Patrimonio Hoy Tools
Internal Rate of Return

- IRR = Internal Rate of Return = Break Even Rate (pp. 220-224)
  - IRR is the discount rate that makes the net present value of a sequence of cash flows equal to zero, $0 = CF_0 + CF_1/(1+IRR) + CF_2/(1+IRR)^2 + \ldots$
  - Two rules: Accept projects that have an NPV > 0 or (mostly equivalently) have an IRR > discount rate
- A preview: What drives discount rates?
  - Puts future **cash flows on an apples-to-apples basis**: Allow us to compare risky benefits (costs) in the future to costs (benefits) today
  - **In the next module…** We will think carefully about how the discount rate is determined: The appropriate discount rate is the return on the best available alternative investment with equivalent risk