Tesco Cooks the Books

As of 2014, British supermarket chain Tesco held approximately 29 percent of Britain's grocery market, with more than 3,500 stores and over 310,000 employees. Tesco was Britain's largest grocery chain and the third-largest retailer by sales in the world. But with shifts in the industry, changes in company management, and growing competition from rivals and discount chains, Tesco saw a decline in sales. From 2013 to 2014, the company saw its stock price fall by more than 50 percent. By October 2014, chairman Richard Broadbent announced his resignation.

Broadbent's resignation came in the wake of an internal investigation into the company's profit reporting. Tesco reported that it had overstated its profits by £263 million (approximately $423 million at the time), of which £118 million related to reports from the first half of 2014 and £145 million from the previous two years. The company stated that the discrepancy came from booking income from suppliers too quickly. Several other executives were asked to step aside, and the Serious Fraud Office (SFO) in Britain soon launched a criminal investigation into accounting irregularities. Britain's financial regulator, the Financial Conduct Authority, also began an investigation into company profits.

Tesco's finance director Carl Rogberg, managing director Chris Bush, and food commercial director John Scouler were charged with fraud by abuse of power and false accounting. According to prosecutor Sasha Wass, the three executives "encouraged the manipulation of profits and indeed pressurised others working under their control to misconduct themselves in such a way that the stock market was ultimately misled." Wass continued, "Each of these three defendants used their managerial authority and actively encouraged those working beneath them to falsify the figures."

Amit Soni, a whistleblower in the case and senior accountant at Tesco, said he alerted senior management to a profits misstatement in 2014. He reported that accounting teams were told to "pull forward" future income from suppliers by placing it on the books in advance of actually earning the money. This created a growing gap between budgets and the company's actual performance. He said his team was "falling apart" under pressure, stating, "It was to the point that even [my team] could see that the future was not looking any better."

In 2017, Tesco reached an agreement with the SFO to avoid criminal charges and instead enter a prosecution agreement and pay a penalty of £129 million (approximately $162 million at the time). In 2018, Rogberg suffered a heart attack, and the court prosecuting him, Bush, and Scouler chose to abandon the case. The SFO has left the option open to pursue a re-trial.

In response to the company's agreement with the SFO, Tesco chief executive Dave Lewis stated, "Over the last two and a half years, we have fully cooperated with this investigation into historic accounting practices, while at the same time fundamentally transforming our business. We sincerely regret the issues which occurred in 2014 and we are committed to doing everything we can to continue to restore trust in our business and brand."

Concept: Fiduciary Duty

Ethical Insight:

A fiduciary duty is a duty of trust and confidence. The officers of public companies have an obligation to report financial information fairly and accurately to the company's owners, the shareholders. In the face of declining profits, leaders at British grocery chain Tesco instructed accounting employees to "pull forward" future income from suppliers, which created misstatements in the company's accounting that went unreported. These illegitimate accounting practices, including illicitly recognizing income before it had truly been earned, and consequent financial misreporting created a major scandal for the company. Soon, Tesco became the subject of a criminal investigation for fraud; it had misrepresented the company's value to shareholders and the public at large.

Discussion Questions:

1. The officers of a public company owe a fiduciary duty, a duty of trust and confidence, to the company's shareholders. What was the fiduciary duty of Tesco? How did Tesco officers breach that duty? Why do you think Tesco did this? Explain.
2. Do you think the officers were actually trying to fulfill their fiduciary duty to act in the shareholders' best interests, but doing so in a wrongful (and ultimately self-defeating) way? Why or why not?
3. If the accounting irregularities had been an honest mistake, do you think Tesco would still be liable for breaking their fiduciary duty? Why or why not?
4. As the shareholder of a public company, would you want your company's officers to fudge the numbers in order to avoid damage to the company's share price?
5. If you were one of the accountants who faced pressure by managers to "pull forward" future income, what would you have done and why?
6. In what other ways might corporate officers breach their fiduciary duty to shareholders?
7. Do you believe that corporate officers should owe a fiduciary duty only to shareholders, and not to other sorts of company constituents, such as employees, suppliers, and customers?

8. Can you think of other examples of companies that have broken their fiduciary duties? What was the fiduciary duty of the company and how did the breach of trust affect the company?
9. Tesco's case demonstrates the pitfalls of a number of biases and behaviors. Can you identify other behavioral ethics concepts at work in this case study? Explain and discuss their significance.

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