Industry-Wide Corporate Fraud: The Truth behind the Volkswagen Scandal

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Abstract

Corporate fraud committed under climate mitigation pressures is becoming more frequently observed in line with the ever increasing environmental standards and relevant regulation enforcements. One example is the Volkswagen Emission Gate Scandal. Using firm-level panel data of major automobile manufacturers from 2000 to 2015, this study empirically identifies the motives behind the corporate deception scandal. We develop a conceptual model summarising the factors affecting decision-making, and the firms’ environmentally responsible investments (ERIs) including the truthfulness of related public communications. Our findings identify legal and regulatory pressures, the firm’s existing level of ERIs competency and expertise, pressures from emission regulation, market competitors, consumers, owners, or shareholders as the key factors inducing the scandal. The empirical findings show that firms are more likely to experience corporate fraud if their senior managers are paid with substantial variable components that may lead them to engage in riskier business behaviour and to be more short-term focused, thereby supporting the well-established contract theory. To avoid corporate fraud and engage in legitimate business competitiveness, we suggest that firms should focus on technological innovation as well as improving corporate governance and leverage ratios to effectively control and monitor management. In addition, policy makers should be more realistic about practical and commercial limitations in the policy-setting process, and take on a more supporting role in achieving technological innovations and effective corporate governance. In summary, we argue that cleaner production is not only the result of technologically progress and research, but importantly it also involves issues associated with corporate governance and business ethics.
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