

Calculating Average Rate of Return (ARR)

Formula:

$$\frac{\text{Total net profit}}{\text{Number of years}} = \text{average annual return}$$

$$\frac{\text{Average annual return}}{\text{Investment cost}} \times 100 = \text{ARR (\%)}$$

Example:

Cost of project	£70 000
Net profit (Year 1)	£25 000
Net profit (Year 2)	£30 000
Net profit (Year 3)	£35 000

Calculate the ARR as a percentage to 1 d.p.

Answer:

Total net profit = £90 000

Number of years = 3

$$\frac{£90\,000}{3} = £30\,000$$

$$\frac{£30\,000}{£70\,000} = 42.9\% \text{ (1 d.p.)}$$

ARR = 42.9% (1 d.p.)