

Payback Period and NPV: Their Different Cash Flows

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Abstract

One of the major topics which is taught in the field of Finance is the rules of capital budgeting, including the Payback Period and the Net Present Value (NPV). The purpose of this paper is to show that for a given capital budgeting project the cash flows to which the Payback Period rule is applied are different from the cash flows to which the NPV rule is applied. This is in contrast to the way these two capital budgeting rules are customarily taught in the field of Finance.

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² See, for example, Berk, DeMarzo, and Harford (2012, Chapter 8, pp. 210-246), Brealey, Myers, and Marcus (2012, Chapter 8, pp. 226-260), Brigham and Ehrhardt (2011, Chapter 10, pp. 379-422), Brigham and Houston (2013, Chapter 11, pp. 367-398), Keown, Martin, and Petty (2011, Chapter 10, pp. 264-301), and Ross, Weterfield, and Jaffe (2010, Chapter 5, pp. 135-170).