Why Do Managers Prefer IRR

Finance textbooks tell us to use Net Present Value (NPV) as an evaluation tool for Capital Budgeting. Yet surveys of managers have consistently shown that managers prefer Internal rate of Return (IRR) to NPV. This article rigorously establishes the validity of the interpretation of IRR as the return earned on funds that remain internally invested in the project. Using this interpretation IRR can be viewed as a tool to evaluate the riskiness of the capital budgeting proposal.