Ethical Principles in Corporate Financial Management: A Literature Study on Investment and Risk

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A R T I C L E I N F O

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A B S T R A C T

The application of ethical principles in corporate financial management is a crucial aspect that influences the integrity of investment decisions and the effectiveness of risk management. This study examines the challenges faced by companies in internalizing ethical values into financial practices through a systematic literature review approach. Based on an analysis of various scientific sources, it was found that conflicts of interest between managers and shareholders, weak organizational culture, inconsistent internal supervision, and external pressure from the market are the main obstacles to the consistent application of ethical principles. The lack of accountability, global regulatory dynamics, and limited ethical awareness within organizations further complicate the application of ethical values in financial decision-making. This study emphasizes the need for a multidimensional approach in building a strong ethical framework within companies, including ethical leadership, continuous training, and a transparent and integrity-based accountability system. Thus, ethics is not only a normative discourse, but also a strategic foundation for sustainable and responsible financial management. These findings make an important contribution to the development of corporate financial ethics theory and practice.

INTRODUCTION

In recent decades, attention to the application of ethical principles in corporate financial management has increased significantly. This phenomenon emerged in response to various major financial scandals that shook global markets, such as the Enron scandal in the early 2000s, which highlighted the importance of transparency and accountability in corporate financial practices. The scandal revealed how financial statement manipulation and disregard for ethical principles can undermine public trust and cause significant financial losses (Lemus & Orta, 2014).

As a result of these events, many companies and regulators began to emphasize the importance of integrity in financial decision-making. Ethical principles, such as honesty, responsibility, and transparency, are now considered the foundation of investment decision-making and risk management processes (Hartman et al., 2011). This is reflected in the implementation of regulations such as the Sarbanes-Oxley Act in the United States, which aims to increase accountability and prevent financial manipulation (Engelen & van Essen, 2012).

In the context of corporate financial management, the application of ethical principles is not limited to regulatory compliance, but also includes moral considerations in investment decision-making (Richardson, 2009). Socially responsible investing (SRI) is a concrete example of how companies can integrate ethical values into their investment strategies (Berry & Junkus, 2013). SRI involves selecting investments based on environmental, social, and governance (ESG) criteria, reflecting a company's commitment to sustainability and social responsibility (Puaschunder, 2012).

Risk management is also increasingly influenced by ethical considerations. Companies now tend to identify and manage risks that could affect their reputation and relationships with stakeholders, rather than focusing solely on financial aspects. This approach shows that effective risk management must include an evaluation of the social and environmental impacts of a company's financial decisions (Landi et al., 2022).

The phenomenon of conflicts of interest in corporate financial management has become a central issue in agency theory studies (Panda & Leepsa, 2017). According to Jensen and Meckling (1976), this conflict arises when managers (agents) have personal incentives that are not in line with the interests of shareholders (principals), which can lead to suboptimal

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and detrimental decision-making for the company. Practices such as financial statement manipulation and tax avoidance often occur, creating uncertainty and damaging market confidence in the company's integrity (Healy & Wahlen, 1999). A real-life example of this is the Enron scandal, in which management engaged in creative accounting practices to hide debt and inflate profits, ultimately leading to the company's bankruptcy (Healy & Wahlen, 1999).

The challenge of ensuring the internalization of ethical principles within corporate culture is also a significant issue. The phenomenon of "tone at the top" shows that the attitudes and behaviors of top leaders greatly influence the ethical culture within an organization (Arjoon, 2019). If leaders do not demonstrate a genuine commitment to ethics, then these values tend not to be internalized by employees, which can lead to unethical behavior in financial decision-making. For example, in the Volkswagen scandal, unethical managerial decisions related to the manipulation of motor vehicle emissions tests show how failure to set a strong tone at the top can contribute to serious ethical violations (Hotten, 2015).

The lack of an effective monitoring system also exacerbates this problem. Weak internal audits and a lack of transparency in financial reporting enable management to commit irregularities and abuse their authority (Nwaobia et al., 2016). According to Cohen et al. (2002), inadequate supervision can lead to poor quality financial reports and increase the risk of fraud. This is exacerbated by pressure from stakeholders to achieve high financial performance in a short period of time, which can encourage management to take unethical measures to meet these expectations (Cohen et al., 2002).

The main problem in applying ethical principles in corporate financial management involves the complexity of the relationship between management and shareholders, as well as the challenge of building and maintaining a strong ethical culture within the organization. Failure to manage conflicts of interest and ensure the internalization of ethical values can lead to decisions that are detrimental to the company and other stakeholders, as well as damage the company's reputation and long-term sustainability (Hartman et al., 2011).

The importance of observing the application of ethical principles in corporate financial management is related to regulatory compliance, as well as the sustainability and long-term reputation of the company. Companies that fail to integrate ethics into financial decisions risk facing a reputation crisis, legal sanctions, and significant financial losses. Studies in this field are therefore essential to identify best practices and develop frameworks that can help corporates make ethical and responsible financial decisions.

This study aims to analyze the application of ethical principles in investment decision-making and risk management in corporates, as well as to identify the challenges faced in its implementation. Through a literature review, it is hoped that insights can be found that can help corporates integrate ethical values into their financial management practices.

RESEARCH METHOD

This study uses a literature review approach to analyze the application of ethical principles in corporate financial management, with a focus on investment decision-making and risk management. This approach was chosen because it allows researchers to collect, evaluate, and synthesize findings from various previous studies, thereby providing a comprehensive overview of the topic under study (Webster & Watson, 2002). Literature studies are also effective in identifying research gaps and developing conceptual frameworks for further research (Denyer & Tranfield, 2009).

The literature review process began with the identification of relevant sources, including reputable international journals, books, and industry reports published between 2000 and 2010. Inclusion criteria included studies discussing the application of ethical principles in the context of financial management, investment decision-making, and risk management. Exclusion criteria included studies that were irrelevant to the topic, not peer-reviewed, or published outside the specified time frame. The selection process was conducted through searches of academic databases such as JSTOR, ScienceDirect, and Google Scholar, using keywords such as "ethical principles in financial management," "corporate finance ethics," "investment decision ethics," and "risk management ethics."

After collecting the literature, the next step is to analyze and synthesize the findings. The analysis is conducted by categorizing studies based on main themes, such as conflicts of interest in decision-making, internalization of ethical principles in corporate culture, and challenges in implementing ethical principles. Synthesis is carried out to identify patterns, similarities, and differences among studies, as well as to develop deeper insights into the application of ethical principles in corporate financial management. This approach allows researchers to develop evidence-based understanding of the topic under study (Tranfield, Denyer, & Smart, 2003).

This literature study method is expected to contribute significantly to the understanding of the importance of applying ethical principles in corporate financial management. By identifying challenges and best practices in the implementation of ethical principles, this study can provide a basis for the development of more ethical and responsible managerial policies and practices in financial decision-making.

RESULT AND DISCUSSION

Application of Ethical Principles in Investment Decision Making and Risk Management

The application of ethical principles in investment decision-making and risk management in companies is a crucial aspect that affects financial performance, as well as the reputation and long-term sustainability of the company. Ethical principles include integrity, transparency, and social responsibility, which must be integrated into every aspect of financial decision-making (Sharma, 2023).

In investment decision-making, the application of ethical principles requires companies to consider the social and environmental impacts of their investments (Hofmann et al., 2008). Investments that focus solely on financial gain without regard for ethical considerations can pose significant reputational and legal risks (Renneboog et al., 2008). For example, investments in corporations involved in human rights violations or environmental damage can damage a corporation's image and reduce stakeholder confidence (Gupta et al., 2014).

In risk management, ethical principles require corporations to identify and manage risks from a financial perspective, as well as from a social and environmental impact perspective. Neglecting ethical risks can lead to greater long-term losses than potential short-term financial gains (Scharding, 2015). Corporations therefore need to develop policies and procedures that ensure that all risks, including ethical risks, are identified, evaluated, and managed appropriately (Viviers et al., 2008).

The implementation of ethical principles in investment decisions and risk management also requires a strong commitment from corporate leaders (Demidenko & McNutt, 2010). The phenomenon of "tone at the top" shows that the attitudes and behaviors of top leaders greatly influence the ethical culture within an organization (Arjoon, 2019). If leaders do not demonstrate a genuine commitment to ethical principles, then these values tend not to be internalized by employees, which can lead to unethical behavior in financial decision-making (Ware & Dethmer, 2012).

The lack of an effective monitoring system also exacerbates this problem. Weak internal audits and a lack of transparency in financial reporting enable management to commit irregularities and abuse their authority (Yao et al., 2017). According to Cohen et al. (2002), inadequate supervision can lead to poor quality financial reports and increase the risk of fraud. This is exacerbated by pressure from stakeholders to achieve high financial performance in a short period of time, which can encourage management to take unethical measures to meet these expectations (Vujnović-Gligorić et al., 2018).

The application of ethical principles is a moral obligation and a smart business strategy (Chang, 2021). Corporations that integrate ethical principles into their investment decisions and risk management tend to have a better reputation, stronger relationships with stakeholders, and more stable financial performance in the long term (Jacob, 2012). Conversely, corporations that disregard ethical principles risk facing scandals, litigation, and financial losses that can damage their business sustainability.

It is therefore important for corporations to develop and implement clear ethical policies, involve all levels of the organization in their implementation, and ensure that there is an effective monitoring system in place to detect and prevent ethical violations. In this way, the application of ethical principles in investment decision-making and risk management will improve corporate performance and contribute to sustainable and responsible economic development.

Challenges in Implementing Ethical Principles in Corporate Financial Management

Corporations face various challenges in applying ethical principles in their financial management, which can influence investment decisions and risk management (Boatright, 2010). These challenges include conflicts of interest, organizational cultural influences, transparency limitations, and external pressures that can lead to unethical behavior. The inability to overcome these challenges can result in decisions that are detrimental to both the corporation and its stakeholders (Karadag, 2015). The corporation's reputation may be threatened, which in turn can reduce investor and customer confidence and affect long-term business sustainability (Kerich, 2016).

One of the main challenges is the conflict of interest that arises between management and shareholders (Ingley & Van Der, 2004). According to agency theory, differences in objectives between principals and agents can cause agents to act contrary to the interests of principals, especially if the incentives provided are not aligned with the company's long-term objectives (Pepper & Gore, 2015). For example, managers may focus more on achieving short-term targets to earn bonuses, even though this may harm the corporate long-term financial health (Chouhan & Naghshbandi, 2012).

An organizational culture that does not support ethical principles can also be a significant obstacle. The phenomenon of "tone at the top" shows that the attitudes and behaviors of top leaders greatly influence the ethical culture within an organization (Arjoon, 2019). If leaders do not demonstrate a genuine commitment to ethical principles, then these values tend not to be internalized by employees, which can lead to unethical behavior in financial decision-making (Cheng & Ho, 2019).

Limited transparency in financial reporting and information disclosure also poses a major challenge (Barth & Schipper, 2008). The lack of clear and consistent standards in financial reporting can result in the information presented not accurately reflecting the company's financial condition, making it difficult for stakeholders to make informed and ethical decisions (Evers et al., 2014).

External pressure from investors and the market can also encourage corporations to disregard ethical principles in order to achieve quick financial results (Bardy et al., 2012). Investors who are more focused on short-term profits may not consider the social and environmental impacts of their investments, thereby encouraging corporations to make unethical decisions in order to meet these expectations (Dhingra et al., 2014).

The lack of training and ethical awareness among employees is also an obstacle to the implementation of ethical principles. Without a sufficient understanding of the importance of ethics in financial decision-making, employees may not be aware of the consequences of their actions, which can lead to unethical behavior (Liesegang & Bartley, 2014).

Regulatory uncertainty and changing regulations can also make it difficult for companies to ensure that their practices remain in line with applicable ethical standards (Awrey et al., 2013). Rapid regulatory changes can make it difficult for corporate to adjust their policies and procedures, thereby increasing the risk of ethical violations (Owolabi & Omotilewa, 2020).

Corporations also face challenges in balancing social responsibility and financial profit. Investments in social and environmental initiatives often require additional costs, which can conflict with the goal of maximizing profits (Richardson, 2013). This can lead to ethical dilemmas in investment decision-making. Corporations must consider the long-term impact of their decisions on the community and the environment, which can affect their reputation and business sustainability (Siegrist et al., 2020). Pressure from stakeholders to achieve quick financial results often hinders efforts to invest in greater social responsibility (Altenburger, 2018).

The lack of accountability and internal oversight can also enable abuse of authority and unethical decision-making. Without an effective oversight system, individuals within the organization may feel that there are no consequences for their actions, which can lead to unethical behavior (Sherif et al., 2016). This undermines the integrity of the organization and can result in significant financial and reputational losses. An opaque work environment can also lower employee morale and reduce public trust in the corporation, ultimately negatively impacting long-term performance (Ramachandran, 2010).

Corporate must also face the challenge of managing the differing expectations of various stakeholders. Stakeholders such as customers, employees, and local communities may have different expectations regarding corporate ethical practices, making it difficult for corporations to meet all of these expectations simultaneously (Deus et al., 2019).

Finally, globalization and cross-border operations add complexity to the application of ethical principles (Nadalutti, 2020). Cultural differences and ethical standards between countries can make it difficult for corporations to establish consistent ethical policies across their operations, which can increase the risk of ethical violations.

Overall, these challenges demonstrate that applying ethical principles in corporate financial management requires strong commitment from all levels of the organization, as well as supportive systems and policies to ensure that financial decisions are made with consideration for broader social and environmental impacts.

CONCLUSION

The application of ethical principles in corporation financial management is a fundamental element that has a direct impact on the quality of investment decisions and the effectiveness of risk management. The success of ethical implementation is determined by external regulations, which are greatly influenced by internal organizational commitment, particularly leadership and corporate culture. Neglecting ethical values in financial decision-making causes financial losses and can threaten the company's reputation, stakeholder trust, and long-term sustainability.

A number of complex challenges have been identified in efforts to apply ethical principles to financial management practices. Conflicts of interest between management and shareholders, market pressure for short-term results, unclear accountability systems, weak internal oversight, and organizational cultural barriers are factors that significantly hinder the consistent application of ethics. These challenges are exacerbated by limited resources for building ethical awareness and strengthening organizational integrity, as well as global dynamics that expand the complexity of ethical standards and practices.

From this analysis, it is important for businesses, regulators, and other stakeholders to strengthen the ethical architecture within corporations. This includes developing a rigorous internal monitoring system, providing ongoing ethics training, and integrating ethical principles into strategic decision-making policies. Without proper and structured commitment, corporations risk becoming entangled in ethical dilemmas that ultimately harm all parties involved.

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