How to do a startup valuation: 8 different methods

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Startup valuations provide insight into a company's ability to use new capital to grow, meet customer and investor expectations, and hit the next milestone. Today, unicorn valuations — businesses valued at $1 billion or more — number in the hundreds. There are now "decacorns," startups valued at $10 billion, and even "hectocorns," valued at over $100 billion.

While impressive, these calculations aren't as objective as you might think. A startup valuation may account for factors like your team's expertise, product, assets, business model, total addressable market, competitor performance, market opportunity, goodwill, and more.

If you have actual revenues, you're able to use concrete economic numbers as a starting point. But in the context of fundraising, your company is ultimately worth what you and your investors agree it's worth. And most angel investors and venture capital firms use multiple formulas to find the pre-money value of a business, or how much it's worth before they invest.

It's fair to say that valuing a startup is both an art and a science. Whether you're in the pre-seed stage or just issuing stock options to your employees, it will help you to understand the different startup valuation methods. In this article, we'll go over eight methods you can use to value your startup and prepare for future fundraising talks.

8 common startup valuation methods.

Calculating value will always involve a little guesswork, but there are some helpful materials you can have ready. Financial statements like a balance sheet are essential. Be prepared to assess the skills and experience of your team and identify any strengths and weaknesses.

You can use databases like AngelList or Crunchbase to directly compare your valuation to similar businesses, or you can check online indexes and public business reports.

By nature, valuations will differ across locations, industries, and years. For example, a Silicon Valley property technology startup founded in 2009 shouldn't be the measuring stick for a Boston proptech startup in 2020. And a B2B company may have dramatically different inputs than a B2C company.

1. The Berkus Method.

The Berkus Method was created by venture capitalist Dave Berkus to find valuations specifically for pre-revenue startups, i.e., businesses not yet selling their products at scale. The idea is to assign dollar amounts to five key success metrics found in early-stage startups.

The simple formula helps founders and investors avoid faulty valuations based on projected revenues, which few new businesses meet in the expected time period.

Here’s a summary:

If it exists:	Add to company value (up to):
Sound Idea (basic value)	$500,000
Prototype (reducing technology risk)	$500,000
Quality Management Team (reducing execution risk)	$500,000
Strategic relationships (reducing market risk)	$500,000
Product Rollout or Sales (reducing production risk)	$500,000

This method caps pre-revenue valuations at $2 million and post-revenue valuations at $2.5 million. Although it doesn’t take other market factors into account, the limited scope is useful for businesses looking for an uncomplicated tool.

2. Comparable transactions method.

The Comparable Transactions Method is one the most popular startup valuation techniques because it’s built on precedent. You’re answering the question, “How much were startups like mine acquired for?”

For instance, imagine that Rapid, a fictional shipping startup, was acquired for $24 million. Its mobile app and website had 700,000 users. That’s roughly $34 per user. Your shipping startup has 120,000 users. That gives your business a valuation of about $4 million.

You can also find revenue multiples for similar companies in your sector. In your market, it may be normal for SaaS companies to generate 5x to 7x the previous year’s net revenue.

With any comparison model, you need to factor in ratios or multipliers for anything that’s dramatically different between your two businesses. For example, if another SaaS company has proprietary technology and you don’t, you may want to use the multiplier on the lower end of the range, like 5x (or lower) in our example above. This method is similar to the Market Multiples Approach.

3. Scorecard valuation method.

The Scorecard Method is another option for pre-revenue businesses. It also works by comparing your startup to others that are already funded but with added criteria.

First, you find the average pre-money valuation of comparable companies.Then, you’ll consider how your business stacks up according to the following qualities.

- **Strength of the team:** 0-30%
- **Size of the opportunity:** 0-25%
- **Product or service:** 0-15%

- **Competitive environment:** 0-10%
- **Marketing, sales channels, and partnerships:** 0-10%
- **Need for additional investment:** 0-5%
- **Other:** 0-5%

You'll then assign each quality a comparison percentage. Essentially, you can be on par (100%), below average (<100%), or above average (>100%) for each quality compared to your competitors. For example, you give your ecommerce team a 150% score because it's complete, fully trained, and has experienced developers and marketers, some from rival businesses. You'd multiply 30% by 150% to get a factor of .45.

Do this for each startup quality and find the sum of all factors. Finally, multiply that sum by the average valuation in your business sector to get your pre-revenue valuation. Learn exactly how to assign percentages and weigh each factor in this explanation by Bill Payne, the method's creator.

4. Cost-to-duplicate approach.

The key to this method is in the name. You're figuring out how much it would cost to recreate your startup elsewhere — minus any intangible assets, like your brand or goodwill.

You simply add up the fair market value of your physical assets. You may also include research and development costs, product prototype costs, patent costs, and more.

One major drawback is that this method inherently doesn't capture the full value of a company, particularly if it's generating revenue. In calculating your startup's valuation, you may have to ignore elements that are particularly relevant, like your customer engagement.

5. Risk factor summation method.

This is a broader method of valuing your startup. Start with an initial valuation based on one of the other methods mentioned here. Then, increase or decrease that monetary value in multiples of $250,000 based on risks affecting your business.

Low-risk elements get a double-plus grade (++), which means you add $500,000 to your valuation. High-risk elements get a double-minus grade (--), and you subtract $500,000.

For instance, if your online custom clothing store has a slight but low risk of competition, you can grade it positively but add only $250,000.

The 12 common risk categories are as follows:

1. Management
2. Stage of the business
3. Legislation/political risk
4. Manufacturing risk
5. Sales and marketing risk
6. Funding/capital raising risk

7. Competition risk
8. Technology risk
9. Litigation risk
10. International risk
11. Reputation risk
12. Potential lucrative exit

The difficult portion of this method is finding an objective point of reference to measure each component. Starting with comparable methods, like the Scorecard Method or Comparable Transactions Approach, may help.

6. Discounted cash flow method.

Businesses can also be valued using the Discounted Cash Flow (DCF) Method. You may need to work closely with a market analyst or an investor to use this method.

You take your forecasted future cash flows and then apply a discount rate, or the expected rate of return on investment (ROI). Generally, the higher the discount rate, the riskier the investment — and the better your growth rate needs to be.

The idea behind this is that investing in startups is a high-risk move compared to investing in businesses already operating and earning consistent revenue.

You can also consider the First Chicago Method, which expands on the DCF method. It considers three scenarios — the other two being one in which the startup performs poorly, according to projections, and one in which it performs even better than expected — giving you three different business valuations.

7. Venture capital method.

As the name suggests, this method is a go-to for venture capital firms, and it's another option to consider if you need a pre-revenue valuation. It also reflects the mindset of investors who are looking to exit a business within several years.

There are two formulas you'll use to worked toward your valuation:

- Anticipated Return on Investment (ROI) = Terminal Value ÷ Post-Money Valuation
- Post-Money Valuation = Terminal Value ÷ Anticipated ROI

First, you'll calculate your startup's terminal value, or the expected selling price after the VC firm has invested. You can find this using estimated revenue multiples for your industry or the price-to-earnings ratio.

Determine the anticipated ROI, such as 10x, and plug everything in to find your post-money valuation. From there, subtract the investment amount you're asking for to get your pre-money valuation.

8. Book value method.

The book value method will give you an asset-based valuation. It’s similar to the cost-to-duplicate approach, but even simpler.

Traditionally, a startup company's book value is its total assets minus its liabilities. In other words, the Book Value method equates the net worth of your startup with your valuation.

Bringing it all together.

As a startup founder, you need a valuation estimate you can justify to potential investors and trust for any other reason. A precise valuation helps you craft your long-term capital raising strategy and keep your funding requests in perspective.

No single startup valuation method is accurate all the time. More than likely, you’ll work through multiple methods and combine techniques to find a fair value. Don’t forget to take advantage of company databases to make sure you’re in the right ballpark.