JOURNAL ARTICLE

Why the NPV Criterion does not Maximize NPV

Get access

Elazar Berkovitch , Ronen Israel

The Review of Financial Studies, Volume 17, Issue 1, January 2004, Pages 239–255, https://doi.org/10.1093/rfs/hhg023

Published: 01 January 2004

Abstract

This article presents a theory of capital allocation that shows how the use of net present value (NPV) as an investment criterion leads to inefficient capital budgeting outcomes and how this criterion may be dominated by other capital budgeting criteria, like the internal rate of return and the profitability index. The essence of our theory is rooted in the mainstream paradigm of corporate finance: while firms use NPV to measure the addition to firm value from prospective projects, "classical" informational and agency considerations prevent it from implementing the optimal capital budgeting outcome. Our theory also identifies conditions when alternative criteria should be used. Finally, we characterize when direct monitoring through capital budgeting dominates compensation contracts in alleviating the agency problem.

Issue Section: Articles

- Save searches
- Purchase content
- Activate your purchase/trial code
- Add your ORCID iD

Sign in

Register

Sign in through your institution

Sign in with a library card

Sign in with username/password

Recommend to your librarian

Institutional account management

Sign in as administrator

Purchase

Subscription prices and ordering for this journal

Purchasing options for books and journals across Oxford Academic

Short-term Access

To purchase short-term access, please sign in to your personal account above.

Don't already have a personal account? Register

Why the NPV Criterion does not Maximize NPV - 24 Hours access

EUR €53.00 GBP £44.00 USD $58.00

Rental

Read this now at deepdyve

This article is also available for rental through DeepDyve.