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RANKING MUTUALLY EXCLUSIVE PROJECTS: THE ROLE OF DURATION

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Abstract

This paper develops a new measure of cash-flow timing called “return duration.” Numerically quite close to Macaulay duration, return duration is a straightforward function of a project's net present value (NPV) and internal rate of return (IRR). When comparing mutually exclusive projects, differences in return duration can explain ranking conflicts between NPV and IRR. The paper also clarifies the conditions under which a manager should consider duration or generalized NPV before making investment decisions when faced with such ranking conflicts.

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