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Why did Volkswagen risk so much for small sliver of U.S. market?

By Thomas Lee

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Photo: Michael Sohn, Associated Press
A Greenpeace activist protests in front of a factory gate at Volkswagen in Wolfsburg, Germany.

Fraud, like any business strategy, is a game of risk and reward.

The potential payoffs may seem so great that they justify the potential consequences. Accounting fraud at Enron and Worldcom, for example, added billions of dollars to the companies' market value and enriched a whole lot of people before the schemes fell apart.

But then there's Volkswagen. The German automaker recently admitted that it installed software in 500,000 cars in the United States, powered by "clean diesel" engines, that automatically lowered emissions whenever regulators tested the vehicles.

Volkswagen later said 11 million cars around the world had the same software. CEO Martin Winterkorn resigned, and the company set aside $7 billion to cover the costs of making the cars comply with pollution standards.

But the most puzzling question is motive. Volkswagen's overall market share in the United States is tiny, as is the number of cars in the country equipped with clean diesel technology. Deliberately breaking the law to support an immaterial business has caused incalculable damage to Volkswagen's overall reputation as the company faces lost sales, costly lawsuits and hefty fines for the foreseeable future.

In a risk/reward calculation, what exactly was the reward? Why risk so much for so little?

"That's the question everyone is asking," said Lisa Copeland, a top auto sales executive who sits on the board of the National Chrysler Dealers Council. "Why put everything on the line for such a small market? It makes no sense."

Volkswagen is the world's second-largest automaker, selling more than 6 million cars in 2014. But only 6.1 percent of those sales — 366,970 vehicles — were in the United States.

Volkswagen has made no secret of its desire to promote clean diesel cars in the United States, a technology already popular in Europe.

"We have invested a lot in engineering to develop the diesel engine into one of today's most advanced combustion engines," Heinz-Jakob Neusser, a top executive and engineer at Volkswagen, told Viavision, a company publication, in May. "Even in the traditionally diesel-skeptical United States, (Transportation Secretary) Ray LaHood has as far back as 2011 praised clean diesel emphatically."

Photo: Jens Meyer, Associated Press
Volkswagen CEO Martin Winterkorn has resigned, being replaced by Matthias Müller.

In the same publication, Thomas Steg, Volkswagen's general representative for global government affairs, said the technology was ready for mass adoption.

“The auto industry has done its job, now it’s time to get these cleaner engines on the road as quickly as possible,” Steg said. “In terms of fleet renewal, political support is needed.”

But Volkswagen clearly wasn’t doing its job. With the software turned off, the company’s cars emitted 40 times as much pollution permitted under the Clean Air Act.

“Volkswagen’s distribution goals in the United States were so aggressive that they came into conflict with quality,” said Rob Bogosian, founder of RVB Associates consulting group. “They just cheated.”

But how realistic were those goals?

Even if Volkswagen managed to indefinitely fool the Environmental Protection Agency and other regulators, it seems a stretch to think that American drivers would buy clean diesel vehicles in significant numbers anytime soon. Diesel vehicles made up only 3 percent of the U.S. market last year. Most automakers are turning to electric cars to meet pollution standards, Copeland said.

In cases of fraud and reckless behavior, logic does not necessarily apply, said Robert Hurley, a professor of management at Fordham University in New York.

“They are very short-term companies drifting into a bad place because of short-term pressures,” Hurley said. “Grow, grow, grow can easily slip into cutting corners. You look to relieve constraints and start to rationalize it.”

Maybe so. But what's troubling about Volkswagen is the premeditated nature of the fraud. In other industry scandals, like the General Motors recall of faulty ignition switches, automakers discovered defects after the fact and tried to hide them. In Volkswagen's case, the company went to a lot of trouble to create and install software designed to specifically deceive regulators.

In any case, Volkswagen's actions have hurt the entire industry, Copeland said.

"Once again, consumers have been lied to by an auto manufacturer," she said. "This is 100 percent on Volkswagen. All of us spend billions of dollars to comply with the law. That's what you need to do to sell cars in the United States."

Thomas Lee is a San Francisco Chronicle columnist. E-mail: tlee@sfchronicle.com Twitter: @ByTomLee