

METHODS USED TO EVALUATE CAPITAL INVESTMENTS

METHOD	ADVANTAGES	DISADVANTAGES
Average Rate of Return	<p>Easy to calculate</p> <p>Considers accounting income (often used to evaluate managers)</p>	<p>Ignores cash flows</p> <p>Ignores the time value of money</p>
Cash Payback	<p>Considers cash flows</p> <p>Shows when funds are available for reinvestment</p>	<p>Ignores profitability (accounting income)</p> <p>Ignores cash flows after the payback period</p> <p>Ignores the time value of money</p>
Net Present Value	<p>Considers cash flows and the time value of money</p>	<p>Assumes that cash received from the project can be reinvested at the rate of return</p> <p>Necessary to evaluate projects of unequal size using a present value index</p>

Internal Rate of Return	Considers cash flows and the time value of money Ability to compare projects of unequal size	Requires complex calculations or trial-and-error methods Assumes that cash received from the project can be reinvested at the internal rate of return
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