The Engineering Economist ›
A Journal Devoted to the Problems of Capital Investment
Volume 55, 2010 - Issue 2

Original Articles

Average Internal Rate of Return and Investment Decisions: A New Perspective

Carlo Alberto Magni

Pages 150-180 | Published online: 04 Jun 2010

Cite this article https://doi.org/10.1080/00137911003791856

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project's profitability and correctly ranks competing projects. With such a measure, which we call average internal rate of return, complex-valued numbers disappear and all the above-mentioned problems are wiped out. The economic meaning is compelling: it is the project return rate implicitly determined by the market. The traditional IRR notion may be found as a particular case.

Notes

For example, the cash flow stream (−4,12,−9) has a unique IRR equal to 50%. According to the IRR criterion, the project must be accepted if the market rate is smaller than 50%, but the NPV is negative for any rate different from 50%, so the project is not worth undertaking. (Note that this example implicitly introduces a further class of problems: if a project is not unambiguously individuated as either an investment or a borrowing, the IRR profitability rule is ambiguous.)

The approach is compatible with a bounded-rationality perspective: in this case r is a subjective threshold (Magni, 2009b).

The IRR rule is semantically not satisfactory because it is not associated with a univocal definitio … know whether …

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116