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**Review Article**

# The CFO financial performance and the financial market scenario: A Review

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**Abstract:**

This article introduces a literature review on the CFO's financial performance in the ever-challenging Brazilian financial market scenario. Key findings pointed out that the CFO of unlisted companies shows a lower inclination to estimate the cost of equity. The study also highlighted the need for technical and organizational solutions to agency problems, such as sound corporate governance practices, computer-aided accounting systems, incentive-based compensation, clear performance goals, and delegation of operational decisions. The study also examined the CFO's perspective and the companies' strategic ecosystem, finding that duality in the roles can negatively impact financial reporting quality.

**Keywords: CFO; Financial Performance; Agency Problems; Corporate Governance**

## Introduction

This article outlines a review of the literature on CFOs' financial performance, based on the doctoral thesis of one of the authors (Pereira, 2023), including the economic uncertainty environment context of the Brazilian economy. Firstly, Ching and Gerab (2012) investigated the impact of corporate governance practices on a company's financial performance. The research uses the Corporate Governance Perception Index (CGPI) to measure operational and stock performance. Their results showed that corporate governance practices positively affect operational performance (CR, ROA, ROE) and stock performance (PBV).

The Chief Financial Officer (CFO) plays a pivotal role as a transformative change catalyst and a trusted confidant to the Chief Executive Officer (CEO) (Chandra et al., 2018). While the Agency and Contingency theories provide a framework for understanding the principal (CEO) - agent (CFO) relationship (Eisenhardt, 1989), the majority of studies are conducted from the employers' perspective.

Historically, the CFO role originated from the corporate demand for a financial control system's gatekeeper, a right-hand man for the CEO. Furthermore, a definite trend in the evolution of CFO competencies has attracted scholars' attention over the past decades. According to Zorn (2004), the CFO role expanded and became a key player in strategic and operational decisions based on enhanced visibility and power.

In addition, the role of CFOs is primarily focused on the CFO as (a) a leader (Bass, 1990; Goleman, 2000; Dias et al., 2023; Dias et al., 2022; Morrow & Stern, 1988; Lippitt, 1999; Maccoby, 1979; Bales & Slater, 1955; Benne & Sheats, 1948; Burns, 1978). Also, (b) CFO's financial performance (Ching & Gerab, 2012); (c) capital budgeting techniques (Mendes-Da-Silva & Saito, 2014); (d) organizational structure and agency costs (Chaddad & Valentinov, 2017); (e) the relationship between CFOs and the financial market scenario (Benetti et al., 2022), and the (f) strategic ecosystem of companies (Buchheit et al., 2019; Favaro, 2001; Walther & Johansson, 1998).

In sum, despite many studies on performance, leadership, and scenarios, the factors that influence the activity still need to be uncovered, a shortcoming this research addresses. In addition, the study on the Brazilian scenario remains uncovered. Nevertheless, we acknowledge that new scenarios and markets do not constitute a theoretical contribution, following Whetten (1989). Therefore, this study contributes by exploring the factors that will help explain the mechanism of building a loyal relationship between the principal and agent from the agent's perspective.

## Background

The Brazilian political-economic uncertainties lead the senior corporate executives to make strategic decisions to enhance the company's competitiveness. According to Gea et al. (2021), Brazil has experienced several political shocks, such as (i) Operations Car Wash (*Operação Lava Jato*) which accused several politicians of corruption, including the conviction and imprisonment of former president Luis Inacio Lula da Silva; (ii) the impeachment of President Dilma Rousseff; (iii) scandals of corruption in Michael Temer's administration (iv) the problematic relationship between Chief Executive Jair Bolsonaro and the other Powers of the Brazilian Republic (Gea et al., 2021), leading to economic policy uncertainty and market volatility in the last decade.

The economic uncertainty environment is illustrated by the Brazilian interest rate SELIC (Special Settlement and Custody System, or *Sistema Especial de Liquidação e Custódia*), which has shown more volatility in the last decades than the London Interbank Offered Rate (LIBOR), the world's most widely used financial benchmark (Schrimpf and Sushko, 2019). Despite the LIBOR rate being discontinued on June 30, 2023, its historical series meets the purposes of this research. The replacement rate (SOFR) would not be able to represent the desired historical series (2001-2021), which is why we maintained the LIBOR rate as a market reference. Figure 1 shows the comparison between the Brazilian Selic versus LIBOR evolution over the past two decades:

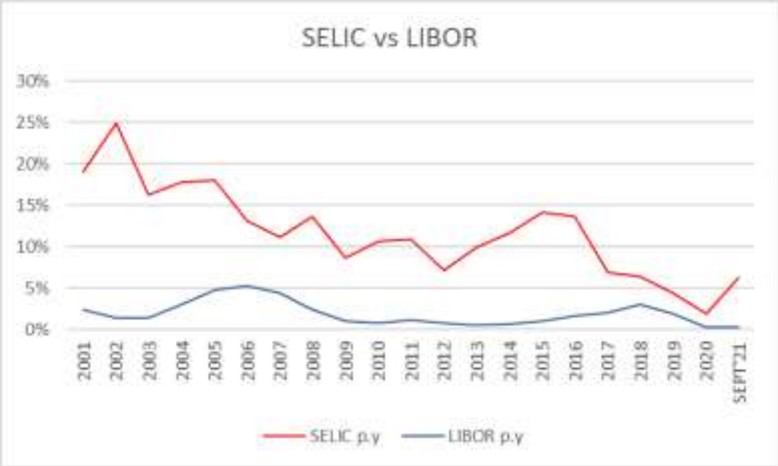


**Figure 1 Comparison between the Brazilian SELIC versus LIBOR evolution (2001-2020)**
**Source: BACEN, 2021; Bank of England, 2021.**

Compare in Figure 1 how SELIC (in red) is less stable than LIBOR[1] (in blue). SELIC and LIBOR were used to compare the volatile interest rate in the Brazilian market versus a relatively stable benchmark. In addition, the Brazilian government uses SELIC as the bank's overnight and introductory interest rates. Therefore, it is an essential monetary instrument to manage inflation and exchange rate pressures. LIBOR (London Interbank Offered Rate) is administered by the ICE (Intercontinental Exchange) and is considered a global reference benchmark for short-term interest rates. LIBOR is calculated in five currencies: (i) the UK Pound Sterling, (ii) the Swiss Franc, (iii) the Euro, (iv) the Japanese Yen, and (v) the U.S. dollar. It is a reliable benchmark for debt instruments, mortgages, corporate and personal loans, and government bonds.

According to Alvarez et al. (2001), it is a consensus that the short-term interest rate is an instrument of monetary policy to control inflation. Thus, the volatility in SELIC mainly indicates BACEN (Brazil Central Bank) adopting measurements periodically to control inflation and manage the country's economic growth. In comparison, LIBOR is calculated in mature countries' currencies and has a more linear curve without much volatility. Therefore, this comparison assumes that the Brazilian economy is more volatile than mature ones. Brazilian IT companies' CFOs have to make strategic decisions within this environment. In addition, the volatile Brazilian environment may influence the company's management and strategic decisions. Thus, Henderson and Venkatraman (1999) describe the interrelationship between external and internal components as a strategic fit. Within this ecosystem, the CFO plays an essential role in understanding market behavior, making sound recommendations to senior leadership, and strategically positioning the company to face competitors.

## II. Methodology

This research is cross-sectional, constructionist, interpretative, inductive, and qualitative. The present study employed a comprehensive literature review on the current epistemology on the topic

## III. The CFO financial performance

According to Mendes-Da-Silva & Saito (2014), which performed a comparative analysis of capital budgeting methodologies used by publicly listed and privately held firms in Brazil, a survey was conducted on a sample of 398 publicly listed companies and 300 large privately held companies, explicitly targeting these organizations' Chief Financial Officers (CFOs). Based on responses from 91 participants, the study indicated that CFOs of listed companies exhibit a greater propensity to employ more sophisticated financial evaluation techniques, such as Net Present Value (NPV) and Capital Asset Pricing Model (CAPM). Conversely, CFOs of unlisted companies, despite their significant size, demonstrate a lower inclination to estimate the cost of equity. As mentioned earlier, the results suggest that the capital budgeting process may need to be enhanced to meet the requirements of a stock market listing.

Benetti et al. (2022) reproduced a survey conducted in Brazil to understand the cost of capital, capital budgeting, and capital structure. The survey is similar to those in North America and Europe: Graham and Harvey's (2001) survey and the extended form

[1] Libor was phased out in 2021, prompting market participants to transition to risk-free interest rates like the Secured Overnight Financing Rate (SOFR). As of late 2022, parts of Libor have been discontinued, and the rest is set to end in summer 2023. The last rates were published on June 30, 2023, after writing this section.

employed by Brounen, de Jong, and Koedijk (2004). Our survey also resembles Bancel and Mittoo's (2004) survey, which aimed to understand how organizations interact within different institutions and make decisions in response to different constraints. The study provided insights into the corporate experience of capital budgeting, cost of capital, and capital structure reported by Brazilian CFOs, which suits our research objectives.

According to da Silva Filho, H. (2018), who investigated the CFO's job performance at the Brazilian luxury fashion business. Conversely, Favaro (2001) investigated that the traditional role of a CFO was to manage finances and inform the board, top management, and investment community. However, today, in his perspective, CFOs must lead in four key areas: strategic management, providing real-time information, transforming investor relations into a competitive advantage, and transcending finance to all company areas. On the other hand, Walther & Johansson (1998) investigated the strategic ecosystem of companies in North America. They found an ecosystem more straightforward, with black phones, Fords, checks, bathtubs, and America dominating the global productive capacity.

Buchheit et al. (2019) investigated whether the time spent on non-core CFO activities can negatively impact financial reporting quality. Their study examined the operational acumen of CFOs and the potential negative reporting consequences of CFO/COO duality. It found that duality occurs more frequently and is not uncommon. However, they found no evidence that combining the roles adversely affects operations. Finally, Buchheit et al. (2019) suggested that unifying control of operations and reporting can be an effective corporate reconfiguration.

## IV. Discussion

The research highlights the significance of CFOs in various areas such as financial performance, capital budgeting techniques, organizational structure, agency costs, financial market scenario, strategic ecosystem, and leadership. The findings indicate a favorable relationship between corporate governance standards and operational performance metrics such as cash flow return, return on assets, and return on equity. Capital budgeting techniques are also examined, with Mendes-Da-Silva & Saito's 2014 study finding that CFOs of listed companies tend to use more sophisticated financial evaluation techniques like Net Present Value (NPV) and Capital Asset Pricing Model (CAPM), while those of unlisted companies show a lower inclination to estimate the cost of equity.

In conclusion, the study highlights the importance of understanding the factors driving CFO activity in the Brazilian IT industry and the need for more comprehensive studies to better understand the CFO's decision-making process. The CFO's role has evolved over time, from managing finances to providing real-time information, transforming investor relations into a competitive advantage, and transcending finance to all company areas. The research gap is addressed by exploring factors that help explain the mechanism to build a loyal relationship between principal and agent from the agent's perspective, integrating agency and contingency theories. This expands previous studies based on the CFO perspective almost exclusively to understand the CFO-CEO link.

The top concerns and challenges for CFOs in Brazilian IT companies include motivating people, helping the CEO, interacting with clients, dealing with market and sales, and improving relationships with business partners. Motivation is a critical leadership skill that generates teamwork and can be achieved through remote leadership. The study also explores the impact of situational variables on CFO behavior given the challenging scenarios CFOs face in the Brazilian IT business environment. The top concerns and challenges for CFOs include motivating employees, helping the CEO, interacting with clients, dealing with market and sales, and improving relationships with business partners.

## V. Implications

CFO's performance, strategies, and leadership styles have been the subject of substantial study by scholars, politicians, stakeholders, and business professionals. However, the elements influencing the activity are seldom apparent. This study examines the relevance of these elements to stakeholders and the CEO, offering a novel viewpoint on their effect. The role of the Chief Financial Officer can contribute to understanding the new concerns and challenges a CFO faces daily by allowing many interest groups to influence the company's financial activity.

CFOs are top financial officers responsible for tracking cash flow, financial planning, analyzing company strengths and weaknesses, and proposing strategic directions. They are accountable to organizations' regulatory authorities and know the financial norms and regulations, depending on the country. In addition, the Chief Financial Officer (CFO) has a dual responsibility. Firstly, they are tasked with supervising the company's financial operations, which includes overseeing the finance and accounting professionals responsible for operational tasks. Secondly, they also serve as a strategic adviser to the Chief Executive Officer (CEO) and other high-level executives in the business.

CFOs play a crucial role in an organization's financial health, ensuring liquidity, a strong return on investment (ROI), and accurately forecasting future outcomes. They must manage customer payments, control expenses, and ensure a strong return on investment (ROI). CFOs also contribute to the company's financial reporting by analyzing internal and external factors affecting revenue and expenses. They rely on government data, analyst firms, business media, trade and association memberships, and input from board members, lenders, and others. Financial reports, including balance sheets and cash flow statements, help internal and external stakeholders understand the business's financial state. While private companies must file financial reports with the CVM (Comissão de Valores Mobiliários), the equivalent to the North American SEC, many businesses create these statements to ensure they are available for potential funding sources. However, it may also result in the concentration of power within influential leaders, leading to instances of unfair competition and the capture of policies. Therefore, this research provides new viewpoints on the factors influencing CFO activity.

Finally, this research may affect other fields and subfields of research, such as: (a) leadership styles (Pan & Dias, 2024; Dias et al., 2023; Dias et al., 2022; Vieira et al., 2021); (b) negotiation (Dias, 2021; Dias et al., 2021; Dias & Navarro, 2020); (c) trust (Santos & Dias, 2024, 2024a).

## VI. Future Research

Future researchers are encouraged to conduct statistical studies on a scale to assess the CFO's capabilities, which help describe job positions and assess future candidates. Further research is suggested to enrich the discourse in Brazil on the responsibilities and functions of Chief Financial Officers (CFOs) in various organizations. It is common practice to do comparative analyses of Brazilian Chief Financial Officers (CFOs) across many nations, including whole regions such as the Americas, Europe, and Asia.

## VII. Conclusion

In conclusion, the study highlights the importance of understanding the CFO's role in Brazilian companies and the factors influencing their activities. By addressing these concerns and challenges, the research contributes to a better understanding of the contingency theory and the role of the CFO in the organization.

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