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Editorial

DOES COST BEHAVIOR INFLUENCE THE ACCURACY OF RETURN FORECASTS?

Laura Brandão Costa (UFJF/GV)
laura.costa@ufjf.br
Currículo Lattes: http://lattes.cnpq.br/4478390096724399
Orcid ID: 0000-0002-0564-6818

Marcelo Tavares (UFU)
mtavares@ufu.br
Currículo Lattes: http://lattes.cnpq.br/4142478901587907
Orcid ID: 0000-0003-3008-3460

The traditional accounting perspective posits that an entity's costs adjust proportionally to variations in volume, thereby tracking the fluctuations in operational levels (Banker; Ciftci & Mashruwala, 2008). Conversely, uncertainties related to future demand, managerial decisions concerning resource allocation, and the contemporary macroeconomic environment may no longer be adequately accounted for under this framework. This situation underscores the necessity for an alternative conceptualization of cost behavior to more accurately elucidate cost dynamics, taking into consideration their implications for the managerial requirements of organizations (Novák; Dvorský; Popesko & Strouhal, 2017).

It is widely recognized, both within academic circles and in practical contexts, that there exists a broadly disseminated consensus regarding the linear behavior of costs in relation to volume. Nevertheless, for over two decades, an alternative interpretation has been under discussion, which posits that costs exhibit asymmetric dynamics in response to variations in operational activity (Anderson; Banker & Janakiraman, 2003). This behavior, termed the cost stickiness phenomenon, is underpinned by the Sticky Cost Theory, which asserts that costs respond asymmetrically to changes in operational levels, whether increases or decreases.

The operational activities of entities are influenced by the economic context, uncertainties regarding future demand, as well as investment deliberations by managers. Such factors result in managerial decisions that give rise to adjustment costs, which stem from the occurrence of cost reductions or additions that do not necessarily change proportionally with fluctuations in operational volume (Subramaniam & Watson, 2016). It can be inferred, therefore, that the cost stickiness phenomenon results from adjustments implemented by entities, which prevent costs from tracking volume variations proportionally, implying elasticity (asymmetry) in cost behavior.

Costs are understood to comprise variable and fixed components. In this regard, Kim & Prather-Kinsey (2010) assert that sales revenues and expenses evolve at different rates. Considering that cost information is internal and primarily based on strategic and managerial arguments, external users do not have access to it. For future projections and estimates, investors, for instance, use equal rates for revenues and expenses, which leads to errors in forecasts. Anderson et al. (2003) argue that fixed costs do not respond immediately to a reduction in operational volume, thereby causing cost stickiness.

This text aims to present arguments supporting the view that the asymmetric behavior of costs can impact returns and their future predictability. Furthermore, it posits the thesis that cost stickiness may also affect the accuracy and reliability of investment decisions within entities, from the perspective of external users of accounting information who lack access to strategic information related to costs and volume.

There is a well-established understanding in the literature that cost stickiness manifests, among other factors, due to managerial decisions wherein expenditures are incurred or eliminated based on expectations of demand for the entities (Ibrahim; Ali & Aboelkheir, 2022). These discretionary costs are more flexible and, therefore, dependent on return expectations for the entities (Medeiros; Costa; Silva, 2005). Much of this asymmetry can be explained by determining factors such as the utilization of productive capacity, empire building (managers' tendency to expand a firm beyond its optimal size), earnings targets, sales forecasting, and risk management (Tseng; Zhou; Gordon & Loeb, 2022).

In this context, cost forecasting is a fundamental part of profit forecasting (Weiss, 2010). However, investors, as external users of various entities, rely on published financial statements, and their lack of understanding regarding cost behavior can lead to judgment errors (Novák et al., 2017).

This situation is theoretically supported. Signaling Theory addresses information asymmetry between two parties. The theory posits that a signaling entity, possessing privileged information, makes it available in an environment with multiple receivers. These receivers, in turn, will only have access to the information if it is effectively signaled.

Signals are private pieces of information, which may be positive or negative, serving as transmitters of organizational attributes. However, for information to be considered a signal, it must be perceived by the receivers; for this to occur, the signaling party must demonstrate reliability so as to establish credible trustworthiness. Signaling to the market aims to reduce informational asymmetry (Conelly; Certo; Ireland & Reutzel, 2011).

From the perspective of Signaling Theory, it is understood that cost stickiness could be signaled by entities that publish financial statements to the capital market environment. Thus, receivers, from the investors' viewpoint, could incorporate it into their interpretations, analyses of financial statements, and return estimates, particularly in investment decisions. It is assumed that information has the potential to influence investment decisions. It is from this standpoint that this paper argues that cost stickiness should be signaled by entities to the capital market, thereby enabling interested investors to make more accurate and precise return forecasts, enhancing public financial information.

Brazil ranks among countries with emerging economies. In this context, there is a clear tendency for a large volume of capital to be traded (Ghysels; Plazzi & Valkanov, 2016). Given this, it is considered that entities operating in the Brazilian capital market are optimistic regarding future demand expectations and, therefore, are willing to incur new costs under the premise of anticipated increases in future sales (Costa, 2025).

When there is a willingness to assume new expenses beyond those already incurred, adjustment costs arise, which lead to cost asymmetry. In the case of more optimistic entities, the asymmetry is sticky, that is, the magnitude of cost increases associated with growth in operational activity exceeds the magnitude of cost reductions accompanying a decline in volume. This occurs because there are fixed components in the cost structure that do not promptly follow fluctuations in sales revenue.

Given the volume of capital traded in the Brazilian capital market, it is understood that entities are optimistic and prone to incur new costs based on positive future expectations. In this context, investors interested in the financial information of these entities—seek analyses of elements that indicate forecasts of returns on investments. However, these users may lack knowledge regarding the asymmetric behavior of costs and how such behavior may impact predictability (Costa, 2025).

It has been demonstrated that cost stickiness manifests both in its presence and magnitude, with the latter indicating the extent of fixed costs in an entity's structure. Anderson et al.'s (2003) model posits that the cost behavior to be estimated is the dependent variable, functioning as a response to changes in operational activity. Levels of asymmetry are identified by summing the estimated coefficients of the variables representing increases in sales revenue from the prior to the current period, and the variable identifying entities that experienced revenue declines between these periods. Therefore, using only historical financial information, sales revenue can serve as a proxy for operational volume, enabling verification of cost asymmetry (Costa, 2025).

Another important point is that investors focus on returns on investments. It is common for the analysis of financial statements to use current growth and profitability to assess future values. In this regard, Fairfield and Yohn (2001) argue that since financial statement analysis also aims to forecast future performance, disaggregating elements can improve profitability forecasts.

The DuPont analysis can be developed using accounting variables disclosed by entities. Fairfield and Yohn (2001) state that return on net operating assets (RNOA) includes financial assets and excludes operating liabilities from its base, making it similar to return on invested capital and a relevant indicator for investor analysis. RNOA is decomposed into asset turnover and profit margin, providing insights into growth in operating assets and the sales generated by these assets within organizations.

From the perspective of interpreting operating profitability, this decomposition enhances profitability forecasts because changes in asset turnover predict future changes in RNOA, proving useful in these estimates. The RNOA forecasting model treats RNOA as the dependent variable, with changes in asset turnover and profit margin as predictors (Penman & Zhang, 2002). However, based on Fairfield and Yohn's (2001) suggestion that further research should employ current financial statement information to improve future profitability forecasts, Costa (2025) incorporated cost stickiness variables into the RNOA predictability model to examine whether asymmetric cost behavior is associated with return forecasts.

It is argued that accounting reports disclosed to the market do not signal the asymmetric dynamics of costs. Therefore, to prevent misinterpretation or incomplete understanding of an entity's return persistence, forecasting errors, and biased investment decisions, there is the possibility of employing a model that considers cost asymmetry in forecasting returns on operating assets (Costa, 2025).

There is consensus that cost asymmetry exists among entities in the Brazilian capital market (Medeiros; Costa & Silva, 2005; Pereira & Tavares, 2020; Costa, 2025). Consequently, it was found that cost stickiness, both in presence and magnitude, is a phenomenon that negatively influences the prediction of future returns, with higher asymmetry levels associated with lower RNOA. Therefore, it is argued that the cost structure of publicly traded entities in Brazil likely includes significant fixed cost components. This results from new expenditures made in response to managers' optimistic expectations, which due to cost elasticity, lead to asymmetric behavior and, consequently, lower future RNOA values, negatively impacting forecasts (Costa, 2025).

On the other hand, although it is known that cost stickiness may be associated with lower future returns, models that incorporate this phenomenon in forecasts demonstrate greater precision. Weiss (2010) argues that reduced forecast errors imply higher accuracy, and that cost asymmetry serves as a proxy for more volatile earnings. It is therefore considered that, despite cost asymmetry signaling lower returns, its inclusion in forecasting models allows for more accurate estimates.

Thus, the model forecasting future returns that incorporates cost behavior incrementally enhances investment analyses, as it encompasses operational volume fluctuations and signals the incurrence of new costs by managers in response to optimistic market expectations.

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The context described above indicates the fundamental importance of communicating to the market the potential occurrence of cost stickiness in publicly traded Brazilian entities. Accordingly, the following theoretical and practical implications concerning cost accounting and financial statement analysis are presented:

1) enhancement of the usefulness of financial statement analysis for estimating organizational growth: The literature shows that profit margin, asset turnover, and cost stickiness variables are associated with return forecasts (Penman & Zhang, 2002; Costa, 2025). It is therefore argued that the use of this information by the market would signal to investors the return on invested capital in the entity, given that the capital market environment independently controls the production and use of information. Thus, ignorance about cost behavior leads to forecasting errors, hindering new investments. The inclusion of such additional information, involving financial data, contributes to improving the quality and utility of accounting information;
2) use of historical information: it is possible to estimate return predictability based on balance sheet elements at historical values. Using only publicly available data disclosed to the market allows estimation of cost behavior patterns to forecast future costs, thereby assisting decision-making (Pichetkun & Panmanee, 2014). On the other hand, accounting and financial reports published by entities do not signal cost stickiness or its potential impacts on future returns;
3) new return predictability model: the inclusion of variables related to cost stickiness proves useful in forecasting returns. Although the presence and level of asymmetry are associated with lower returns, the predictability model incorporating these elements is more accurate for estimating forecasts in the context of entities traded in the Brazilian capital market. It is assumed that a cost structure with higher fixed cost components and managerial optimism regarding new expenditures signals increased revenues generated by operating assets, as well as growth in operating profit. Therefore, it is relevant to consider cost asymmetry variables for return forecasts with reduced errors;
4) need for public information on costs: users of information may not understand cost behavior, thus there is a possibility of misjudgment regarding this information (Degenhart; Lunardi; Zonatto & Dal Magro, 2021; Novák et al., 2017). Therefore, it is argued that it is appropriate to estimate return forecasts including cost stickiness information in financial statements, especially in explanatory notes, to avoid or reduce forecasting errors;
5) signaling of organizational information to the market: evidence indicates that asymmetric cost behavior results from managerial decisions based on expectations of future demand. The phenomenon may also signal managerial incentives related to compensation tied to earnings and stock prices (Bushman & Indjejukian, 1993). Understanding cost behavior is relevant for analyzing current and future profits. Thus, the lack of knowledge about cost dynamics in entities may induce misjudgment by investors who rely on accounting, financial, economic, and strategic information for investment analysis;
6) investors as beneficiaries of cost stickiness signaling: different forms of signaling cost stickiness in the market would reduce informational asymmetry between signalers and receivers. It is also worth highlighting the predictability model, which has practical contributions directed toward other stakeholders in the capital market context;
7) reduction of informational asymmetry: assuming the hypothesis that investors and other external users of entities could comprehend the financial statements available in the market, and also understand cost stickiness as incremental information to the statements, it would be possible to expect a reduction in informational asymmetry among stakeholders involved in capital market investments and return expectations;
8) managers' expectations about future demand: once entities understand cost stickiness and its influence on future returns, managers responsible for general expenditures must recognize that all decisions related to these elements have the power to influence investment returns, including profitability and profitability ratios. Given this, it is suggested that managerial decisions involving costs and their execution and/or reduction be carefully considered, so that managers strategically or occasionally decide on the disclosure of the possibility of cost asymmetry in accounting reports to the market, signaling the phenomenon through explanatory notes, especially those related to income statements, and their possible impacts on forecasts;
9) recommendations to standard-setting and regulatory bodies: various bodies oversee and decide on the content required for the preparation and disclosure of accounting information by entities to the market. It is suggested to improve policies that enhance transparency, as well as new guidelines on the disclosure of cost stickiness in the Brazilian financial market. The revision of the Brazilian accounting standard NBC TG 26, which addresses the presentation of financial statements, is recommended, with changes regarding the content of explanatory notes to highlight the possibility of cost stickiness in the cost structure of companies, as well as the improvement of OCPC 07, which addresses the preparation of explanatory notes. In this regard, it is understood that the IASB, as the guarantor of accounting standards, should establish the recording or explicit disclosure of accounting information that contributes to reducing discretion in disclosure practices in financial statements, especially in explanatory notes. Signaling the phenomenon would allow indication of information related to fixed and variable costs, which would enhance the usefulness of accounting information for investment decision-making by external users;

10) continuity of entities: considering that entities operate under the going concern assumption, cost stickiness information and return forecasts could justify entities' futures. The disclosure of these elements would facilitate understanding of entities' transactions from operational, financial, and accounting perspectives. Therefore, it is suggested that managers and entity administrations reflect on how signaled information might interest the capital market and how, as internal users, they could utilize it for business management and discretionary spending decisions.

Given the reflections presented, new perspectives on financial statement analyses for entities are signaled. Knowledge and understanding of information about cost behavior and its influence on return forecasts are incremental and enable more accurate investment decisions and returns. Therefore, an invitation is extended to the academic community to deepen discussions with entities operating in the capital market. Empirical knowledge developed by research helps assist investors in making more assertive decisions regarding the understanding of cost behavior and its influence on forecasting costs and returns. The analysis of the complete set of financial statements goes far beyond current growth and profitability. Thus, joint action between academia and the market is imperative in light of contemporary managerial scenarios.

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