Internal Rate of Return

The internal rate of return (IRR) is the rate return that discounts future cash flows from an investment in such a way that the sum of the present values of the cash flows is exactly equal to the cost of the initial investment. The internal rate of return effectively assumes that any money received along the way is invested at the internal rate of return.

IRR has several drawbacks. Except in a situation where a steady stream of cash flows result, the IRR can only be found by trial and error. It does not consider the dollar size of an investment. And where there are multiple reversals in the cash-flow streams, more than one internal rate of return could result.