
- With a passive contract he participates in the fraud without any action.

# Four types of fraudsters (4/6)

	<b>Direct benefit</b>	<b>Indirect benefit</b>
<b>Active contract</b>	Fraudster A	Fraudster B
<b>Passive contract</b>	Fraudster C	Fraudster D

# Four types of fraudsters (5/6)

- Fraudster A steals money from a colleague.
- Fraudster C knows about the origin of the money. He benefits from fraudster A via an invitation to an event.
- Fraudster C is the potential whistle-blower.

	Direct benefit	Indirect benefit
Active contract	Fraudster A	Fraudster B
Passive contract	Fraudster C	Fraudster D



# Four types of fraudsters (6/6)

- Fraudster B manipulates the financial statement.
- Fraudster D participates in the fraud, while he earns an additional bonus because of the high profit shown in the financial statement.
- Fraudster D is the potential whistle-blower.

	Direct benefit	Indirect benefit
Active contract	Fraudster A	Fraudster B
Passive contract	Fraudster C	Fraudster D

# Objectivity as rational behavior (1/2)

- Standard 1100 states: „Objectivity is an unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. ...

## Objectivity as rational behavior (2/2)

- ... Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others.”
- The IPPF expects internal auditors to act strictly objective, in other words: rational.

# The game (example)

<b>FIFA 2014 Final game</b>	<b>Romero decides to defend right side</b>	<b>Romero decides to defend left side</b>
<b>Götze decides to shoot on right side</b>	Götze: 0 Romero: 1	Götze: 1 Romero: 0 
<b>Götze decides to shoot on left side</b>	Götze: 1 Romero: 0 	Götze: 0 Romero: 1

# The employee – employee - game

- 2 Colleagues.
- Both know about the fraud.
- Both know, that the other knows about the fraud.

		MA 1	
		active $q$	passive $1 - q$
MA 2	active $p$	$\begin{matrix} K - \mu \\ \cdot (AV + KR) \\ - AW - OE \end{matrix}$	0
	passive $1 - p$	$\begin{matrix} -\mu \cdot (AV + KR) \\ + K - AW - OE \\ - SO \end{matrix}$	$\begin{matrix} K - \mu \\ \cdot (AV + KR) \\ - AW - OE - SO \end{matrix}$
		0	$-\beta \cdot (AV) - S$

# Payoff function (1/8)

- A short term risk of being fired because of whistle-blowing.
- A long term risk of not getting an equal job, because employees may not want to hire a whistle-blower.

## Payoff function (2/8)

- Costs for a lawyer because there will be conflicts with the employer or appearance as a witness in a trial.
- The media will give attention. This will lead to costs of public interest.

## Payoff function (3/8)

- Education is an investment in oneself and people move to the place where the employer is based.
- The social network has to be rebuilt. The first points of contact are colleagues from the company.



## Payoff function (4/8)

- If he blows the whistle he will face social exclusion in his neighborhood, because friends work for the same company and children attend the same school.
- This is especially a problem, where a whole area is dominated by one big employer.

# Payoff function (5/8)

- If he blows the whistle, he will be seen as a key witness and can realize a sort of protection.
- Sometimes there is a monetary incentive.

# Payoff function (6/8)

- All the elements shown can be found when the employee blows the whistle and discloses the hidden information.

# Payoff function (7/8)

- If he is quiet – and later all will be revealed – he is ashamed, because he kept secret and will be blamed by others.
- He is at risk regarding his job, because he can't be sure whether he will be made responsible as a fraudster type D (indirect/passive).

# Payoff function (8/8)

- In the staff game both players (MA 1 and MA 2) have the same payoff function.
- The passive one could be seen as more loyal than his active colleague.

# The audit on culture (1/7)

- Internal Audit performs an Audit on corporate culture
  - with significant findings and relevant recommendations and
  - Top management is very interested and decides to take action.

# The audit on culture (2/7)

- As a result
  - a hot line is implemented,
  - a training program is launched and
  - the protection of whistle-blowers is enhanced.

## The audit on culture (3/7)

- This will lead to a better whistle-blower protection and the employees feel safer now regarding their job while whistleblowing.
- We can see that the audit report improved corporate culture.



# The audit on culture (4/7)

- And because of the effect that corporate culture is positively related to the value of the job, the value of jobs increases as well: as a result high potentials are more willing to work in this company.

# The audit on culture (5/7)

- Some elements of the employee's payoff function are exogenous factors, while other elements can be influenced by corporate measures.

# The audit on culture (6/7)

- Risk of being fired:  $\mu \cdot (-AV)$
- Risk of not getting an equal job:  $\mu \cdot (-KR)$
- The factor  $\mu$ , with  $0 \leq \mu \leq 1$ , is the probability of being fired.
- Protection of the whistle blower:  $(+K)$   
[Sometimes a monetary incentive]

# The audit on culture (7/7)

- If the value after the audit  
 $[K_1 - \mu_1^*(AV_1 + KR_1)]$   
is higher ( $>$ ) than before the audit  
 $[K_0 - \mu_0^*(AV_0 + KR_0)]$   
we have a better environment for  
corporate whistle-blowing.

# Before the audit ...

Risk of being fired:  $\mu \cdot (-AV = -10)$

Risk of not getting an equal job:  $\mu \cdot (-KR = -15)$

The factor  $\mu = 0.60$ , with  $0 \leq \mu \leq 1$ , is the probability of being fired.

Protection of the whistle blower:  $(+K = 16)$

$$[K_0 - \mu_0^*(AV_0 + KR_0)] = [16 - 0.60^*(10+15)] = 1$$

# After the audit ...

A better whistle-blower protection:

(K=20) with + 4

The employees feel safer now:

( $\mu=0.55$ ) with - 0.05

The value of jobs increases as well:

(AV=16) with + 6 and (KR=21) with + 6



... we get a surprising result

A better whistle-blower protection: (K=20)

The employees feel safer now: ( $\mu=0.55$ )

The value of jobs increases as well: (AV=16),  
(KR=21)

$$[K_1 - \mu_1 * (AV_1 + KR_1)] =$$

$$[20 - 0.55 * (16 + 21)] = \underline{-0.35}$$

# The governance's dilemma (1/2)

- A strong corporate culture leads to a high job value.
- As worst case a strong corporate culture will help to cover the fraud because the employee isn't willing to blow the whistle.



## The governance's dilemma (2/2)

- We have to differentiate between corporate governance and the payoffs of an individual employee.
- In our case the employee behaves according to his payoff function.
- The payoff function of the organization has no relevance for him.

## To take home (Conclusion II)

- No easy answers on Corporate Culture
- Don't judge by the results: mind the gap
- Don't assume all employees are brave actors – literature tells us another story
- Carry on auditing culture: why not using game theory ?

# Contact

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# Backup

# Literature (1/3)

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