A definition of shareholder value creation

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Abstract

In this paper, we will define and analyze shareholder value creation. To help us understand this concept better, we will use the example of a listed company, General Electric, between 1991 and 1999. To obtain the created shareholder value, we must first define the increase of equity market value, the shareholder value added, the shareholder return, and the required return to equity. A company creates value for its shareholders when the shareholder return exceeds the required return to equity. In other words, a company creates value in one year when it outperforms expectations. The created shareholder value is quantified as follows: Created shareholder value = Equity market value x (Shareholder return - Ke). The created shareholder value can also be calculated as follows: Created shareholder value = Shareholder value added - (Equity market value x Ke). We also calculate the created shareholder value of 142 American companies during the three-year period 1997-1999 and during the eight-year period 1992-1999.

Suggested Citation

Fernández, Pablo, 2002. "**A definition of shareholder value creation**," IESE Research Papers D/448, IESE Business School.

Handle: *RePEc:ebg:iesewp:d-0448*