Shareholder value can be measured in 3 ways: shareholder value added, economic profit and total shareholder return.

Shareholder value added

- Uses discounted cash flow techniques (DCF) to estimate the value of an investment, discounting forecast cash flows by the cost of capital
- Rappaport stated the value of a company is dependent upon 7 drivers of value:
    - Increase sales growth, increase operating profit margin, reduce cash tax rate, reduce incremental investment in capital expenditure, reduce investment in working capital, increase time period of competitive advantage and reduce cost of capital
    - Useful way to explore sensitivity analysis and evaluate synergies in acquisitions
- This technique is most effectively applied to individual business units within a company, whose separate values can be cumulated to arrive at the value of a business
- Mainly used for valuation and planning than a periodic measure of performance

Economic profit

- Covers many variants of profit-based measures of SH value
- Surplus earned by a business in a period after deducting all expenses including cost of capital
- Primarily used for performance measurement
- Advantage- encourages managers to minimise capital employed
- Where SVA shows value of business over its lifetime, EP shows whether the company is creating a positive NPV in any single period
- SVA and EP are internal measures of SH value- show how well company is implementing competitive strategy to create value from product-market mix it selects

Total Shareholder Return

- TSR is an external measure looking at value created for SH's
- Represents the total return to the shareholders in a period- the increase in share price plus dividends paid during period
- Often calculated over 3-year period, commonly used in directors' long-term incentive plans
- SH's view TSR as the most accurate measure of value- shows exactly what they have received from the company in the period
- Limitations- share prices reflect market expectations rather than corporate performance
    - Also a company can be doing well but SP falls due to out-of-favour sector

Fundamental value: the exact price at which the company's shares should trade

- Differs from market value due to asymmetry of information where market has different views to executives
- Also government issues can influence perceptions of risk which affects price
- Ideally, a company's market value should reflect fundamental value
    - If not, stakeholders will suffer