Equity Risk Premium

Equity risk premium is also called the market premium, and market risk premium. The equity risk premium is the extra return an investor earns over the risk-free rate for owning risky equity instead of risk-free government bonds.

Equity risk premium is usually used within the context of the Capital Asset Pricing Model (CAPM). And it is usually defined as follows:

$$Equity\ Risk\ Premium = \ RP_m = (K_m - K_{RF})$$

$$K_m = Required\ return\ on\ the\ market\ portfolio$$
$$K_{RF} = Risk - free\ rate$$

K_m is also the return necessary to compensate an investor for assuming an “average” amount of risk.