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Corporate Governance, Innovation, and Economic Performance – A Case Study on Volkswagen

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Abstract

In the debate on globalisation of the financial markets and its effect on corporate governance it is often claimed that the pressure for higher rates of return exerted by institutional investors in the name of shareholder value, has led to a fundamental change of company policy among listed companies. Due to short-term profit orientation and increased dividend pay-outs to investors, the critiques argue, long-term development of the innovation potential of these companies will suffer, and this ultimately will have negative consequences on employment and growth. Since in the 1990s almost all major German companies listed on the stock exchange have declared their commitment to the principles of shareholder value. Hitherto there is little empirical evidence of the consequences of such an orientation on company-internal structures and processes. The present case study on the Volkswagen AG helps to close this gap. Central questions in this study are the following: To what extent have the distinct characteristics of Volkswagen's corporate governance systems changes in response to shareholder value demands? What is the role of the stock market for the company? Have the incentive systems and the systems of target setting and controlling changed to better correspond with shareholder expectations, and what are the effects on investment/disinvestments decisions and thus on the long-term innovation potential of the firm? And finally, what are the effects on the economic and the financial performance of the company?

Zusammenfassung

In der Diskussion über die Globalisierung der Finanzmärkte und der Veränderungen der Corporate Governance wird häufig die These vertreten, dass der von institutionellen Investoren ausgehende, verschärfte Renditedruck und die Verbreitung des Shareholder-Value-Konzepts zu einer stärker kapitalmarktorientierten Unternehmensführung bei den börsennotierten Aktiengesellschaften führen. Damit ist auch die Befürchtung verbunden, eine kurzfristige Gewinnorientierung und vermehrte Gewinnausschüttungen an Investoren könnten zu Lasten der langfristigen Entwicklung von Innovationspotentialen in den Unternehmen gehen und damit letztlich negative Auswirkungen auf Wachstum und Beschäftigung haben. Seit den 1990er Jahren proklamieren auch in Deutschland die großen börsennotierten Unternehmen fast durchgängig die Einführung einer „wertorientierten Unternehmensführung", d.h. eine stärkere Orientierung am Kapitalmarkt. Bisher existieren noch kaum empirische Studien zu den Auswirkungen einer solchen Orientierung auf unternehmensinterne Strukturen und Prozesse. Die vorliegende Fallstudie zur Volkswagen AG hilft, diese Lücke zu schließen. Zentrale Fragen der Studie sind, welche Rolle das Verhältnis zum Kapitalmarkt für VW spielt und in der Vergangenheit gespielt hat, inwieweit eine Veränderung der Corporate Governance als Resultat der von den Investoren ausgehenden Anforderungen feststellbar ist und wie sich diese ggf. auf die Ziel- und Controllingsysteme sowie die Anreizsysteme für das Management auswirken und welche Folgen dies wiederum auf Investitions- bzw. Desinvestitionsentscheidungen und die Entwicklung der langfristigen Investitionspotentiale des Unternehmens hat.

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1. General Background and Aims of the Study[1]

The car industry has come under pressure of the capital markets. It has been singled out a major value destroyer in terms of shareholder value. The low market capitalization of some of the companies puts them under threat of a hostile take-over. Institutional investors voice their discontent about corporate governance structures in the car industry. In sum, there is a strong pressure on companies to change their traditional corporate governance systems.

In the German economy, the car industry plays a key role. It has been at the centre of the debate about the "German model" both with regard to its strengths and weaknesses. It is a major employer and in its employment pattern representative for long-term well-paid jobs. The car industry is the most important power base for Germany's strongest union, IG Metall, and crucial for the further development of Germany's co-determination system.

In the 1990s the industry experienced profound restructuring. Owing to the 1992-1995 recession, the adoption of lean production practices and business reengineering, employment levels fell by a third, process/supply chains were redefined, and company structures reorganized. The latter included decentralization of management responsibilities, the introduction of business units as profit or cost centres and finance-oriented objectives for the managers of these units. Restructuring continued through the latter half of the 1990s, driven by the wave of mergers and acquisitions, which particularly affected the supplier sector.

By the end of the 1990s the traditional system of corporate governance (as described in our country report Jürgens/Rupp 2001) entered a period of transformation. Capital market and shareholder value orientations became more important. This shift was driven by a range of factors and events:

– The adoption of new controlling methods for companies after restructuring and decentralization was the first major driving force. In the mid-1990s Daimler, Siemens, VEBA and a number of other major companies took a lead in this respect.
– Mergers & Acquisitions became the second major driving force in the second half of the 1990s. The merger between Daimler and Chrysler gave the starting shot followed by the acquisition of Rover by BMW, and purchases of a number of luxury brands by Volkswagen. Consolidation in the automotive supplier sector also increased the importance of equity-facilitated M&As.
– The Neuer Markt and IT bubble made the traditional industrial sectors look old. Investors turned their backs at the very moment companies wanted to mobilize equity to finance their M&A strategies.
– Institutional investors, in particular from Anglo-Saxon countries, exercised pressure to introduce new corporate governance standards and to de-conglomerate.

1 A research project funded by the Targeted Socio-Economic Research (TSER) Programme of the European Commission (DGXII) under the Fourth Framework Programme, European Commission (Contract no.: SOE1-CT98-1114; Project no: 053), coordinated by William Lazonick and Mary O'Sullivan at the European Institute of Business Administration (INSEAD). I particularly want to thank Bill Lazonick and Thomas Sablowski for their critical comments and their support for this study.

– Government measures fostered the unbundling of cross-shareholding in a reform of taxation; the debate about a takeover code/law.

With many small and medium suppliers being taken over by US-American companies and German companies becoming aware of the possibility of equity-facilitated M&A, and with the increasing importance of institutional investors, shareholder value orientations have made their entry into the industry. Hostile takeovers have become a concern even for flagship companies like DC and VW.

The central question of the study is how this shift towards an increased role of capital markets and of shareholder value orientations affects corporate governance. (Our general understanding of corporate governance is as a process of allocating resources and returns, cf. O'Sullivan/Lazonick 2000). The central questions in this study are the following:

1. To what extent have the distinct characteristics of the companies' corporate governance systems changed in response to capital market/shareholder value demands?
2. What is the role of stock markets for the companies, and to what extent do they rely on stocks to finance their operations?
3. Have incentive systems changed in the direction of capital market-oriented performance measures?
4. Have systems of target-setting and controlling changed to better correspond with shareholder expectations?
5. What were the effects on investment/disinvestment decisions? What is the effect on the long-term innovation potential of the firms?
6. What are the effects on economic and financial performance?

The study is based on company interviews and on data analyses from annual reports and other publicly available sources. In view of the early stage of the development, it is expected that there will be few, if any, hard data on a shift towards a new, more capital-oriented corporate governance system. The expectation is that changes, if they exist, will be more likely in the realm of attitudes, planning and the setting up of new procedures. Such changes can only be assessed on the basis of interviews with observers and protagonists within the companies. This paper is structured as follows: The following chapter provides some background information about the German car industry. Chapter 3 deals with case studies carried out at Volkswagen. Chapter 4: Summary and conclusions.

2. The German Car Industry – Industry Structure and the Role of the Corporate Sector

According to the 2001 Yearbook on International Auto Statistics by the Association of the Automobile Industry (VDA), the German car industry (manufacturers of motor vehicles and motor vehicle parts, NACE 34) comprises around 2,500 enterprises with a total workforce of 890,000.

In 2000 the car industry accounted for 11.7% of employees in total manufacturing, and 18.2% in terms of turnover of total manufacturing. As the table shows, the weight of the

car industry in terms of turnover has increased considerably since 1996. By international comparison this is the greatest weight the car industry has in any country (in terms of turnover Mexico is equal with around 18%, Sweden follows with around 16%; cf. VDA, 2001, pp. 336ff.). The rather successful development of the German car industry can also be seen from an increase of the share of the car industry in total manufacturing turnover from 15.4% in 1997 to 18.2% in 2000. This increase went along with a slight decrease in the share of persons employed (from 12.1% to 11.7.%; see VDA, 2001, pp. 110f.).

Wage and salary levels in the automotive industry are high both in inter-sectoral comparison within Germany as in comparison with other countries. Calculated per employee hour on an yearly average, the German auto industry had the highest wage costs since 1985 up to the year 2001. Average working hours per year and employee in 1999 were 1,492 compared to 2,152 hours per year in the USA and 2,012 hours per year in Japan. Between 1987 and 1999 the effective yearly working time per employee was reduced by 63 hours (VDA, 2000, p. 47).

Labour productivity is high. According to VDA it was highest in Europe with DM 83 per hour (however, lower than the DM 100 per hour in the USA and DM 94 per hour in Japan).

In terms of innovation the industry comes out well in the statistics, too. Contrary to the general trend in Germany, the industry has increased spending on research and development by two thirds since 1990. In 1997 it spent DM 14.7 billion on R&D, 24% of total business sector R&D spending in Germany that year. In 1995 50,000 persons were engaged in R&D, 6% more than in 1991. The effects are evident in patent statistics. The automotive sector registered 1,892 patents in 1990, 2,940 in 1996 (out of a total of 9,342 patents registered world-wide). Thus 31% per cent of patents registered in 1995 were German, compared to 25% Japanese and 19% US-American; German patents make up 60% out of the total of European patents in this sector) (VDA, 1999, p. 43).

Innovation expenditure by the transport vehicle industry (90% of which is the car industry) in 1998 made up almost a third of total innovation spending by the manufacturing industry as a whole (33.4 of DM 109 billion). It has increased since the 1990s and there is no sign that the trend is leveling out. Thus the general picture does not provide evidence that innovation activities are slowing down owing to a shift of company priorities in the recent years.

During the 1990s the auto industry increased its “human capital intensity” considerably. The percentage of university (and technical college) graduates among total white collar workers increased from 26.3% in 1990 (total manufacturing industry 14.9%) to 32.0% (17.0%) in 1996 (previous Federal Republic); in 1997 the figure was 33.1% in Germany as a whole (18.9% in manufacturing industries). The percentage of employees with an apprenticeship/skilled worker qualification among total employees was 66.0% (manufacturing industries total 64.6%) in 1990 and 74.8% (69.9%) in 1996 (old FRG) and in 1997 in Germany as a whole 75.6% (71.7%) (cf. Bundesministerium für Bildung und Forschung, 1999).

Table 1: The Number of Tax Liable Companies in the German Auto Industry and their Turnover 1996* by Legal Forms

	Total		Sole proprietorship		General commercial partnership	
	(1) No. of tax liable companies	(2) Turnover (in DM billion)	(1) Percentage of total no. of tax liable companies	(2) Percentage of total turnover	(1)	(2)
34. Producers of motor vehicles and parts	3695	314	49.1%	0.7%	6.7%	0.5%
– Producers of passenger cars and engines	368	256	44%	0.04%	5.4%	0.02%
– Producers of motor vehicle parts and engines	1216	48	35.9%	1.9%	c	c

Limited commercial partnership		Stock corporation		Limited Liability Company		Other legal forms			
(1)	(2)	(1)	(2)	(1)	(2)	(1)	(2)	(1)	(2)
11.4%	7.3%	0.6%	84.1%	31.2%	7.0%	0.9%	0.0%	100%	100%
1.0%	0.7%	0.2%	88.8%	37.2%	0.4%	0.01%	0.0%	100%	100%
15.7%	37.5%	c	c	39.6%	35.4%	c	c	100%	100%

Note: A "c" means no data published for confidentiality reasons

* The latest figures available are from 1998 (cf. Statistisches Bundesamt, 1998, Fachserie 14, Reihe 8). However, for anonymisation reasons, much less detailed information is given here. As no fundamental shifts are visible between 1996 and 1998, the 1996 data have used.

Thus in terms of investment in human resources there also appears to be no slowdown due to shifting priorities, at least not in aggregate statistics.

Turning now to the company level, it should be stressed that only a small minority of companies in the car industry are publicly traded firms. As Table 1 shows, the total number of companies producing cars and car parts in Germany in 1996 was 3,695, of which 368 were producers of passenger cars and engines and 1,216 were suppliers of car and engine parts. Among the 3,695 car and car parts manufacturers, 24 were AGs (stock corporations) (0.6%) producing 84.1% of the total turnover (total turnover 1996: 314 billion DM). Eight out of these 24 stock corporations where producers of passenger cars and engines. Their turnover made up almost 90% of the total turnover of the entire motor-vehicle industry. Thus listed companies dominate the industry in terms of turnover on the level of final assemblers; on the level of suppliers their share of total turnover is small (around 10% as an estimate).[2] Of the total number of producers of motor vehicles and parts, stock corporations make up 0.6% of all companies (84.1% of total turnover); 49.1% are sole proprietorships (0,7% of total turnover), 6.7% are general commercial partnerships (0.5% of total turnover), 11.4% are limited commercial partnerships (7.3% of total turnover), 31.2% are limited liability companies (7% of total turnover), and 0.9% have other legal forms (0.0% of total turnover).

It is obvious that the stock corporations in the passenger car segment are the industry's centre of gravity. There are about 10 stock corporations in the supplier segment (exact number not disclosed by the Federal Statistical Office) with about 20% of total turnover of this segment. Thus, in this segment stock corporations do not predominate; limited commercial partnerships (37.5% of total turnover) and limited liability companies (39.6% of total turnover) are more important. The difference between the car maker and supplier segments and their legal forms corresponds with the traditional view of the industry: a small number of globally oriented lead manufacturers with a large number of family-owned SME suppliers huddled around them. However, this picture changed drastically in the 1990s. A wave of mergers and acquisitions has almost wiped out the traditional small and middle-sized suppliers; a considerable number of them has been taken over by foreign companies, in particular US-American.

In terms of ownership and exposure to the capital market, all German car companies are still more or less firmly anchored in block ownership (main source for the following is Deutsche Informationsbörse: www.dib-ag.de, September 2000):

Volkswagen:

Different sources attribute an 18.6% (Deutsches Aktieninstitut, 2001) or 14.29% share in Volkswagen to the state of Lower Saxony. According to Deutsche Informationsbörse, VW's ownership structure in late September 2000 was:
76.02% free float,
14.29% Lower Saxony,
4.41% Capital Growth Managed Limited,
3.88% Janus Capital Corp.,
1.40% Allianz.

2 Precise figures are not available due to anonymisation; cf. Table 1.

The calculation by Deutsche Informationsbörse seems to be based on the total number of shares, common and preference shares. Due to a share buy-back by VW in 2000 the share of Niedersachsen has increased to 20% again. As of the end of December 2000 Volkswagen's ownership structure is as follows: 20% State of Lower Saxony, 10.2% self-control led by VW, 12.1% national institutional investors, 3.5% other European institutional investors, 3% US institutional investors, and 51.4% floating capital (Share-world-LEREPS, in Dupuy and Lung, 2001).

DaimlerChrysler:

In the case of Daimler Chrysler block ownership is around 19%, 11.6% is held by Deutsche Bank and 7.5% by Kuwaiti Sheiks. Other institutional investors hold 56% and small private shareholders hold the remaining 25%.

BMW:

BMW is still held by the Quandt family. According to Deutsche Informationsbörse the ownership structure is as follows:
45.34% free float,
15.53% Hanna Quandt,
15.25% Stefan Quandt,
11.62% Susanne Klatten,
10.16% GFA Gesellschaft für Automobilwerte mbH,
2.10% employees.

Porsche:

Finally, 55.0% of Porsche shares are held by the Porsche and Piëch families, leaving a free float of 45%.

Ford (98%), Opel (100%) and Audi (100%) are fully owned subsidiaries of the parent corporations.

The protection of the leading car assemblers by block ownership is not just a German phenomenon. In fact, the situation of a full exposure to the stock market in terms of floating capital holds true only for a minority of car makers – General Motors being the prominent example. Family, state or other block owner protections exist at Ford, at all Japanese and Korean car makers and most of the European car makers. Table 2 shows the ownership structure for four European flagship car makers Fiat, PSA, Renault and Volkswagen. The table shows that Fiat and PSA are to a large extent still family-dominated companies, whereas Renault and VW are state-dominated companies.

As we have seen, very few of the suppliers are listed, and stock-market flotations have been quite rare. Besides Volkswagen and Porsche as OEMs, only 15 automotive IPOs were registered between 1949 and 1999 in one of the stock exchange segments. No increase in IPO intensity is apparent during the bubble period from 1997 to 2000: only four new automotive companies went public during that period.

It has to be noted that a number of companies with a strong global market position and a record of high innovation intensity have the legal form of a foundation. The most prominent example is Bosch.

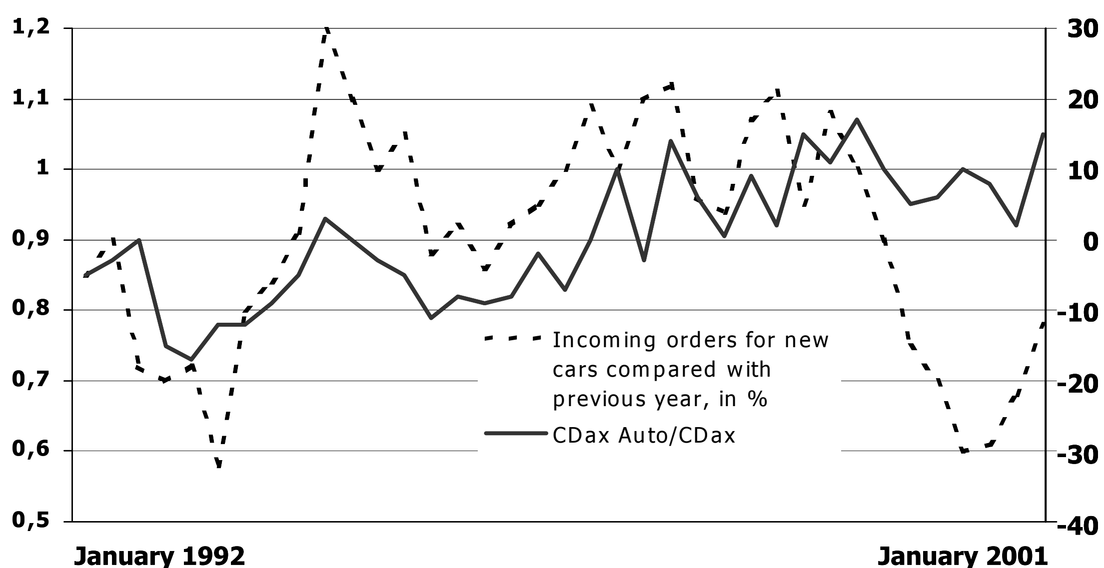
Table 2: Ownership Structure and Control of the 4 European Car Makers (December 31st, 2000)

Car maker	Family/State control	Self-con-trol (1)	Traditional allies		Institutional investors (2)			Floating capital (3)
			Industrial	Financial	National	Other European	USA	
Fiat	21.3% (Agnelli family)		20% (General Motors)	13%	3.3%	2.0%	2.5%	37.9%
PSA	24.6% (Peugeot family)	6.6%	5.35% (Michelin, Lafargue)	6.5% (Société Générale, CDC)	8.0%	5.3%	3.7%	40.0%
Renault	44.2% (French State)	4.9%	1.5% (Lagardère)		11.3%	4.6%	4.9%	28.6%
VW	20% (State of Niedersachsen)	10.2%			12.1%	3.5%	3.0%	51.4%

(1) stakes owned by the company and by their salaries
(2) except financial allies
(3) shareholders not identified

Source: Jürgens et al. (2002, p. 63)

Fig. 1: The Development of Share Values (CDax Auto) vs. the Volume of Production Orders in the Car Industry



Source: Financial Times Germany, 16.3.2001, p. 30

As we have mentioned automotive corporations did not profit from the 1997 – 2000 stock market boom. As figure 1 shows, the CDax Auto developed negatively while Dax and Neuer Markt reached record highs especially between November 1999 and May 2000.

Obviously, shareholders considered the auto industry as old economy during this time. In terms of the average dividends paid by the auto industry as compared to the dividends in other areas of the industry sector, this "discrimination" was not justified. As Table 3 shows, the vehicle industry paid above average dividends in 1998/99.

The development of the CDax Auto versus the development of incoming orders i.e. business opportunities of the auto industries, shows a decoupling occurring in 1999 with share values dropping steeply while the order volume continued at previous levels.

Table 3: Average Dividends in the Vehicle Industry Compared to the Industrial Sector in Total Economy 1998 and 1999

	Number of public listed companies	Equity in million Euro	Dividend per 1 Euro share	
			1998	1999
Vehicle industry	16	7,538	0.41	0.41
Industrial sector	356	34,184	0.28	0.30
Total economy	849	67,493	0.27	0.29

Source: Hoppenstedt: Aktienführer (2001, p. V6)

Table 4: The Relationship between Market Value and Turnover of Selected Auto Companies (May 2001)

Company	Market Value*	Turnover
Toyota	153	73
DaimlerChrysler	56	162
Ford	55	180
Honda	50	28
General Motors	36	196
Nissan	31	28
BMW	26	35
Volkswagen	20	85
Peugeot	15	44
Renault	13	40

* Figures in billion Euro, Stand: 25. Mai 2001

Source: Bloomberg (Capital 31.5.2001)

This development meant that German car companies became very cheap on the market place. Thus by the end of May 2000 Nokia was worth 260 billion Euro, almost three times as much as Germany's Big Three car makers were worth at the time: 92 billion

Euro (DaimlerChrysler 58.3 billion, Volkswagen AG 13.4 billion and BMW 20.3 billion Euro) at this date. Thus the prospect of a hostile takeover, in particular by "financial raiders" seemed not unrealistic.

Volkswagen was in a particularly weak position among the auto companies if one considers the relationship between market value and turnover, as can be seen from Table 4.

Thus the stages set now for the following case study on the experience at Volkswagen adopting shareholder value principles in its company policy.

3. Case Study Volkswagen

3.1 The Traditional Corporate Governance System of Volkswagen in a Historical Perspective[3]

Volkswagen's governance structure has often been discussed as an example of German neo-corporatism. Here it is important to briefly analyse the founding of the company and its relations with shareholders. The Volkswagen works were run as a state company after the British allied force withdrew in 1949. In 1960 Volkswagen Works Limited became a stock corporation (AG) and was partially privatised. State institutions now held 40% of the shares, with the state of Lower Saxony and the German Federal Government each holding 20%. The remaining shares were widely spread among banks and insurance companies and private shareholders, many of whom were Volkswagen employees. As a consequence, governmental representatives remained a dominating influence on the supervisory board, the body that determined long term strategies and personnel selection for the executive board. Traditionally, these representatives were the ministers of finance and of economic affairs, and sometimes the minister of social and labour affairs. In periods when both Lower Saxony and the Federal Republic were governed by Social Democrat majorities – this was the case in the 1970s –, and since 1990 up until today, labour-oriented (state and union) representatives have made up the majority of Volkswagen's supervisory board.

Governmental influence on VW remained strong, even after 1988 when the federal government sold its Volkswagen shares, since the Lower Saxony government remained the single most important shareholder. Hence the composition of the 20-strong supervisory board in 2000 was as follows. On the side of labour: three representatives of IG Metall (among them the leader of IG Metall as deputy chairman of the board) and six representatives of Volkswagen's works council; on the side of capital, four representatives from other companies (among them the chairman of the board), three persons representing banks and a shareholder association, and two representatives of Lower Saxony, among them the prime minister of the current Social Democratic government. In principle this composition of the supervisory board has not changed much since the company went public in 1960.

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3 This section draws from a study of the author on VW in the context of the Gerpisa programme on industrial models (cf. Jürgens 1998).

The distinctiveness of VW's governance structure is based on a special law, the "VW Act" enacted in 1960 when Volkswagen was privatised, and a corresponding company statute. On this basis the state of Lower Saxony has guaranteed status as the dominant share owner. Important clauses of the VW law of 1960 and the corresponding company statute:

– Any increase in shareholder ownership beyond 20% of total shares does not lead to further voting rights; this holds true also for indirectly controlled shares or attempts of share pooling; in this way Lower Saxony with its 20% share ownership could not be outvoted by another block owner. In addition, the state owners where guaranteed the right to fill two positions in the supervisory board.
– Decisions on new plants or plant relocation require a two-third majority on the supervisory board. In this way government and labour representatives could hardly be overruled in decisions concerning changes of location and employment security.
– The VW act requires banks to receive authorization for proxy voting from each shareholder in advance of each general shareholder assembly. In view of the efforts this would have required banks never attained the same degree of proxy voting power at VW as they had in other German companies.[4]

Various political initiatives had been taken in the past to abolish the VW Act. Allegedly by request of a German Bank, the EU has been scrutinizing the legal situation in 2000/01 and has already declared it is an impediment to free capital flow within the EU. In any case, the protection the VW act provides for Volkswagen up to now cannot be taken for granted any longer in the future.

Concerning union influence, the chairman of IG Metall traditionally has been a member of Volkswagen's supervisory board. The chairmen of the works councils of most of VW's German plants were also members of the board. Thus, labour's standpoint was always strongly represented on the board and greatly influenced the selection of the chief officers who ran the company. This influence was only strengthened when in 1976 a law was passed to extend the system of co-determination in supervisory boards to all companies with a certain minimum number of employees.

In any case, union relations at Volkswagen are characterized by a high degree of "jointness" between management and works councils in company policy, which exceed the formal co-determination framework of industrial relations in Germany. The foundations of this partnership were laid in the early post-war period when the works council system was given strong support by the British allied command. The partnership developed over the decades, not least of all owing to the long and continuous reign of both the first German chief executive, Nordhoff, and the leader of the works council, Bork. Nordhoff, a manager at General Motors German Operations before the war, held his position from 1949 to 1968, and Bork, who was the first IG Metall candidate to win the top position in the works council system, held this position from 1951 until 1971. As a Social Democrat, he was also mayor of the city of Wolfsburg during the 1960s and early 1970s. Close co-operation between management and works council and the vision of a happy "VW

4 Many shareholders do not authorize banks to represent their votes. As a consequence only a limited number of votes is present and represented on VW's general shareholder assemblies. Thus on the last assembly of June 2001 only 36.6% of votes were present and so the land of Lower Saxony had the majority of almost 55% of the votes on this assembly.

family” fostered by Nordhoff did not reduce the influence of IG Metall. On the contrary, IG Metall obviously profited from this configuration. Its influence grew slowly from a rather low level especially among white collar employees in the early 1950s. It did not achieve a clear majority in works council elections before 1955, and it was not until 1967 that individual IG Metall membership reached the 50% mark (Koch, 1987, p. 5). The gradual strengthening of IG Metall’s influence among white collar employees continued until the 1980s when it stabilized at a high level. In 1995 about 96% of employees at VW’s main location, the Wolfsburg plant, including almost 90% of white collar employees, were members of IG Metall. It was therefore hardly surprising that IG Metall candidates regularly get the lion’s share in works council elections. Thus, strong union influence and a strong position for the works councils turned out to be complementary and self-reinforcing characteristics of VW’s system. Its stability was further strengthened by the long spells of continuous leadership. The position of the chief works council representative was held by four persons through the years from 1951 to 2001. During this time the company had six chief executives on the management side. The long periods of continuity and at times close personal relationship helped to solve problems in many cases before they could turn into conflicts or even threaten industrial peace. The influence of the works council at VW has often been cited as an example of “co-management”. The flip-side of the strong role of the works councils in the system was that it worked against initiatives that might be taken among rank and file employees and did not support any evolution towards direct participation and grass roots activities on the shop floor (cf. Koch, 1987).

These elements remained central to the industrial model as it evolved into the mid-1990s. A pre-requisite of its stability was the fact that no major changes in the political regulatory environment took place during this period. We refer here to the constitutive elements of the West German neo-corporatist system, particularly to the system of co-determination. The system is sufficiently independent of party platforms and alliances not to be attributable to Social Democracy alone. Conservative governments also supported this structure. Of particular relevance in this regard was the system of co-determination. It was based on the influence of works councils exercised through elected officials representing blue – and white – collar interests at different levels within the company. The Industrial Constitution Act of 1952 (with major revisions 1972) gave the works council varying levels of influence, depending on the subject matter, extending from the right to information concerning economic data and business performance, to the right to consultation, and the right of co-determination – that is the right to veto certain measures proposed by management. Plant agreements between management and the works councils further extend the influence of the elected counsellors in defining work organization, the introduction of new technology, training, and other matters. Through their legally mandated representation on company boards, the delegates from the union and the works councils can, under certain conditions, exert strong influence on the appointment of the executive board and on strategic company decisions.

Collective bargaining takes place between national unions and employer associations with collective agreements reached on a regional level encompassing the whole range of metal related industries, and not just the automotive industry. Volkswagen is an unusual case in this regard, however. As it did not become a member of the employer association “Gesamtmetall”, collective agreements have to be negotiated directly with the union, IG Metall. As a consequence, Volkswagen became a unique case of a company-

wide collective bargaining system. At VW the "dual system" of industrial relations in Germany – in which the union concludes general agreements on wages and salaries, and the works councils at the plant level deal with the details of wage differentiation, working conditions and grievances – was therefore "short circuited" to a certain degree.

The year 1967 marked the beginning of a crisis in the post-war model at VW. The recession demonstrated the vulnerability of VW's product strategy. The decrease in demand in Germany affected VW more than other car manufacturers. Costs became an issue for the first time. It became evident that product differentiation had its price when even a slight deviation from the standard product required a separate process and work organization. Thus labour costs also became an issue for the first time after the boom years. After sales had picked up again in 1968 the dependency on the Beetle remained. None of the new car models (the 1500/1600 and 411/412 series) became a success in the market place. In America the criticism of the Beetle as an unsafe car by Ralph Nader and the consumer movement and the strong revaluation of the D-Mark against the Dollar after the end of the Bretton Woods system made prospects ever bleaker. The various interest groups represented in VW's governance structure were unable to reach consensus on building a plant in the United States, a plan which had been on the agenda since the mid 1950s.

VW's governance structure played a decisive role in this critical period. Close cooperation between management and the works council was an essential ingredient of Volkswagen's industrial model. The neo-corporatist governance structure resulting from the specific history and ownership of Volkswagen helped to reconfirm this relationship. This was the basis for a new phase of jointness in its future-oriented strategies.

The company fared well in most of its major markets (except North America) during much of this period from the late 1970s to the 1980s). The second oil crisis, which was strongly felt by many companies in North America and Europe, had little impact on Volkswagen. The company now profited from strong sales of its product range especially in Europe. This was the period in which Volkswagen gained its position as Europe's largest automobile company, when it bought SEAT and started its activities in China. Sales increased almost threefold within a decade and an expansionist mood took root.

A closer look at the figures reveals that the increase in sales by value was in fact much higher than the increase in output volume. Volkswagen in particular benefited from a market trend towards more expensive model variants during the 1980s as customers tended to move up the product range. A continuous increase in value/price per unit lasted into the 1990s. Growth seems to have taken another path, not by volume but by value. This brings us to the centre of what came to be regarded as the basis of the "German model", or "the strategy of diversified quality production". According to Sorge and Streeck, countries with the highest wage costs and with strong unions and workers' interest representation like Germany and Sweden adopted this strategy and fared better than countries like the United States and the United Kingdom which instead sought competitiveness through low costs. "Diversified quality production" was said to respond flexibly to consumer desires and take advantage of the market trend towards higher quality products and customisation. Flexible production technology, a high skill level and an "intelligent" form of work organization were prerequisites for such a strategy (Streeck, 1989; Sorge and Streeck, 1988). Thus the adoption of diversified quality

production can bee seen as a validation of the effectiveness of the German system of co-determination, humanization of work and centralized collective bargaining in securing growth and employment.

This “German model” approach seemed to open up an alternative to the low-cost strategy of catching up with the Japanese. It stood in perfect harmony with West Germany’s “ingrained social and productive principles” (Boyer/Freyssenet 1995).

Post-war records in sales were achieved in 1992. Yet in the second half of 1992, sales and order volumes began to decline and the economic recession reached Volkswagen. The company entered another stage of acute crisis. The group made a record net loss of almost DM 2 billion in 1993. VW’s fundamental weakness had become apparent the year before. While sales had increased by about 12% for the group (likewise for the VW AG) the economic result was negative and profits plummeted by 87% (70% for the VW AG). The organization was shaken to the core and its underlying industrial model again entered a trial by fire.

As 20 years before, the new crisis resulted from the coincidence of corporate governance problems and market problems. And as in 1974 the supervisory board sought a solution by appointing new chief executive manager. The choice fell on Piëch, the grandson of the father of the Beetle, Porsche. Piëch had been chief executive at Audi. In this role he was a controversial figure, autocratic in his management style and technocratic in his product conception. His appointment was widely regarded as a decision in favour of a policy of re-establishing profitability and focusing on the core business of auto production in the classical sense.

Once again the importance of the governance structure and its embeddedness in the German political economy was demonstrated. As far as what the name Piëch stood for, it was by no means self-evident that the representatives of labour, the head of IG Metall and the leading works council representatives, and the Lower Saxony prime minister – a Social Democrat, would opt for Piëch. Obviously they saw the need for a tough policy of rationalization and a return to profitability. The hiring of Lopez from General Motors together with the forced exit of most of the executive boards’ old guard demonstrated Piech’s determination to shake off “path dependencies” rooted in the fiefdoms of the past.

Piëch’s term as head of the executive board formally was until the end of 2002. By his own decision he set the date of April 2002. By surprise action the nomination of his successor was taken early in September 2001. The reason for this early decision is related to the topic of this paper, and the way how this decision was taken is very instructive of the changes and continuities of Volkswagen’s corporate governance system. We will come back to this at the end of this paper.

In sum, Volkswagen clearly has a distinctive corporate governance system with the special form of co-determination as the central element. It is a prime example of what has been called “co-management” by industrial relations researchers. In a recent brochure published by the central and corporate works council of the Volkswagen AG this system is referred to as “cooperative coping with conflicts based on four pillars: 1. a high degree of union membership, 2. top management committed to the goals of social responsibility and competitivity, 3. a priority on location and employment interests and 4.

a company-based bargaining system between IG Metall and the Executive Board of the Volkswagen AG." (Gesamt- und Konzernbetriebsrat der Volkswagen AG)

3.2 Changes of VW's Corporate Governance Towards a Shareholder-Value Orientation

Accepting shareholder-value principles has been a process driven by the top management of the company. In view of the dismal record of profitability of the company, Piëch after taking the position of the head of the executive board[5] in 1993 stressed the need for profitability. Responding to critiques by investors he declared his commitment to realize a return of sales target of 8% "in the mid-term". This target later on was reduced to 6.5% and was complemented by a return on capital target. Since 1998 Piëch has taken these targets more and more seriously, linking their achievement to the last year before his retirement (set for April 2002). With his well-known autocratic management style there was no doubt that adopting and adapting to this goal was a "must" for the company. In this way achieving the financial and profitability goals was pushed through with the same vigour by Piëch in his final years, as his productionist goals for improving product quality in the first half of his reign.

Clearly shareholder-value orientation has gained momentum within the company. Two events which played a major role in fostering this reorientation, should be mentioned: One is the failed attempt to increase capital in 1997. This capital increase aimed at providing the company with M&A funds for its expansion plans – the names of Scania and BMW were rumoured to be targets – VW met the resistance of capital investors who demanded more concrete details about its M&A measures which Piëch refused to offer. The new share issue had to be cancelled. The second event was the Mannesmann case, the acquisition of one of the German flagship companies by a hitherto almost unknown British telecommunication company. The fear of a hostile takeover became an issue on which management and works councils were united. With a market value of 15 billion Euro Volkswagen seemed an easy prey for any group of investors – if it had not been for the blocking stake of the Lower Saxony government. The Mannesmann case was seen as the writing on the wall. Although Volkswagen was at the forefront of those who lobbied against the takeover directive proposed by the EU (and did so successfully), it was obvious that it could not rely on state government protection forever.

In 2000 a number of measures were taken by Volkswagen to step up "efforts to enhance communication with its investors", states VW's annual report 2000. The following measures are listed:

– Enhancing relations with institutional investors and analysts and with private investors. Thus, among others, over 100 one-to-one meetings were held to explain corporate strategy and to answer questions from financial analysts and investors. The in-

5 It would be misleading to call the head of a German company (Vorstandsvorsitzender) a CEO. The members of the executive boards under German law have a collective responsibility with the head of the board more or less playing a "speakers' role".

vestor relations function was restructured and an office was established in London to promote contexts with international financial analysts.
– A share buy back scheme was launched in September 2000. VW acquired ordinary share amounting to 9.8% of the share capital. As a consequence Volkswagen's share outperformed the CDax Automotive Index and the Dax. (In 2001 management achieved authorization from the general shareholder meeting for a second share buy-back of 10% to be realized after the first share quantum had been used.)
– The company stated its commitment to support the OECD principles on corporate governance adopted in 1999 (ibid., p. 12). In a rather vague formulation the report continues: "We are investigating implementation of the farther-reaching criteria under discussion based on an analysis of the Company's situation." (ibid.)
– The adoption of the International Accounting Standards (IAS) instead of the traditional German Commercial Code (HGB) standards.
– The adoption of segmental reporting in the 2000 annual report for the first time.

As of now, these measures have failed to impress financial analysts. "The one great weakness of the company from an investor's perspective is that it really has been a bastion of German traditional accounting and disclosure," is a statement of one of them quoted by the journal "Investor Relations" (1.6.2001). "Volkswagen is Europe's least transparent car maker," another investor is quoted, and in the context of the critique of the investor community against preference shares at Volkswagen, a German funds manager complained: "VW is kind of a socialist company, it's getting harder and harder to see why VW shares should be held at all." (Wall Street Journal Europe, 8.6.2001)

The concept of "workholder value" developed by Volkswagen's labour director in 1999 showed the uneasiness felt by company management and the search for a compromise. According to this concept, personnel policy should combine two sets of goals in the future. One is workholder value with social responsibility, knowledge management, employability and flexibility as central elements; the other is shareholder value aiming to increase company value, improve results, value added per employee and yield. "Shareholder Value", according to a company personnel manager at a conference in May 2000, "has an outstanding influence on the development of the company. Twenty-four hours a day companies are analysed, evaluated, rewarded, or graded for their decisions, successes, and the expectations they raise. In future, corporate governance will require keeping up in this great race while nevertheless keeping one's mind clear for long term goals and societal obligations … However, shareholder value reflects the potential of a company only to a limited degree. The difference between market value and equity is often explained in terms of human capital. It is this human capital that decides the future prospects of a company. … For us Volkswagen's corporate success is defined not only in terms of shareholder value, of its value as a going concern, but equally in terms of workholder value, which the workforce generates through their work and their know-how."

The combination of shareholder and workholder values is to be realized by the "Volkswagen Corporate Concept" characterized by specific employment concepts, a variable remuneration system and by the "M4-employee" *(Menschlich* – human, *Mobil* – mobile, *Mehrfachqualifiziert* – multi-skilled, *Mitgestaltend* – participatory). "More than in the past we will discover management and workforce as the real value leverage of the com-

pany. The workforce support shareholder value and the imagination of the shareholders." (unpublished manuscript, April 2000)

Although the workholder value concept was not given a high profile in these public relations activities, internally at VW it certainly reflected a wide-spread consensus. In any case shareholder value has not officially become the lead orientation for the company. However, pressure in this direction has increased in recent years.

The works council observes that the capital side on the supervisory board does indeed ask more intensively about performance on the capital market. Despite all the criticism of VW as a "socialist state enterprise", VW's success on the market place has in the past calmed everyone down. Without this success conflicts would certainly have become more intense.

Has Volkswagen then really adopted shareholder value as a primary goal or is it only lip serving the financial community?

3.3 The Role of the Stock Market for Company Financing

At *Volkswagen* the stock market only since very recently has been regarded as important for company policy. On the rare events when in the past the company increased its equity base, all measures were taken to maintain the existing ownership structure. In the past capital intake from the stock market was in most cased linked to major acquisitions. This was the case in 1965 when Volkswagen bought Audi Union from Daimler Benz and increased its capital by 150 million DM (from the 1960 IPO base of 600 million DM).[6] This capital increase was financed out of the undisclosed reserve of VW itself and passed over to the existing owners. The next increase 1970 was related to the leap in investments required for the next generation of models after the Beetle. In 1977 300 million DM of shares were issued in the context of investment in the new US site at Westmoreland and the purchase of Triumph-Adler. 1986 another 300 million DM were added in view of the acquisition of Seat. At this point Volkswagen decided to introduce preference shares. The reason might have been that Lower Saxony at this time had a conservative government which might have opted not to follow the increase in capital. In this way VW could mobilise new capital without affecting the existing ownership structure. During the 1990s at several times new preference shares were issued. In 2000 preference shares made up one fourth of total shares. 1990 also saw an increase in common shares (by 12.5%) necessary, obviously in view of the full acquisition of Seat and 30% of Škoda to be raised stepwise up to 70% in 1994 and 1995. In the second half of the 1990s under the reign of Piëch, new shares, either common or preference shares, were issued almost every second year, however in small amounts (an increase of 22% of the equity base altogether between 1995 and 2000).

The stated policy of the company is to finance investments and regular operations out of the cash flow. Considering the development of cash flow as percentage of capital investments in tangible fixed assets during the 1990s for the Volkswagen Group this did not pose a problem (cf. Table 5). For the automotive business (since recently the Annual

6 The reference in the following account is nominal capital, not the market value.

Reports have provided the data for the business areas "automobile" and "financial services") investments exceeded cash flow slightly in the years 1996 and 1997, they were hardly covered by the cash flow in 1998 and 1999 before in 2000 cash flow exceeded investment again by a comfortable margin (of 22%).

While the automobile business could largely be financed out of the cash flow, the expansion of the finance service business required a more frequent interchange with the capital markets. It led to a diversification of the means of re-financing. Already in 1977 Volkswagen International Finance was founded as a subsidiary – now part of the financing division – "in order to source finance for the Group at favourable terms worldwide on international capital markets. The company makes use of primary and derivative financial instruments." (Volkswagen Annual Report, 2000: 75) An analysis of the changes in Volkswagen's liability structure shows an increased importance of bonds (increased by 69% from 1995 to 2000), of credits from banks (+31%), but most importantly re-financing occurred through a commercial paper programme and a multi-currency Euro medium-term note (EMTN) programme as well as through company-internal loans.

Table 5: Cash flow and Capital Investments in Tangible Fixed Assets at VW, 1991-2000

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Cash flow as % of capital investments in tangible fixed assets	137.8	150.5	224.7	294.0	234.6	152.8	149.5	143.2	171.0	209.8
VW AG automotive division	n.a.	n.a.	n.a.	n.a.	137.5	99.7	92.7	102.3	102.9	122.2

Source: Volkswagen AG, Annual Reports

In any case, refinancing has become a major concern for the company. Obviously it perceives increasing difficulties of refinancing itself through banks. "The intensified efforts of the banks to improve their equity yield", VW states in its Annual Report, "combined with the ongoing global process of consolidation in the banking industry, meant that banks where increasingly reluctant to provide additional credit lines at the previously applicable terms during the period under review. The trend, again some years ago, toward the use of international capital markets with the establishment of short- and medium-term tap issue programmes gained further momentum in the period under review, and made a major contribution to the Group's liquidity. Automotive and Financial Services division companies have continued to utilise the capital markets with regular issues of commercial paper and medium-term notes, and have established themselves as respected market players in the eyes of investors and of the banks." (Volkswagen Annual Report, 2000: 35)

The special attention the company has paid to stock market development in recent times is clearly linked to its acquisition policy and its concern about a hostile take-over. And it is in this context when Volkswagen realised that it had a serious problem in its relationship with investors. This became evident in 1997 when the company had

tionship with investors. This became evident in 1997 when the company had decided to increase its nominal capital by 300 million DM. The intention was to offer half of this amount to its shareholders (first tranche) and the other half to national and international investors (second tranche). The company refused however to explain its strategy. According to rumours Volkswagen planned major acquisitions – BMW and Scania were among the household names mentioned in this context. The investor community reacted critically leaving Volkswagen in an embarrassing situation. The company decided to postpone the issue and in the following year it decided to go on with the issue of the first tranche and cancel the second. This negative experience of VW with investors on the stock market can be seen as a major explanation for the change in mind set in the company and the growth of awareness that the company had to improve its investor relations.

At the same time when VW discovered the usefulness of the stock market to provide "acquisition money" it became aware of its own weakness as target for hostile takeovers. Rumours of Ford being interested in acquiring Volkswagen, the EU Wettbewerbskommissar scrutinising the VW-law and the low market capitalisation of the Volkswagen – all this contributed to a rising fear of a hostile take-over which almost became the phobia in 2000/2001. With authorisation of the 2000 general shareholder meeting Volkswagen had bought back 10% of its shares already and the 2001 general assembly again authorised another share buy-back. While Volkswagen is not allowed to hold more than 10% of its own shares under self-control it could exchange these shares with "friendly" companies (Deutsche Post and Thyssen-Krupp were mentioned as such possible partners), then buy another 10% and use it in the same manner. In 2001 various possibilities to build a protection wall around Volkswagen were played through with the help of consultants. Together with the share block of Lower Saxony (20%), the cross shareholdings held with other companies could efficiently block off any hostile takeover attempt.

3.4 Changes in the Incentive System

The question addressed in this section is whether this reorientation towards shareholder value is supported by a system of incentives. If targets are not reached, are there any monetary sanctions? How are stock option programs designed in view of stock market performance?

While stock options in the past have played a small role, bonuses have played a role particularly for the higher ranking management. At the executive board level the proportion of variable income is more than 50% of total salary. It is about 50% at the second level and decreases down the hierarchy to 25% for those eligible for these bonuses. Bonuses are paid for white-collar employees not subject to collective agreements. The bonus is determined on the basis of the adjusted company earnings at the brand level. There is no differentiation according to different business units within the brands. The bonuses have three elements, first a company-related part differentiated according to hierarchical levels, second according to individual performance on the basis of personnel appraisal, and third stock options.

In any case, tying bonuses to performance targets requires a detailed area-specific planning and a controlling system which does not exist except for a few pilot areas. There are also no specific performance-oriented guidelines for personnel appraisal systems. Rough criteria are entrepreneurial, functional and social competence. It is the decision of management in the different business areas to use individual goal agreements. At the Wolfsburg plant a pilot experiment is being conducted for the group of first-level supervisors. Monetary and career advancement over the three levels of supervisor positions was rare and thus little performance incentive existed for this group, which traditionally has a crucial function on the shop floor in German manufacturing companies.

Bonuses are also paid at the level of employees subject to collective agreements, but not linked to targets/performance.

With the introduction of the 28.8 hour week and the corresponding reduction of wages, a new system was introduced with three types of bonuses for employees subject to collective agreements: first the minimum bonus (the rest of the former Christmas and holiday bonuses), second a performance bonus with overtime and extra shift work components and which is thus not really performance-based, and, third, a company performance bonus partially paid in the form of "time asset" papers.

The "time asset" scheme was introduced in 1998. It relates to the "workholder value" concept. The strategic aim is to combine the goals of employment protection and result orientation. In early 2001 450 million DM were invested in "time asset" papers, around 100 million DM of which result from collective agreements. The balance was paid on an individual voluntary basis out of bonus payments, overtime payments, or premiums for improvement suggestions. As they are not subject to income tax and social security contributions at the time of payment, it is a very attractive savings system. "Time money" invested in this asset is administered by special capital funds which, according to the 2000 annual report, have yielded an average return since they were created at the beginning of 1997 of approximately 8,7% p.a. The company expects that savings on the time account will be used by employees later to finance temporary old-age work time schemes or early retirement.

Building on the experience with the time asset, the company pension scheme was restructured in early 2001. A pension fund administered jointly by management and works council was set up to finance new vested pension rights of employees in the future. In this way employees shall benefit from the growth of the capital market and the company shall reduce its liabilities for future company pensions.

The first stock option plan was introduced in 1999 (a previous plan decided in 1997 was stalled by litigation). Its main feature is that it is also open to ordinary blue and white collar employees. Subscription is differentiated according to three groups: 1. wage and salary earners subject to collective agreements, 2. salary earners and management not subject to collective agreements below top management, 3. top management (the latter comprises about 100 persons). Employees of the first group can subscribe for ten options, the second for 100 options, and the third for 1,000 options. Each option gives the right to buy 10 shares. The subscription of stock options presupposes that the employee also subscribes for time asset papers. For each option he has to have 100 DM on his time asset paper account. Thus the time asset scheme is bolstered by means of the share option plan.

For tax reasons the "time asset" paper is in particular advantageous for managers. They are made more attractive by linkage to the stock option schemes. The time asset scheme can thus also help to solve problems of retaining personnel.

Despite the long experience at VW with employee share ownership and despite the fact that there is no risk involved in investing in a stock option, only 48.5% of ordinary employees (covered by collective agreements) participated in the first year in contrast to 81.8% of middle management and higher-level salaried employees not covered by agreements (außertarifliche Angestellte) and 95.4% of top management. In the year after 51% of ordinary employees participated in the second tranche, in contrast to 77.3% of middle managers and higher level salaried employees and 91.4% of top management. This low participation is noted with some embarrassment by the protagonists of the stock option program. Besides the fact that the original conversion price was set too low in the first year, a lack of awareness and interest in the topic and mistrust about the goals of the company were named as explanations for this reluctance.

Altogether the measures introduced by VW reveal an endeavour to combine finance market considerations with elements of employment protection and company considerations aiming at greater personnel flexibility and lower short-term liabilities (overtime pay, pension liabilities).

There are no specific stock option schemes for specific groups of employees such as IT specialists. However, stock option considerations played a role in plans to list Gedas, the IT company and 100% subsidiary of VW. The planned IPO has been postponed however due to the situation on the stock markets.

3.5 Towards a Finance-oriented System of Target Setting and Controlling

As a consequence of the crisis in the early 1990s, the company board took the initiative in 1993 to increase profitability in the company. This initiative was fully supported by the works council. Financial targets were set that focused on returns on sales and sales growth figures to be attained in a number of years. The head of the executive board committed himself to reaching these goals before he retired, i.e. 2002. The more recent measures to introduce a results-oriented controlling system within the company is seen as his attempt to deliver on this commitment.

As of the beginning of 2000, VW has started to shift from a budget system to a results-oriented system. Traditionally, targets are determined in the yearly "planning rounds" which take place in November each year. Among other things, the planning round 49 (2000) decided:

Financial targets:

- Return on capital should be within a corridor between 9% and 11%;
- break-even of max. 60%;
- return on sales should reach 4.7% and increase to 6.5% by 2005;
- investments should be paid out of the cash flow and have a cap of DM 6 billion.

Besides this, various performance targets were set, such as material price reduction of 2%, fixed cost reduction of 3%, etc.

The new system of financial control at Volkswagen was announced in January 2000 and is based on capital costs and return on capital as target indicators, with the aim of measuring in detail the success of the individual brands and regions of the group, and also of the different products and projects. The previous system at VW was based on return on sales, with sales and earnings before taxes as central targets. It did not give information about whether capital employed – from the viewpoint of the investor – yielded an adequate return. The future system takes into account capital market expectations of a minimum return on invested capital. According to a company-internal brochure, the purpose of the revision is to allow a value-based control system serving the interests of all stakeholders. In the preamble Piëch and Adelt (VW's CFO) explain the purpose of this new system in a manner which can be seen as a typical example of fine-balancing stakeholder interests: "In order to be successful also on the capital market we have to increase our market value by continuously improving our profitability. Only in this way we will make the company attractive to capital investors and make sure that we have the financial leeway to finance our future projects and our innovation also via the capital market. Investments and innovation at the same time ensure the long-term stability of employment." (Finanzielle Steuerungsgrößen des Volkswagen-Konzerns, 2000)

At the current stage the targets based on return on capital employed/return on investment are not differentiated according to different business units and group companies, with the exception of targets related to certain country affiliates. While they are the same for European countries, they are higher for countries such as Mexico, Brazil, South Africa and China owing to higher investment risks or capital costs in these countries.

The implementation of the new system is in its early stages. There are only a few cases where the result-oriented controlling system is already being practiced. In Wolfsburg it was introduced in an area producing trim parts which is threatened by outsourcing. The reason for introducing the new system is explicitly to enable this area to become competitive and remain an in-house supplier. Another example is the Brunswick component plant which among others produces axles and parts of the steering system. This focus on component production areas is no accident. Currently, component production is an integral part of the Volkswagen production and industrial relations system. Due to strong competition on the supplier market, these internal suppliers would not be able to meet the financial targets. Either different targets would be set for different business units corresponding with their different market situations, or business units such as component production would be singled out as systemic underperformers and come under pressure for outsourcing. This is the perspective obvious to all protagonists. A solution proposed by the works council is to set targets for internal suppliers in relation to the reference group of competing suppliers.

Table 6 shows the return on sales of VW's brands. It shows the high variance with each segment seemingly on a different level/trajectory. A uniform target does not seem to make much sense under these conditions. It is, by the way, the first segmented account of performance results in VW's annual reports.

Since 2000, the Volkswagen group has been split into three divisions: The automotive division; financial services; and financing division (cf. for the following Volkswagen's Annual Report 2000).

The *automotive division* is structured by brands and regions: Volkswagen passenger cars, Volkswagen commercial vehicles, Audi, Seat, Škoda, Rolls-Royce/Bentley as brands which report separately; the two remaining brands, Lamborghini and Bugatti, report under Audi resp. VW passenger cars; and the regions: North America, South America and Asia Pacific. Table 6 shows the differences of returns between the brands and regions with VW commercial vehicles leading the profitability league followed by Audi in terms of the brands and with Asia Pacific leading the regional league followed by North America.

Table 6: Return on Sales of VW's Brands and Investment and Financial Planning of the VW Group Automotive Division (DM billion)

Return on Sales of VW's Brands			Investment and Financial Planning of the VW Group Automotive Division (DM billion)		
	2000	**1999**	**2001-2005**		
			Capital investments in tangible assets (1)	**Cash flow (2)**	**(2):(1) in %**
Volkswagen passenger cars	3.6	3.1	26.3 (42.6)	42.6	161.9
Volkswagen commercial vehicles	5.7	5.7	3.8 (6.1)	4.6	121.1
Audi	4.8	4.7	14.5 (23.5)	23.7	163.4
Seat	2.4	2.3	3.0 (4.9)	5.4	180.0
Škoda	2.7	2.9	3.9 (6.3)	5.5	141.0
Rolls Royce/Bentley	-38.4	-84.7	0.7 (1.1)	1.2	171.4
North America region	4.4	3.2	5.0 (8.1)	8.4	168.0
South America region	-0.1	-7.1	4.4 (7.1)	5.6	127.3
Asia-Pacific region	7.4	7.7	0.2 (0.3)	0.5	250.0
Financial service division	10.1	4.2			

Source: Volkswagen Annual Report 2000

The *financial services division* handles dealer and customer finance and leasing operations for the VW Group. It also operates fleet management services, agency business for insurance and commercial papers as well as savings accounts. With effect from January 1, 2000 the division incorporates the group's car rental business (the Europcar group) and insurance business (Volkswagen-Versicherungsdienst GmbH). Banking and leasing operations have been growing fast in recent years: balance-sheet total from 59,618 million DM in 1999 to 74,897 million DM in 2000, capital investments in leasing and rental assets from 13,575 million DM in 1999 to 22,700 million DM in 2000;

the workforce from 4,200 in 1999 to 10,100 in 2000. 27.3% of all vehicles delivered by the group were leased or financed in 2000. Direct banking business expanded with direct bank deposits increasing by 28% in 2000 over 1999. VW banking is the second-biggest private banking operation in Germany and the firm has announced its intention to expand further. This is also true for the leasing and rental business which increased by 11% from 1999 to 2000. The goal for Europcar, VW's car-rental operation, is to become European market leader. Currently it holds second position after Avis with 15% market share in Europe. Financial services is an area VW is also focussing on regarding its acquisition policy. The company has announced its interest to buy ABN Amro Leasing, the worldwide leading leasing company for passenger cars. With the acquisition of Amro-Leasing Volkswagen would have a market share of one third of the German passenger car-leasing market. As Table 6 shows, financial services has the highest rate of return among the reporting business units. The expectation repeatedly stressed by Piëchis that financial services contributes 30% to VW's overall profits. Pischetsrieder, the successor to Piëch since April 2002, has already announced his intention to expand business in this area. Pischetsrieder also stressed the importance of financial services to help VW to achieve a return on sales in the order of 6-7%. Without contributions from financing new car sales, fleet management and used-car retailing, he suggested that margins would be no more than 3-4%. "Six to 7% is a possible target including financial services, which is a precondition for a successful car business." (Financial Times, 12.9.2001, "VW may expand financial arm")

Despite the announced intention to expand financial services VW has not followed Ford and other companies in officially announcing a strategy of "value migration" away from automobile manufacturing as low-margin activity towards higher-margin activities downstream the value chain. The official policy is that financial services supports VW's core business activities of auto manufacturing. This core business as of 2000 makes up 80% of Volkswagen's turnover.

The *financing division,* finally, is a small division in terms of people. As of the end of 2000 it employed 72 people. The financing division "opens up access to international capital markets, frees the group from dependency on the economically, structurally and in part politically based fluctuations of the domestic credit and capital markets, and enables funds to be acquired in foreign currencies and permits utilization of international money and capital markets." (annual report, 2000, p. 74): Business development is largely determined by factoring and intra-group finance operations. Pre-tax profit totalled DM 342 million, up 18.8% on 1999.

Table 7 is a breakdown of sales and their development from 1996 to 2000. There is no obvious shift in the relevance of the segments to be seen in this period. With regard to activities other than OEM production and assembly, leasing and rental business makes up almost 10% of turnover, spare parts almost 6% and other sales almost 5%. While the returns from the spare parts business have not been published it is known that they played an important role in contributing to overall profits and in times of crisis as in 1993/94 cash flow from these businesses played an important role to keep the company a float. Volkswagen, like Ford, in recent years has sought to expand its service business. While Ford bought the quick repair service chain Kwik-fit, VW had bought Pit-stop for example. While Ford has made a U-turn in the meantime and started to sell some of its service businesses it had bought, VW is still continuing this policy.

Table 7: Sales of VW Group by Segments

	million DM	2000 Share in %	million DM	1999 Share in %	million DM	1998 Share in %	million DM	1997 Share in %	million DM	**1996 Share in %**
Germany	47,970	28.7	47,390	32.2	46,744	34.8	39,191	34.6	36,419	36.4
Europe (excl. Germany)	66,652	39.8	61,467	41.8	55,735	41.5	44,139	39.0	37,724	37.7
North America	33,108	19.8	24,206	16.5	15,356	11.4	11,617	10.3	7,720	7.7
South America	9,943	6.0	7,731	5.3	11,103	8.3	12,152	10.7	12,036	12.0
Africa	2,063	1.2	1,586	1.1	1,567	1.2	1,731	1.5	1,693	1.7
Asia-Pacific	7,595	4.5	4,633	3.1	3,738	2.8	4,415	3.9	4,531	4.5
Total	167,331	100.0	147,013	100.0	134,243	100.0	113,245	100.0	100,123	100.0
of which:										
Volkswagen vehicles	73,550	44.0	66,048	44.9	61,663	46.0	49,399	43.6	45,657	45.6
Audi vehicles	30,375	18.2	27,859	18.9	25,256	18.8	21,401	18.9	18,008	18.0
Commercial vehicles	9,900	5.9	8,912	6.1	9,550	7.1	9,427	8.3	7,887	7.9
Seat vehicles	9,843	5.9	8,873	6.0	7,000	5.2	6,164	5.4	4,878	4.9
Škoda vehicles	7,256	4.3	5,520	3.8	5,102	3.8	4,005	3.5	2,575	2.6
Ford vehicles	1,572	0.9	1,727	1.2	–	–	–	–	–	–
Bentley vehicles	540	0.3	327	0.2	151	0.1	–	–	–	–
Rolls-Royce vehicles	202	0.1	118	0.1	99	0.1	–	–	–	–
Lamborghini	103	0.1	78	0.0	–	–	–	–	–	–
Spares	9,794	5.9	8,675	5.9	7,808	5.8	7,527	6.6	6,993	7.0
Leasing and rental business	16,294	9.7	12,907	8.8	11,681	8.7	10,084	8.9	9,029	9.0
Other sales	7,902	4.7	5,969	4.1	5,933	4.4	5,238	4.8	5,096	5.0

Source: Volkswagen Annual Report 2000

3.6 Effects on Investment Decisions/Disinvestment Decisions

To what extent do the new systems of target setting and controlling and new incentive systems affect decisions on investments? Are decisions becoming more short-term? Are investments in "innovative" projects (with uncertain returns) or in human capital becoming more difficult owing to the new orientation? Is there a tendency to downsize and distribute rather than retain and reinvest?

Table 8 shows the development of capital investments in tangible fixed assets as percent of sales at VW AG, and most specifically for the automotive division since 1995, since there are separate data reported on a divisional basis. The table also shows the development of financial investments in percent of total investment, of research and development expenditures as percentage of sales and finally of the expenses for education and training as percentage of total labour costs. All these are indicators which should reflect the impact of a shift from a productionist orientation towards financialisation. As can be seen from this table, the data do not reflect such a shift.

Table 8: Investments in Tangible Assets at Volkswagen, 1991-2000

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Capital investments in tangible fixed assets as % of sales										
– VW AG	10.9	9.4	5.3	5.0	5.0	7.2	7.2	7.3	8.0	6.6
– automotive division					7.0	8.0	7.9	9.0	8.0	8.0
Financial investments in % of total investment*	9.3	5.8	4.2	11.7	8.1	8.6	9.2	11.4	7.1	13.0
R&D/Sales (%)	3.2	3.2	3.7	3.6	4.5	4.4	4.2	4.2	5.6	6.0
Expenses for education and training as % of total labour costs		0.6	0.7	0.6	0.6	1.4	1.5	1.5	1.6	1.7

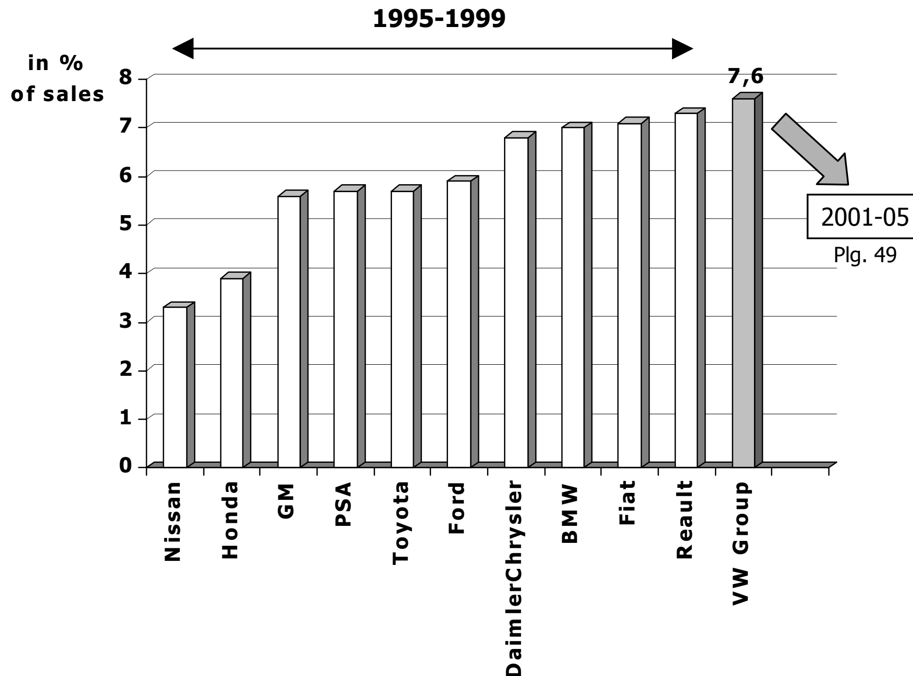
* own calculation

Source: Volkswagen AG, Annual Reports

As Table 8 shows, capital investment in tangible fixed assets as percentage of sales for the automobile business during the six years 1995-2000 was around 8%. The Head of Finance in VW's Executive Board on a presentation for the Association of European Automotive Analysts in December 2000 pointed out that Volkswagen regarded this percentage as too high. He stated Volkswagen's intent to bring this ratio over the mid-term back to the level of VW's main competitors during the period 1995-1999 (cf. Fig. 2).

The same holds true for the investment/R&D ratio. According to the CFO the average ratio of competitors (Honda, GM, PSA, Ford, DC, Fiat and Renault) during 1995-1999 was 10.6%. The VW Group with 11.8% again had invested more in its product programme than the average of the competitors. In the future VW would also go back to the average competition level of the past five years.

Fig. 2: Investment Ratios (Investment as Percentage of Sales of Selected Auto Companies 1995-1999)



Source: Presentation of B. Adelt, member of the executive board (Volkswagen AG) to the Association of European automotive analysts' meeting, December 6th, 2000, Wolfsburg;

http://www.volkswagen-ir.de/deutsch/08/html/adelt/chart4.html of 25.9.2001

This cap on investments decided by the planning round of 2000 and presented to the financial analysts by the head of finance, is one of the few indications that Volkswagen indeed has changed its policy giving priority to financial goals. At Audi investments in the first half of 2001 was reduced by 13%. The cap on investment has already provoked critical comments from the site of the works council.

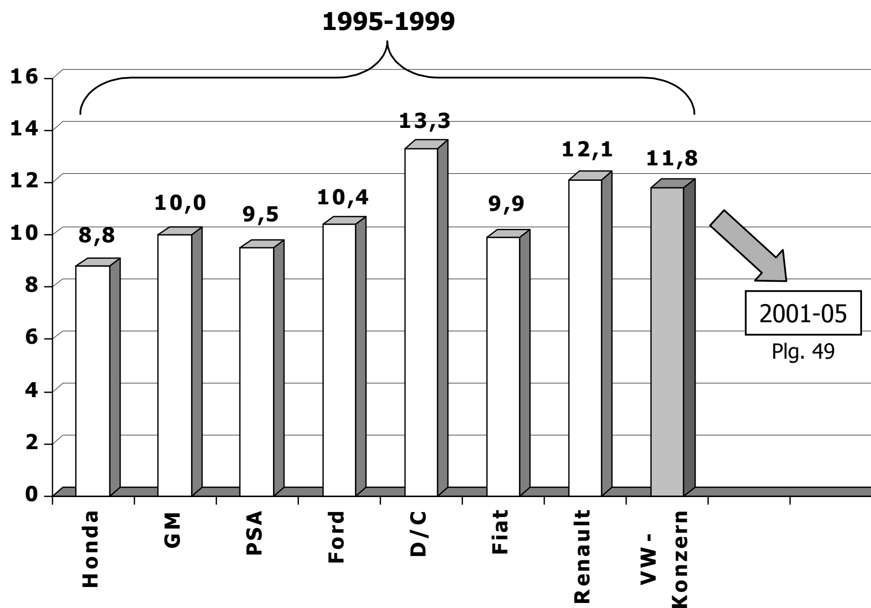
Has there been a shift from internal growth towards acquisitions in Volkswagen's growth strategy?

During in the last 15 years acquisitions have solely focussed on automotive-related businesses, and this is true for most of the companies' history. There was only one period when conglomeration strategy was pursued. This was in the mid-70s. In order to reduce its dependence on the automotive industry VW had decided to strategically broaden the scope of its business. In 1978 Volkswagen purchased the Triumph-Adler Group and consolidated it as an affiliate in business machine and information technology. The board of management declared this to be part of long term company policy.

The new Triumph Werke AG employed around 14,000 persons in 1979, and had sales of 1.2 billion DM. The general perception was that the acquisition was more than just a financial manoeuvre. It was seen rather in the context of Volkswagen's technology orientation, and it was anticipated that the whole group would benefit from the technological potential of its computer affiliate. But these hopes were soon shattered. The Tri-

umph Adler Group lost money and was in need of a long-term strategy itself. Volkswagen's management sought a way out and, in 1986, sold these businesses to Olivetti.

Fig. 3: R&D Expenses as a Percentage of Investment in Fixed Assets of Selected Auto Companies



Source: Presentation of B. Adelt, member of the executive board (Volkswagen AG) to the Association of European automotive analysts' meeting, December 6th, 2000, Wolfsburg;

http://www.volkswagen-ir.de/deutsch/08/html/adelt/chart3.html of 25.9.2001

The failure of Volkswagen's diversification policy cannot be analysed in detail here. The general weakness of the European computer industry is part of the explanation. Also notable was Volkswagen's own short-term orientation to its supposedly "long-term strategic" commitment at that time. Volkswagen's top management decided to abandon the computer field less than five years after entering it. The strategy of diversification was laid to rest, replaced by renewed focus on the core business.

A look into recent M&As does not suggest a shift away from the focus on car production in the sense of a motoring matrix policy suggested by Froud et al.(1998). Mergers & acquisitions in 2000:

- Acquisition of a 18.7% holding in the Swedish commercial vehicle manufacturer Scania AB. The holding entails 34.0% of the voting rights.
- Acquisition of the remaining 30% of shares in Škoda Auto. As a result, Volkswagen is now the sole stockholder in that company.
- Establishment of Bugatti Automobile as a wholly owned subsidiary.
- Volkswagen Beteiligungs-Gesellschaft mbH acquired the remaining shares of the former joint venture company Europcar International.

An analysis (which shall not be elaborated here further) of Volkswagen's direct or indirect affiliates confirms a policy of close orientation toward automotive-related busi-

nesses. Altogether the Volkswagen AG has a direct or indirect interest of over 50% in 31 German group companies and 112 foreign group companies, according to the 2000 annual report. 48 German and 74 foreign affiliated companies are not consolidated. Participation: Income from affiliated companies in 2000: 388 million DM, from associated companies 330 million DM, from valuation of holdings in associated companies 456 million DM. Including other incomes and expenses altogether 976 million DM.

Disinvestments:

Turning to disinvestments, there is no indication of a shift towards a "downsize & distribute" policy nor a policy of the degree of vertical integration at VW. The company has not sold any of its German operations or assets of a size worth mentioning except for the sale of Triumph-Adler mentioned above. Among its foreign operations this is also true except for the dissolution of its North American production network with sales of for instance its plant in Sterling Heights to Chrysler. Altogether disinvestments have been an extremely rare event in Volkswagen's policy.

This is also true for the outsourcing of operations in the area of automotive components. It is true that some parts production, especially in the area of small press parts, have been outsourced, no major component of VW's internal parts suppliers has been outsourced so far. The official language is that VW does not follow a policy of outsourcing. In view of the "core competencies" talk and the examples set by GM and Ford spinning off their component businesses into separate companies, there is a discussion on the future of component business within Volkswagen, however. At the current stage this discussion is largely dominated by the question how to develop competencies in order to enable VW's component units to compete on equal footing with independent component suppliers. The capability to become systems suppliers and the need to develop capabilities in the area of electronics are areas of concern in this regard. Altogether Volkswagen's component workforce makes up 80,000 of VW's workforce of around 320,000. Thus the head of the corporate works council repeatedly is stressing the need for a coherent "component strategy". In view of the increasing relevance of electronics and software, the company has developed an "electronics strategy" to initiate insourcing in core areas. On the whole, it seems that insourcing and capability development in the productive field are more urgent issues than outsourcing at VW.

Evidence of a policy of shifting the distribution of returns to stockholders can also not be observed. Table 9 does not show a relevant shift of returns to stockholders. Rather the state (taxes), creditors (interests) and the company (reserves) had been profiting from the increase of added value since the mid-1990s. The proportion allocated to employees, in contrast, was reduced sharply as the productivity increase during this period was not accompanied by proportional wage increase. Shareholder pressure and the fear of a hostile take-over played their parts to legitimate this development.

Table 9: Sources and Allocation Funds of the Volkswagen Group

Sources	million DM	2000	1999	1997	1996	1995	1994	1993	1992	1991
Sales		167,331	147,013	113,245	100,123	44,598	41,886	42,949	53,182	47,328
plus other income		14,286	12,534	11,512	11,520	4,643	2,118	3,050	3,648	4,421
less expenditures		143,913	127,883	97,047	86,146	37,022	32,778	34,635	43,200	38,927
Added value		**37,704**	**31,664**	**27,710**	**25,497**	**12,219**	**11,226**	**11,364**	**13,630**	**12,822**

Appropriation	million DM	2000	%	1999	%	1997	%	1996	%	1995	%	1994	%	1993	%	1992	%	1991	%
to stockholders	Dividend	992	2.6	641	2.0	483	1.7	323	1.3	254	2.1	192	1.7	126	1.1	279	2.0	484	3.8
to employees	Wages, salaries, fringe benefits	26,207	69.5	23,406	73.9	20,686	74.7	20,708	81.2	11,206	91.7	10,585	94.3	10,833	95.4	12,735	93.4	11,497	89.6
to the State	Taxes, levies	3,329	8.8	3,656	11.6	2,891	10.4	1,665	6.5	349	2.8	274	2.5	334	2.9	484	3.6	392	3.1
to creditors	Interest	4,136	11.0	2,950	9.3	2,772	10.0	2,446	9.6	203	1.7	59	0.5	4	0.0	66	0.5	80	0.6
to the company	Reserves	3,040	8.1	1,011	3.2	878	3.2	355	1.4	207	1.7	106	1.0	67	0.6	66	0.5	369	2.9
Added value		**37,774**	**100.0**	**31664**	**100.0**	**27,710**	**100.0**	**25,497**	**100.0**	**12,219**	**100.0**	**11,226**	**100.0**	**11,364**	**100.0**	**13,630**	**100.0**	**12,822**	**100.0**

Source: Volkswagen AG, Annual Reports

Finally, VW has also not followed a policy of downsizing employment and close plants. When the pressure was there, during the crisis years 1993/94, it rather pursued a policy of reducing the weekly working hours.[7]

When in Autumn 1993 plans, forecasts and commitments were tallied up for the next two years it became evident that a total of 30,000 employees would have to go, a good quarter of VW AG's 108,000 employees. This situation was due to the economic recession, but also to VW's investment in new capacity since the late 1980s, a reduction in the degree of vertical integration and the various measures to improve productivity and performance. In regard to the programs like CIP and group work specifically, all actors were aware that the company would no longer be able to count on shop floor participation, if dismissals on such a scale took place. Moreover, industrial peace at VW itself would be threatened if management insisted on mass dismissals. It was quite characteristic of Volkswagen's governance structure that quick joint action was possible in this situation. An agreement between IG Metall and Volkswagen was struck to reduce working hours in order to share the work among the existing employees. The reduction of weekly working hours by 20% (from 36 to 28.2 hours) secured 20,000 jobs; the remaining 10,000 were to be secured by additional measures. The reduction of work time was paid for by a reduction of income on an annual basis (between 10 and 11%) and by reducing the number of special holidays. In return for these concessions the company guaranteed an employment level of 100,000 for Volkswagen AG. (Of the other group companies only Audi followed with a similar agreement reducing the weekly working hours there by 10%.) A major element of the work sharing agreement was that everybody in the company should share the burden of income reduction. Thus management up to the members of the executive board where also affected by the income reduction. With regard to the shortening of the working hours however, no restriction was put on management. In fact, the working hours of many senior white-collar employees and of management increased considerably because of the reduction of working hours for employees covered by the collective agreement.

The work sharing agreement was designed as a measure to cope with the difficult employment situation, but it was not perceived as temporary. Its duration was limited to two years with the understanding that it would be continued. In September 1995 a new agreement was reached, however with some modifications. Thus, a "performance contribution" of the indirect areas was introduced raising the weekly work time for the indirect hourly and salaried employees by 1.2 hours up to 30 hours per week. Another modification was the flexibilisation of working time to a maximum of 38 hours per week as long as the 28.8 or 30 hours average was reached over a one year period. In a follow-up agreement of June 1996 this one year limitation was abandoned and the concept of an individual "time asset" was created whereby overtime work (exceeding 28.8 or 30 hours) could be saved on an individual time bank-account for longer leave or absence or for early retirement. The flexibilisation of weekly work time was regarded by

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7 Employment security had been a central issue at Volkswagen since the mid-1970s, and the policy of avoiding dismissals was a centrepiece of VW's industrial model from that point on. A former labour director entitled a book he edited on the employment risks of new technology "Working Without Fear" (Briam, 1986). His successor in 1993 took up this motto in his book on the work sharing agreement in 1993: "Each Workplace has a Human Face" (Hartz, 1994).

management as an important step to give factories space to "breathe" in response to fluctuations in order volumes (see Hartz, 1996).

In the current situation of an expected global recession, this approach is widely acclaimed even by its former critics. Due to the possibility to respond to shifts in demand and "breathe" with its capacity in a corridor between 21.8 and 38.8 hours Volkswagen is seen to be well prepared for a recession (cf. Roland Berger and financial analysts quoted in Wolfsburger Allgemeine Zeitung, 10.10.2001, "Volkswagen gilt als krisenfest").

3.7 The Works Councils as Guardians against Short-Termedness

If we don't find any evidence of a shift towards financialisation in the figures, what about the processes? Of particular importance in this regard is the process of investment planning and investment decisions. Let us take a closer look at these processes now.

Investment decisions are part of the yearly "planning rounds". The planning process is from June to October, the decision is in November. In the first stage the decentralized areas, plants, put together their investment plans. The aggregated plans usually exceed the financing possibilities of the company. During the following months central finance and the decentralized areas work out the details and try to narrow the gap between what they think is necessary or financially viable. During the budgetary period, performance is monitored on a monthly basis. There is no general policy on sanctions for overrunning the budget. In any case, it is more a career issue than one of bonus payments or stock options if performance targets are not reached resp. beaten. In the business areas the question of deciding sanctions for deviating from targets can be decided decentrally. Keeping to the budget could indeed be a criterion for bonus allocation.

During the planning round, the works council is closely involved throughout the whole period. Already at this decentralized, works level of detailed planning, the works councils are intensively involved. This is also true for the financial assessment of investment projects. As part of the policy of "location protection" works councils are particularly interested in attracting innovative projects such as the 3-litre car, and of preventing outsourcing. Thus in the case of innovation projects proposed by R&D, according to a works council interviewee during our investigation, a point to check would be whether the new product can be produced in-house and whether investment in process equipment and competencies are to be made to this end. For instance, the works council would point at the need to better coordinate product and process engineering points of view. While this may also be part of the original investment proposal, the works council observes that from the R&D perspective it seems irrelevant whether the new part is produced in-house or by a supplier. However, from the view of protecting employment using and developing in-house capacities would be better, of course.

Investment projects have to meet the criterion of a 40% return on investment (ROI), i.e. they have to amortise within 2 ½ years. This period even has been shortened in recent time. How does this affect projects which are more long-term oriented, but with a high innovation potential?

There are two special funds for business area projects beyond their normal budgets. One is a fund for insourcing and innovative investment endowed with a three-digit million DM sum. Projects supported by these funds do not have to reach the 40% ROI limit. The second fund is for innovation-related overhead costs. Both funds are intended to provide impulse money for new processes and are used mainly by cross-functional projects. Often the innovation projects thus funded here are human-capital oriented. The emphasis is not on technology development as this is regarded as a standard task to be financed out of the normal budgets.

As to the question whether the shift towards decentralized controlling systems and result orientation has negative effects on vocational and further training spending: Is there reluctance on the part of business unit management to "buy" services from the training department which was set up as an independent subsidiary at Volkswagen, the "Coaching-GmbH"? In order to prevent such an attitude among decentralized management, the cost of apprenticeship training is covered by central overhead. Thus the budget for "Coaching" apprenticeship training is negotiated between finance and Coaching at the central level. In the past this was also the case with regard to further training. This has changed and the business areas now have to pay for further training out of their budgets. There is no indication of attempts by decentralized management to save on further training expenses. Firstly, the budget logic is still in place, secondly even under a results-oriented system management is not expected to save on human capital expenses. In any case the works council has a clear position should this happen. If there were a problem with training expenses, according to the works council interviewee, the works council would make sure that finance was provided. At the same time it would support measures to make training more cost-efficient and effective and thus save on the costs and take an active position in reforming the vocational training system. Here we have another example of co-management. With regard to further training Volkswagen has installed a system to make sure that training expenses necessary in connection with the introduction of new technology do not fall prey to financial constraints. The system goes back as far as joint agreements between the company and the works council in the 1980s. For each investment project of a certain size (the threshold is usually DM 1 million) planners are required to factor in costs for further training in the cost calculation for the investment project. Project plans have to include a detailed account of impacts on personnel in terms of headcount, qualification, training requirements. After the investment project has been approved, the money for further training is part of the budget and "Coaching", the VW training subsidiary, can use this as a planning basis for designing its training activities.

Spending on further training thus has to go through the ROI calculations. And, according to our interviews, conflict often arises in trying to reach the 40% target training expenses. But, in the event of conflict, Coaching as a training needs protagonist can always rely on support from very high up in the supervisory board.

As was already mentioned, there has been no major case of outsourcing at VW. Despite considerable activities in this sector Volkswagen has not (yet) established a separate business unit for automotive supplies. Besides engines and transmission VW still produces drive train components such as axles, steering gear, brakes, it still has instrument panel production and seating components. Instead of outsourcing its component production Volkswagen has pursued a policy of upgrading the capabilities of its component

production units. They have to compete with external suppliers in the bidding process for new production programs, however, and thereby to demonstrate their cost competitiveness. Rather than following an outsourcing policy the company has sought to develop the capabilities of its component units (specifically in the area of breaking systems and drive train parts), to upgrade their R&D potential and develop them into systems suppliers. In view of the increasing relevance of electronics and software, the company has developed an "electronics strategy" to initiate *insourcing* in core areas.

The obvious productionist orientation regarding the structure of the company and the range of operations has become an issue of controversy just recently. Obviously relating to discussions in the context of the 2001 planning round the head of VW's corporate council, Volkert, recently came out publicly demanding an "energetic strategy in the area of component and electronics production within the group". The author demanded that the West German VW locations should be modernised through a special investment programme. They should be made fit for the future by raising them to the same level of technology of the new factories of the group in The Czech Republic, Brazil and Hungary. If the executive board wants group-internal competition, the head of the works council argued, it has to make sure that the plants compete under same conditions. In view of the "future challenge auto electronics" he demanded more emphasis and money. It cannot be, he argued, that such a strategy would be judged primarily under budgetary aspects "with the mentality of bean counters". In the future all auto components will be based on electronics and accordingly more and more value-added and employment in auto production will be dependent on electronics. We have to prevent a scenario, Volkert demanded, that in the future there will be a Golf made by Bosch or Sony with the design coming from Volkswagen. ("VW braucht Elektronik-Kompetenz", an interview with the head of the works council Klaus Volkert, Braunschweiger Zeitung, 25.7.2001)

3.8 Transition at the Top: A Critical Test

In a meeting held at the beginning of September 2001, the supervisory board, unexpectedly, nominated the successor of Piëch as head of Volkswagen's executive board from April 2002. Originally this decision was expected for the November meeting of the supervisory board. The surprise decision was the result of meetings between the Prime Minister of the Land Niedersachsen and the representatives of the IG Metall and the works council on the supervisory board determined to take action in order to prevent further speculations regarding Piëch's plans concerning successorship. But there were other reasons behind this early nomination commented by the press as slap on the face of Piëch.

One reason was dissatisfaction with Volkswagen's venture into the luxury range of car production. From the works council side this policy has been criticised repeatedly as burning money which better could have been spent on niche cars missing in Volkswagen's product range such as sport utilities and on modernising Volkswagen's German production plants in order to make them competitive with the new sites set up abroad.

Another reason were plans to restructure the corporation into a holding, thereby merging Volkswagen's eight brands into two separate product lines, one for sporty and one

for classic cars. In this way Volkswagen and Audi would have lost their prominent positions within the VW Group being merged, organisationally, with Škoda, resp. Seat etc.

The third reason was the way Piëch had criticised Audi. In a quite unusual way Piëch had criticised Audi to have dramatically failed in reaching its target rate of return. Piëch also criticised a lack of innovativity in Audi's product development activities. While this critique was obviously related to Piëch's plans of restructuring Volkswagen and a justification for depriving Audi of its independence, it was also a manifestation of the rigidity with which Piëch had pursued his intention of achieving the goal of the 6.5% return on sales target. The way in which Audi reacted was indeed confirming all the critiques concerning the negative consequences of financialisation. To reach the 6.5% target Audi desperately sought to save on all accounts. With 4.1% Audi had markedly underperformed in the first half year. As a consequence R&D budgets were reduced or cut altogether. According to information from R&D employees at Audi reported by the Frankfurter Allgemeine Zeitung, recruitment into product development was stopped and many development projects were delayed by four months until 2002 (Frankfurter Allgemeine Zeitung, 8.9.2001, "Warum bei Volkswagen kräftig gespart werden muss").

While the head of the corporate works council did not observe such negative consequences of the profitability target as a general tendency, there was obvious concern. In any case, the successor of Piëch, Pischetsrieder, in his first statements has put the fixation of a rigid rate of return target into question: "There would be no problem to show a 6.5% rate of return in the balance sheet. We could achieve this by just reducing the investments. But this is exactly what we don't want to do." According to Pischetsrieder, this was the very mistake made by Chrysler, once the car company with the highest rate of profitability. The US company had invested only 3.5% of turnover as compared to an industry average of 8%. (Financial Times Deutschland, 12.9.2001)

4. Summary and Conclusions

Summarising our findings, we relate to the six central questions of this study listed in the introduction.

Firstly, to what extent have the distinct characteristics of VW's corporate governance system changed in response to capital market/shareholder-value demands? Characteristic features of Volkswagen's corporate governance system are the special role of the state based on the Volkswagen-law and the special industrial relations system. We have not found a fundamental change of this corporate governance system due to capital market pressure and shareholder value demands. The distinctiveness of the corporate governance system was confirmed rather by the way a response to this pressure on these demands were sought. Shareholder value has not become the primary goal at VW as it has in other companies. Rather the need to balance this goal with other stakeholder interests was stressed. The concept of "workholder value" is a manifestation of this.

All measures related to shareholder value in the company were carried jointly by management and works council. This does not mean that there were no conflicts in specific cases. As the events in connection with the early nomination of a successor to Piëch has shown these fundamentals of VW's corporate governance systems have demonstrated

their strength and resilience in times of conflict. In such a situation as was formulated recently by a leading representative of VW's corporate works council, the representation of labour interests in the supervisory board based on the codetermination system and the VW-Gesetze and the block ownership of shares by the Land Niedersachsen together make up a "bulwark against short-termed profit thinking of capital" (Uhl: "Ein Bollwerk gegen das Kapital", in: Wolfsburger Nachrichten, 19.9.2001).

Secondly, what is the role of stock markets and to what extent does VW rely on stocks to finance operations? It is the policy of the company to finance its operations out of the cash flow. There have been only few occasions in VW's history so far, when new capital was issued and this was related in most cases with major acquisitions or new product programmes. Since a few years the function of shares as potential "acquisition money" has received special attention at Volkswagen. In view of the unfavourable conditions on the stock markets, negative responses of investors and financial analysts to issue new capital for acquisition purposes, Volkswagen has not used this instrument on a wide scale so far. However, the company disposes of a full chest of such acquisition money after the company has realised a 10% share buy-back programme and has received the authorisation to buy back another 10% of its shares. It can therefore be expected that major acquisitions could be announced in the future (a recent example was ABN Amro-Leasing, as was described earlier).

Rather than as a means for financing the more important role the stock market played for Volkswagen was in its function as a market for corporate control. The low market valuation of the company made it an easy pray for attempts of a hostile takeover. In view of the critique of the Volkswagen-law by the EU and rumoured interests of car companies to buy VW this was regarded as a real threat by the actors at VW. The fear of a hostile takeover has been the main driver for a number of measures to enhance investor relations and improve the profitability of the company.

Thirdly, have incentive systems changed in the direction of capital-market oriented performance measures? If we narrow this down to the question of introduction of stock options – stock options have been introduced since recently. However, the connection to business unit performance is weak. The opening up of the stock options programme to the general workforce shows a more general intent to increase employee stock ownership and not to use stock options specifically to motivate in the direction of capital market oriented performance.

Fourthly, have systems of target setting and controlling changed to better correspond with shareholder expectations? As was shown, the setting of a fixed profit target and a strong commitment of top management to achieve this, has been driving changes after it was linked to a specific date. As the events around Audi in 2001 have shown, non-performing in view of these targets can have quite negative consequences for individual business units. But the Audi case was special, it was linked with other considerations of company politics. At the current stage it is unclear to what extent the targets will actually affect management decisions decentrally und what effects reaching or not reaching targets have for decentral management.

Fifthly, on effects regarding decisions of investment and disinvestment. What is the effect on the long-term innovation potential of the firms? The events around Audi have shown that there is a real danger for long-term innovation if performance targets play

the dominant role. At the same time these events have shown the crucial role of the works councils and of Volkswagen's corporate governance system to keep performance goals in balance with other goals. The involvement of the works councils in VW's co-management environment so far has strongly supported productionist orientation against financialisation. The works councils play a unique role compared to other car manufacturers in the degree of involvement in investment planning and investment decisions. This has led to the fact that VW did not follow other companies with regard to outsourcing and disinvestment. The company has rather sought to insource critical new component technologies and corresponding capabilities.

Sixthly and finally, what are the effects on economic and financial performance? As Table 10 shows, key financial figures have developed positively during the period we discussed in this paper. The figures show clearly a positive trend. Thus we can conclude that the balanced approach of shareholder and workholder interests did not have a negative impact on financial indicators. This finding is confirmed when we compare Volkswagen's performance with the performance of competitors which have put different emphasis on shareholder value orientation. A comparison between Fiat, PSA, Renault and Volkswagen has come to the following result (Jürgens et al., 2002):

Table 10: Key Figures Relating to VW's Financial and Earnings Position

	1996	1997	1998	1999	2000
Cash-flow as % of capital investments in tangible fixed assets[1)]	99.7	92.7	102.3	102.9	122.2
Cash-flow as % of sales proceeds[1)]	7.9	7.3	9.2	8.2	9.7
Capital investments in tangible fixed assets as % of sales proceeds[1)]	8.0	7.9	9.0	8.0	8.0
Return on sales before tax (%)	2.0	3.4	4.7	3.4	4.1
Return on sales after tax (%)	0.7	1.2	1.7	1.1	2.4
Return on equity after tax (%)	5.2	9.8	13.6	8.6	19.1
Return on investment after tax (%)[1) 2)]		4.8	7.3	6.9	7.0

1) Automotive Division, from 1999 excluding Financing Division
2) Standardized operating profit after tax as percentage of average capital invested for the return (ROI or ROCE)

If we order the trend towards shareholder value management policy for the four car companies studied, the scale would be: from VW (less) to PSA, then Renault and, finally, Fiat (more). This order is clearly not related to the type of control, family/state. The analysis of these firms trajectories needs other hypotheses (for example Boyer and Freyssenet, 2002), which clearly confirm the limited role of this explanation factor.

If we take the two indicators employment development and development of gross profit margins as the economic performance indicators representing the different points of interest of employees on the one hand and of shareholders on the other, the companies rank almost in the reverse order to their ranking according to their shareholder value management policy: companies which are the more engaged towards shareholder value

policy are the less performing for capital as well as labour (Fiat, and Renault whose 2001's results would be worth) and the better performers are the more reluctant to the introduction of shareholder value policy (PSA and VW).[8] In view of our findings we may even reverse the causality and claim that the companies which achieve better economic performance have been less under pressure of shareholders, especially institutional investors (Dupuy and Lung, 2002).

Table 11: Two Criteria for Economic Performance in the 90s: Employment and Gross Profit Margin

	1995	**1996**	**1997**	**1998**	**1999**	**2000**
Employment growth (index 100 in 1995)						
Fiat Group	100.0	100.2	102.1	92.9	93.2	94.3
PSA	100.0	99.4	100.2	111.9	118.5	122.9
Renault	100.0	100.7	101.0	98.8	114.0	118.7
VW AG	100.0	107.5	113.3	122.9	126.3	133.8
Gross profit margin (profit before tax/revenue)						
Fiat Group	4.5%	4.9%	4.7%	3.2%	2.1%	1.8%
PSA	1.3%	0.4%	-0.2%	2.4%	3.1%	5.0%
Renault	1.1%	-3.1%	2.0%	4.6%	3.1%	4.3%
VW AG	1.3%	2.0%	3.4%	4.7%	5.0%	4.8%

Source: Volkswagen Annual Reports

In the short term it seems to be clear that economic performance in the auto industry is explained by other factors, especially by the success of the product policy. But the changing of corporate governance may have an effect on the medium/long term, as it implies a progressive change in the routines of the companies at all levels.

Altogether, VW presents a particular interesting case of responding to capital market pressures and shareholder value demands while continuing a productionist orientation and emphasising the need for long-term capability development.

8 Another source confirms this result: In July 2001, the Total Shareholder Return Index calculated by PricewaterhouseCoopers and published by *Automotive News Europe* indicated that PSA Peugeot-Citroën outperformed during the last twelve months – as well as the last three years – in the European car industry, while Fiat is the worst (destruction of shareholder value) regarding the two same criteria. VW follows PSA, performing better than Renault for 2000/2001.

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