NPV & IRR

Accounting & Finance

The two discounted cash flow measures, and when they disagree.

Net present value is the sum of discounted cash flows less the initial outlay; accept if positive.

$$NPV = \Sigma C_t/(1+r)^t - C_o$$

NPV > 0 Adds value.	**Accept**
IRR > cost of capital	**Accept, usually**
Mutually exclusive projects	**Choose highest NPV**

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× Choosing the higher IRR between exclusive projects

✓ Choosing the higher NPV

IRR ignores scale. A 40% return on £10,000 adds less value than a 15% return on £10 million.

IRR also assumes reinvestment at the IRR itself, which is rarely realistic for very high-return projects.