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RANKING MUTUALLY EXCLUSIVE PROJECTS: THE ROLE OF DURATION

L. Dwayne Barney & Morris G. Danielson

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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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Additional information

Notes on contributors

L. Dwayne Barney

Dr. L. Dwayne Barney is a professor of finance at Boise State University, Boise, Idaho (ldbarney@boisestate.edu) where he is formerly Chairman of the Department of Marketing and Finance. He received his M.S. and Ph.D. in Economics from Texas A&M University. Dr. Barney's research interests are in the areas of asset valuation and risk and uncertainty, and included among his publications are articles in the Journal of Risk and Insurance, Journal of Economic Dynamics and Control, International Review of Economics and Finance, and The Journal of Financial Research.

Morris G. Danielson

Dr. Morris G. Danielson is an assistant professor of finance at St. Joseph's University, Philadelphia, Pennsylvania. He received his Ph.D. in Finance from the University of Washington. Dr. Danielson's research explores the relations between fundamental measures of firm performance and firm valuation. Included among his publications are articles in the Financial Analysts Journal; Journal of Accounting, Auditing, and Finance; Journal of Corporate Finance; Review of Accounting Studies; and Financial Management.

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