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HOW TO EVALUATE AN EARLY STAGE STARTUP

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What is startup valuation?

This process calculates the value of a startup company. Founders will strive for a high valuation, whereas pre-revenue investors would prefer a lower valuation that guarantees a higher return on investment.

More difficulties would be faced by an established firm than by a startup. The value of the business could be more easily evaluated when cash flow and financial data are consistent.

How to evaluate an early stage startup

There are various ways to evaluate an early stage startup. To get to the right investors, an early business would march through harsher terrain.

1. Traction is proof of the project

The company's ability to prove its potential customer base, the market's response, and its growth rate are measures that it has established firm ground in the competitive business world.

Your startup earns value when you have evidence that it is profitable, scalable, and viable.

2. What a Founding Team Is Worth

The primary strength of the organisation is the presence of an experienced workforce. They aid in the development of successful solutions, helping businesses keep up with the competition.

3. Prototypes/ MPV

A functional model, such as an MVP or prototype, might attract investors since it shows the potential future and the client base you have built.

When you are prepared to present a competitive operating model to your pre-revenue investors, it proves the tenacity of your idea.

4. Supply chain management

You can attract investors if your business is growing successfully in a competitive industry and when customer demand equals the company's ability to meet supply.

5. Trending Industries

Your startup can thrive and sustain if you choose emerging industries like AI, healthcare, etc.

Our experts have done extensive research and found the eye-opening stats on mobile apps, popular apps, potential ideas and the latest trends. Take a look and see what the future holds for businesses with mobile apps.

6. High Margins

Investors may make higher investments in a strong startup with healthy profit margins and high sales growth forecasts.

6 Methodologies investors choose to evaluate startups

There are methods to help evaluate your startup.

Here are some ways investors embrace to evaluate a startup.

1. Berkus Method

This is one of the valuation methods normally used by pre-revenue startups. It comprises five crucial steps.

- **Concept** – The product idea offers fundamental value with manageable risk.
- **Prototype** – This foresees the future, thereby reducing the technology risk.
- **Quality management** – The startup has objectives to set up a quality management team, if it is lacking.
- **Connections** – Strategic connections with customers, suppliers, and investors help to lower the market's competitive risks.
- **Launch plan** – There is some proof of a sales plan and readiness for delivery of product even though this step does not adhere to all pre-revenue startups.

An early stage startup's valuation is calculated by assigning an arbitrary value to each of these variables. This extremely simplified pattern relies on approximation.

2. Scorecard Method

The scorecard technique involves assigning a relative score to many components, like the size of the opportunity, the product or service, the technology, the stage of the company, the channels of distribution, etc.,

After calculating the weighted average rating, the startup's value is determined by multiplying it by the typical pre-money valuation of a comparable business.

You can compare your business with startups receiving funding using this valuation method.

3. Discounted Cash Flow [DCF]

This strategy is used in the pre-revenue stage companies. The majority of the time, startup businesses evaluate their growth based on the revenue they foresee generating in the future.

Using the forecasted cash flow, the investors calculate the margin and estimate the worth of the cash flow.

Based on the investor's desired rate of return, this value is discounted for the term and associated risks. The DCF calculates the starting value by integrating time, risk, and financial resources.

4. Venture Capital Method

This approach seeks to value your startup according to its exit or terminal value.

The VC technique multiplies these parameters while taking profit margin and other important profit and loss measures into account.

The investor determines an exit value in the context of potential returns. A discount rate is applied to the exit value that was previously determined in order to calculate the net present value.

5. Cost-to-Duplicate

The Cost-to-Duplicate method involves calculating the cost to launch a new business that is similar to the one being evaluated.

It accounts for all production-related costs, including those connected to technology, physical assets, research and development, and marketing, at their fair market value.

The idea behind this strategy is that an investor would not want to pay more than what it would cost to duplicate.

6. Risk Factor Summation Method

Despite being a combination of the Berkus and Scorecard methods, this method primarily focuses on the risks affecting the return on investment.

The most frequently considered risks include those related to management, manufacturing, market competitiveness, company stage, capital requirements, political risk, legal action, technology risk, etc.

A method from the two previously mentioned ones is utilised for valuation.

When various business risks are rated positively or negatively, an estimate is added to or subtracted from the initial estimated value.

The startup's ultimate value is produced once the risk factor summing is put into practice.

5 key aspects early-stage startups should focus on to evaluate their business

Here are 5 crucial elements that you should take into account while getting ready to evaluate your startup.

1. Founding team

Successful business firms have the best founding team working hard to see their products go from prototype to something people love.

Startup owners need to surround themselves with top talent in technology if they want to succeed.

The fact is that a venture investor prefers to fund successful businesses.

Before making an investment, investors look for characteristics like talent, experience, passion and adaptability.

2. ROI

In an effort to win the pitch, many startup founders forget to mention the expected return on investment.

It is better to guarantee a realistic pitch than to assume a bigger investment in order to reduce potential danger in the future.

A good startup founder has realistic goals and objectives based on a business plan. Additionally, checking up on the startup's development might help you calculate the ROI.

3. Competitive advantage

Analyze your direct and indirect competitors to have a better knowledge of your competitive environment.

You can look for approaches to stand out from the crowd by comparing your goals and ambitions with those of your competitors and employing information that can help you understand the landscape of your competitors.

4. Momentum+Market

Investors prefer to see evidence of traction rather than hear about the product's potential in the market.

Be prepared to mention user counts, revenue, and other growth indicators throughout the pitch.

Present evidence to prospective investors that your business has consistent customer demand, a market that can be served, and enough growth potential to progress your product.

5. Mission

Your startup could seem pointless if it lacks a clear mission. While pitching investors, make sure to explain how that objective drives your company culture.

The actions, attitudes, and approaches of the individuals who make up a positive workplace culture reflect the culture of the organisation.

Conclusion

A high estimate can raise the expectations of the investors, and a low estimate might lead the founders to give their investors a larger equity share.

It is crucial for both the startup's founders and potential investors to determine a valuation that is as accurate as feasible.

The likelihood for big returns is boosted by strong management and a business concept with some traction that targets a sizable market.

startup business

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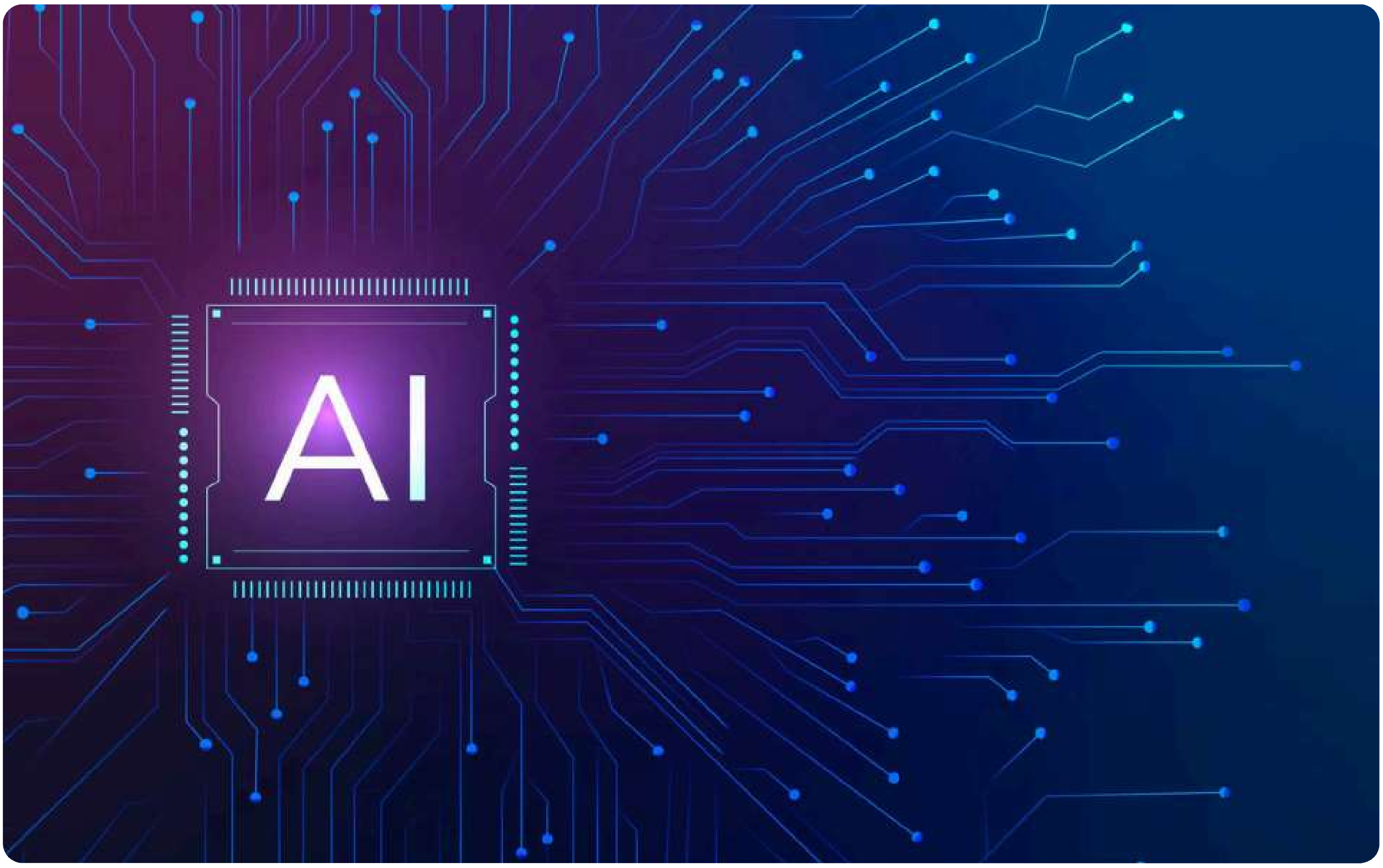

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