JOURNAL ARTICLE

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R. H. Parker

Journal of Accounting Research
Vol. 6, No. 1 (Spring, 1968), pp. 58-71 (14 pages)
Published By: Wiley

https://doi.org/10.2307/2490123
https://www.jstor.org/stable/2490123

Discounted Cash Flow in Historical Perspective

R. H. PARKER*

The purpose of this paper is to survey the development of discounted cash flow criteria of investment evaluation before 1950. No attempt is made to discuss the problem of the cost of capital or the difficulties caused by risk and uncertainty.

The technique of discounted cash flow requires both an understanding of compound interest and an ability to set out the cash inflows and outflows likely to result from a particular decision to invest. Knowledge of compound interest goes back at least as far as the Old Babylonian period (c. 1800–1600 B.C.) in Mesopotamia.[1] Setting out the cash implications of an investment is more difficult. It is not surprising that the earliest applications of discounted cash flow were to loans where the cash outlays and receipts were known and to life insurance where probabilities could be calculated from historical evidence. The extension of discounted cash flow to investment in fixed assets came much later and was based on the work of engineers and economists. We therefore have to consider developments in three fields: actuarial science, engineering economy, and political economy. They will be discussed in the order stated.

Trenchant, Stevin, and the Birth of Actuarial Science

In spite of the medieval Christian Church's ban on usury, European books on mathematics from Leonardo of Pisa's *Liber Abaci* (1202) onwards

* Reader in Management Accounting, Manchester Business School. Much of the research on which this paper is based was carried out while the author was P. D.