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How to Value a Startup Company With No Revenue

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Pre-revenue startup valuation can be a tricky endeavor. There are many things to take into consideration, from the management team and market trends to the demand for the product and the marketing risks involved.

And here's the thing:

After evaluating everything, even with the most effective pre-money valuation formula, the best you can hope for is still just an estimate.

It's important to keep that in mind.

So, with that being said, let's learn dive in and explore some of the common ways you can value a startup company with no revenue.

Editor's note: You can use the table of contents below to jump to specific section of interest:

First off, let's explain the basics.

What is startup valuation?

Startup valuation is the process of calculating the value of a startup company. Startup valuation methods are particularly important because they are typically applied to startup companies that are currently at a pre-revenue stage.

Business owners will hope for a high valuation, whereas pre-revenue investors would prefer a lower value that promises a bigger return on investment (ROI).

So, how does pre-revenue startup valuation compare with a mature business valuation?

Unlike early-stage startups, a mature publicly-listed business will have more hard facts and figures to go on. A steady stream of revenue and financial records make it easier to calculate the value of the business.

This is usually done with the EBITDA formula, which calculates the value of the company based on its earnings before interest, taxes, depreciation, and amortization.

EBITDA = Net Profit + Interest +Taxes + Depreciation + Amortization

Assigning a valuation to a startup company with no revenue can be a challenge, as you won't have these figures at hand.

However, while most startup valuation methods don't have details on profit, taxes, and amortization, you will be able to consider other key factors in the process.

IMPORTANT FACTORS FOR PRE-REVENUE STARTUP VALUATION

More often than not, early-stage startups are valued somewhere in the middle, meaning founders don't get quite as much as they anticipated, and investors pay more than they initially wanted to invest.

Let's look at the key factors worth considering during a pre-revenue startup valuation.

Traction is Proof of Concept

If you're wondering how to value a startup company with no revenue, one of the main indicators is traction. You can get the true story of the business by looking at the following:

1. Number of Users – Proving you already have customers is essential. The more, the better.
2. Effectiveness of Marketing – If you can show you can attract high-value customers for a relatively low acquisition cost, you will also attract the attention of pre-revenue investors.

There is a common thread between these three concepts, as a powerful marketing strategy will lead to impressive growth. When that happens, user numbers will surge. Therefore, by providing proof that you have a viable, scalable business idea, you automatically add value to your startup.

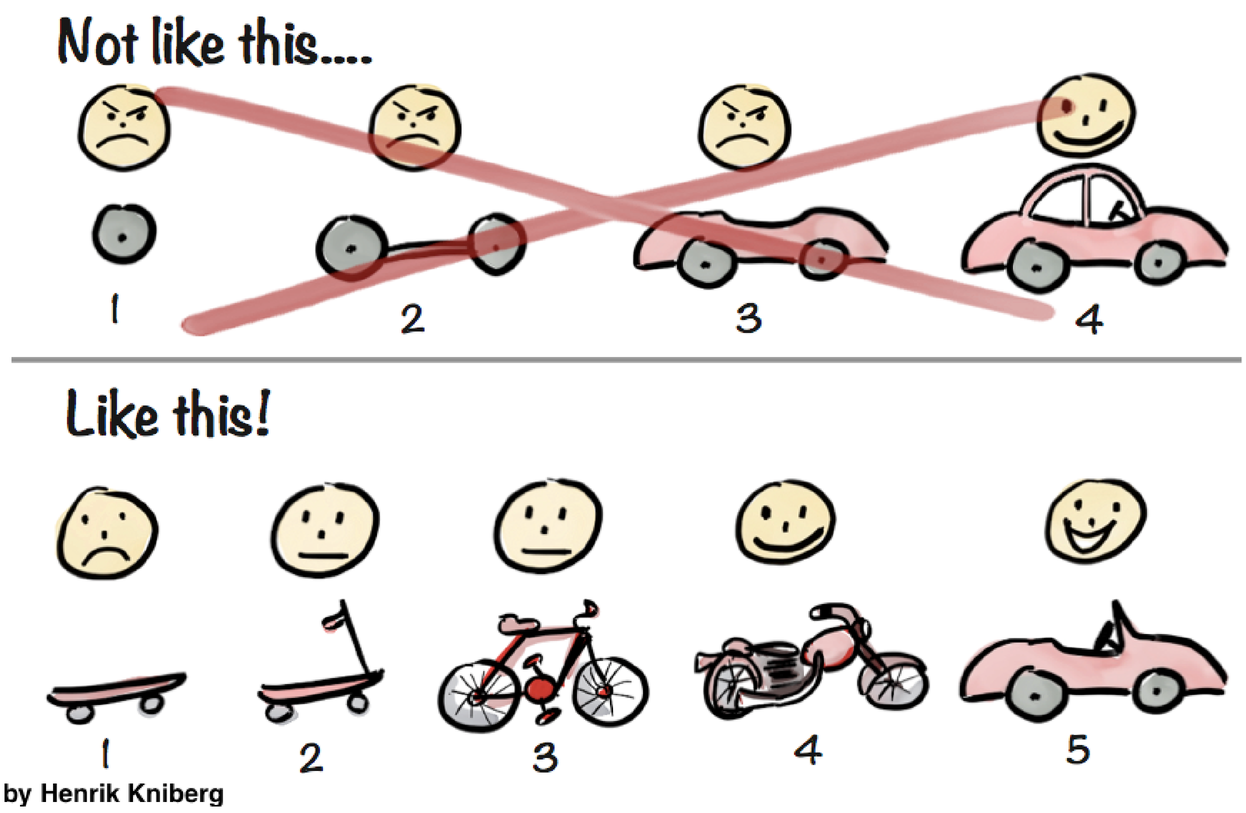
Investors start to see their dollars as fuel for the fire.

The Value of a Founding Team

Pre-revenue investors want to be sure they are backing a team that is destined for success. They will consider the following:

- **Proven Experience** – If the team includes people with prior success with other startup ventures, it will be more tempting than a startup full of inexperienced first-timers.
- **Skills Diversity** – Ideally, a startup team will have a mix of experts whose skills complement each other. A prodigious programmer cannot do everything alone, but if she teams up with a marketing expert, the startup is worth more.
- **Commitment** – Having great people is only part of the puzzle. Those people need to have the time and dedication to make sure the startup gets off the ground. Team of part-time employees will not be attractive.

Prototypes/ MPV



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Regardless of which pre-money valuation formula you use, a prototype is a game-changing addition. Being able to show pre-revenue investors a working model of your product not only proves you have the tenacity

If you have a Minimum Viable Product (MVP) and some early adopters, you could attract investments in the range of $500K to $1.5M.

A working prototype could net you even more if your company is reviewed with the valuation-by-stage method, which is used by many venture capitalists and angel investors. This may result in investment between $2 million and $5 million.

Supply and Demand

If you operate in a market where the number of business owners dwarfs the number of willing investors, then your startup valuation will be impacted. In such a competitive scenario, many business owners are desperate to get investment, and may even sell themselves short to do so.

Conversely, let's imagine you have a rare patented idea for a tech startup that has been making waves in the industry. This could drive demand among investors, which will make your startup more valuable.

Emerging Industries and Hot Trends

In booming industries like AI or mobile gaming, many investors will be more willing to pay a premium. The digital age is alive with opportunities that people view as "the next big thing", so your startup can be worth more if it's in the right industry.

High Margins

Products with low-profit margins are not that appealing to investors. On the other hand, a high-growth startup with high margins and promising forecasts for further revenue growth may be able to command larger investments.

7 WAYS INVESTORS CAN VALUE PRE-REVENUE COMPANIES

Performing a pre-revenue startup valuation by yourself may seem daunting, but thankfully, you can draw from the experience and wisdom of other entrepreneurs, angel investors, and venture capitalists.

Furthermore, by getting familiar with the popular startup valuation methods here, you won't just understand how to evaluate a startup company with no revenue – you'll also know how to negotiate a better deal with pre-revenue investors.

Here are seven strategies you can use:

Method 1: Berkus Method

1.	Sound idea (basic value)	**$300k**
2.	Prototype (technology)	**$500k**
3.	Quality management team (execution)	**$300k**
4.	Strategic relationships (go-to-market)	**$200k**
5.	Product rollout or Sales	**$100k**
	BOX PRE-MONEY VALUATION (max. $2M)	**$1,400,000**

Source: Medium

The angel investor Dave Berkus thinks investors should be able to envision the company breaking $20M within five years. His method assesses five critical aspects of a startup:

- **Concept** – The product offers basic value with acceptable risk.
- **Prototype** – This reduces technology risk.
- **Quality management** – If it's not already there, the startup has plans to install a quality management team.
- **Connections** – There are some strategic relationships in place already, which reduces competitive risks in the market.
- **Launch plan** – There is some evidence of a sales plan and preparation for product rollout. (This doesn't apply to all pre-revenue startups)

Each aspect is given a rating up to $500,000, which means the highest possible valuation is $2.5 million.

The Berkus Method is a simple estimation, often used for tech startups. It is a useful way to gauge value, but as it doesn't take the market into account, it may not offer the scope some people desire.

Method 2: Scorecard Valuation Method

Criteria	Weight	Target Company	Factor
Team	30%	x	=0.3*x
Size of the Opportunity	25%	x	=0.25*x
Product/Technology	15%	x	=0.15*x
Competitive Environment	10%	x	=0.10*x
Sales/Marketing	10%	x	=0.10*x
Need for More Financing	5%	x	=0.05*x
Other	5%	x	=0.05*x
Total			Sum of all factors

Source: Goodfield

To begin, you determine the average valuation for pre-revenue startups in that market space. After that, according to Forbes, you can determine how the startup stacks up against others in the same region by assessing the following factors:

Strength of the Management Team (0–30%)

Founding Team – The value will vary dramatically depending on the background and experience of the founding team. Jeff Bezos or Mark Zuckerberg could make a 10% stake in a new tech startup worth a nine-figure investment, whereas your computer-illiterate pal Joe may only be able to command a few hundred bucks for the same stake.

Size of the Opportunity (0–25%)

Market Size – You may have some warm leads interested in your pilot product. The bigger your potential market is, the better, especially if you have leads that are ready to buy.

Traction and Expected Near-Term Revenues – If you have just a few cold leads that aren't ready to buy, your valuation won't be as high. The finished product will still be worth something, but ideally, you'll have enough traction with 50-100 customers so investors can see the potential for revenue in the short-term. It's also important to consider that 1 potential customer for a $50K product is a riskier than 10 potential customers for a $5K product.

Product/Technology (0–15%)

Competitive Environment (0–10%)

Competition – Entering a market full of high-level competition is a risk, and your valuation will drop as a result. If you have a unicorn startup, you can lay claim to an open market space with no competition, and command much higher investment.

Marketing/Sales Channels/Partnerships (0–10%)

Growth and Engagement – Ideally, you should be able to prove your user base is growing, and that people are engaged. If you have an app, 100,000 sporadic users are worth less than 20,000 loyal fans who use it every day. Also, a shrinking user base is a red flag that needs to be addressed quickly if you want to attract investors.

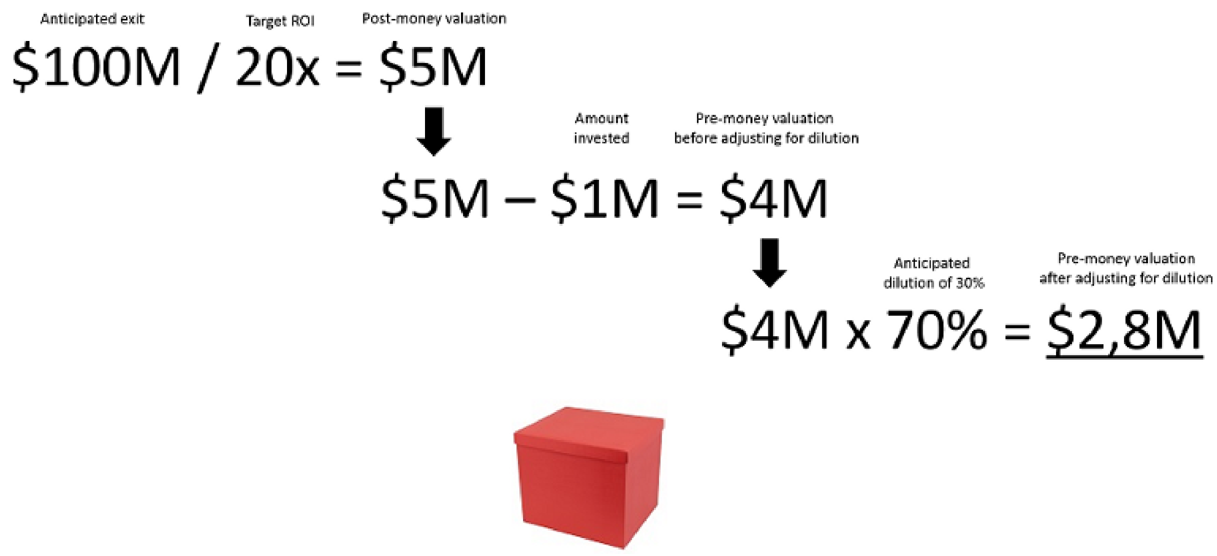
Need for Additional Investment (0–5%)

Other (0–5%)

Like many methods, ranking these factors is a very subjective process.

Just keep in mind that scalability and the team are the top concerns.

As Payne states, "In building a business, the quality of the team is paramount to success. A great team will fix early product flaws, but the reverse is not true."



Source: Innmind

The Harvard Business School Professor Bill Sahlman made the VC method popular.

The VC method is a 2-step process that requires several pre-money valuation formulas.

1. First, we calculate the terminal value of the business in the harvest year.
2. Secondly, we track backward with the expected ROI and investment amount to calculate the pre-money valuation.

Terminal value is the expected value of the startup on a specific date in the future, while the harvest year is the year that an investor will exit the startup. Another term you'll need to know is the Industry P/E ratio, which is the stock price-to-earnings ratio. For example, a P/E ratio of 3 means the stock is valued at 3 x $1 in earnings.

Calculating terminal value

You need the following figures:

- Projected revenue in the harvest year
- Projected profit margin in the harvest year
- Industry P/E ratio

You can research online to find industry averages for the P/E ratio and projected profit margins.

Once you have your figures ready, use this calculation:

- Terminal Value = projected revenue * projected margin * P/E
- Terminal Value = earnings * P/E

E.g. A tech company projects a $10M revenue in 5 years, with a profit margin of 10%. The industry P/E ratio is 20.

So, terminal value = $10M * 10% * 20 = $20M

Calculating the pre-money valuation

- Investment amount

Then use this calculation:

- Pre-Money Valuation = Terminal value / ROI – Investment amount

So, let's say a pre-revenue investor wants an ROI of 10x on his planned investment of $1M.

In this case, Pre-Money Valuation = $20M / 10 – $1M = $1M

With this method, we can deduce the current pre-revenue startup valuation to be $1M. With an investment of $1M and assumptions about growth and industry earnings, the company could be worth $20M in five years' time.

Method 4: Risk Factor Summation Method

Risk Factor Summation Method

The Risk Factor Summation Method

INITIAL VALUE				**$1,500,000**
1.	MANAGEMENT RISK	*Very low*	*+$500,000*	$2,000,000
2.	STAGE OF THE BUSINESS	*Normal*		
3.	LEGISLATION/POLITICAL RISK	*Normal*		
4.	MANUFACTURING RISK	*Normal*		
5.	SALES AND MANUFACTURING RISK	*Normal*		
6.	FUNDING/CAPITAL RAISING RISK	*Normal*		
7.	COMPETITION RISK	*Very high*	*-$500,000*	$1,500,000
8.	TECHNOLOGY RISK	*Low*	*+$250,000*	$1,750,000
9.	LITIGATION RISK	*Very low*	*+$500,000*	$2,250,000
10.	INTERNATIONAL RISK	*Normal*		
11.	REPUTATION RISK	Very low	+$500,000	$2,750,000
12.	POTENTIAL LUCRATIVE EXIT	Normal		
BOX VALUATION				**$2,750,000**

Source: SlideShare

This method combines aspects of the Scorecard Method and the Berkus Method to provide a more-detailed estimation focused on the risks involved with an investment. It takes the following risks into consideration:

- Management
- Stage of the business
- Funding/capital risk
- Manufacturing risk
- Technology risk
- Sales and marketing risk
- Competition risk
- Legislation/political risk
- Litigation risk

- Potential lucrative exit

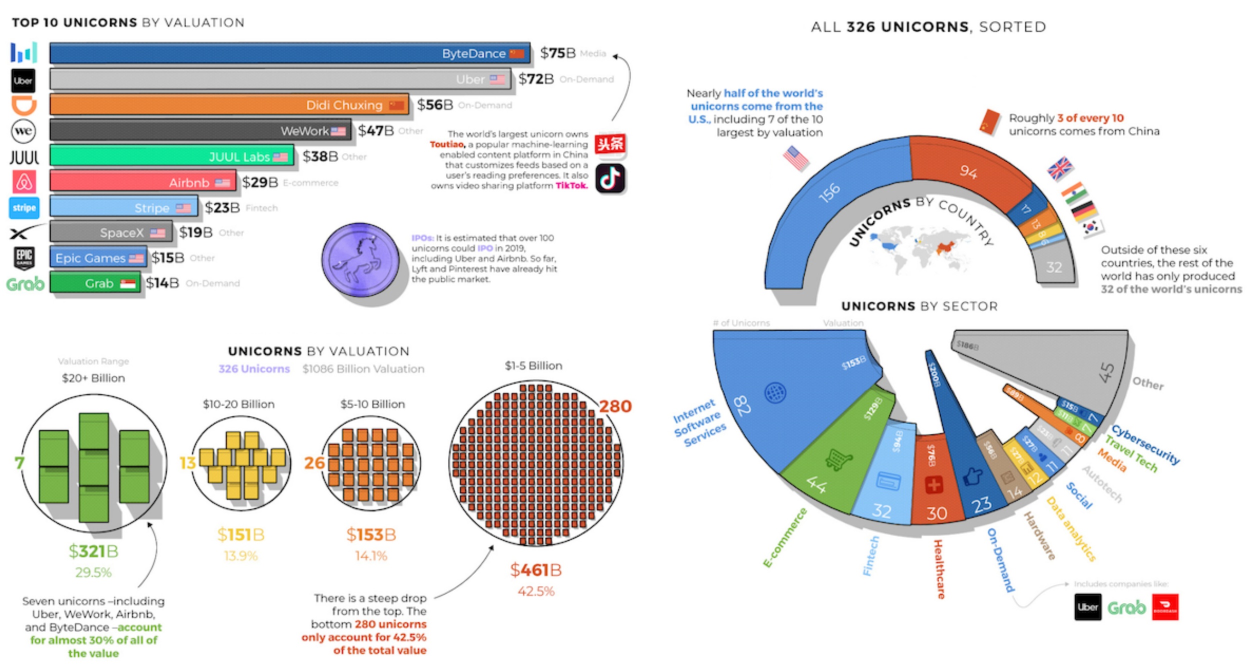
Each of these risk areas will be scored as follows:

- -2 – very negative (-$500,000)
- -1 – negative for scaling the startup and carrying out a successful exit (-$250,000)
- 0 – neutral ($0)
- +1 – positive (+$250,000)
- +2 – very positive for scaling the startup and carrying out a successful exit (+$500,000)

Using the Risk Factor Summation Method, the pre-revenue startup valuation will increase by $250,000 for every +1, or by $500,000 for every +2. Conversely, the pre-revenue valuation falls by $250,000 for every -1, and by $500,000 for every -2.

This technique is well-suited when examining the risks that need to managed to make a successful exit, and it can be paired with the Scorecard Method to give a holistic overview of the startup's valuation.

Method 5: Combo Platter Method



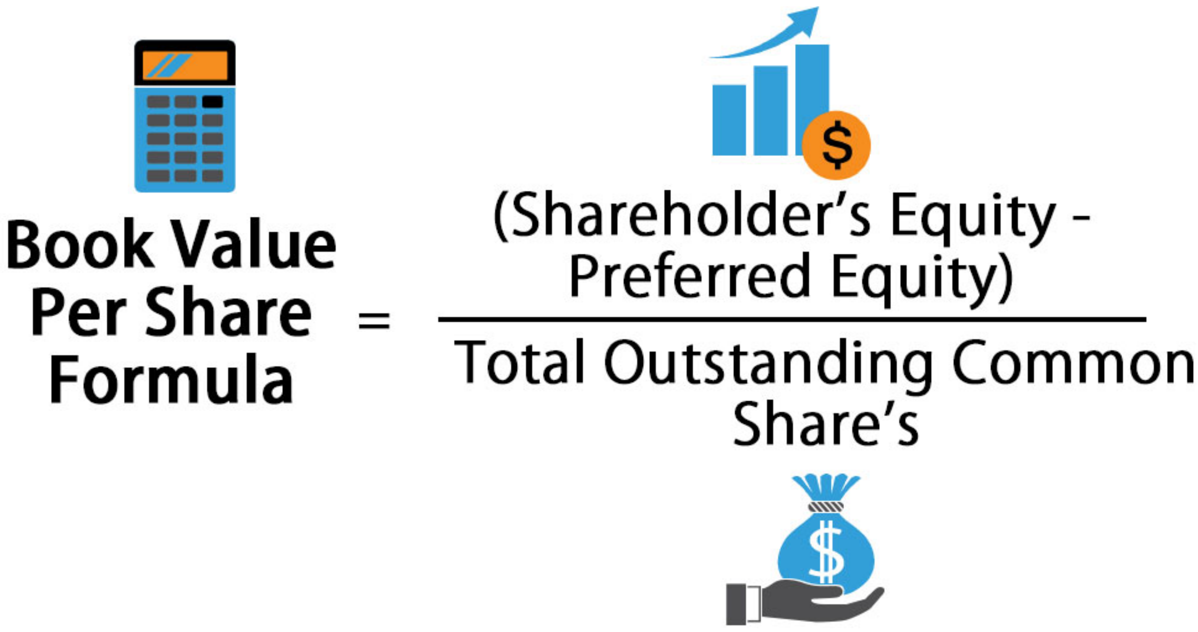
Source: Visual Capitalist

Rich Palmer is the co-founder of Gravyty, a company that uses artificial intelligence (AI) technology to supercharge fundraising efforts. When his startup was approaching pre-revenue investors, he and his team came up with a novel approach that comprised elements of several startup valuation methods.

By researching Angel List to get a better understanding of similar AI startups in Boston, they devised three tiers of value – essentially the best, moderate, and worse-case scenarios.

This wide scope and deep level of research helped dispel any doubts about the risks involved with Gravyty, and Rich and his team managed to raise a $1M seed round at a valuation.

Method 6: Asset-Based Valuation method (aka Book Value Valuation)



Source: Educba

When you're looking to know how to value a startup company with no revenue, the asset-based valuation may be the easiest method to use, as it offers a solid assessment of the real value of the startup.

This method entails a bit of financial juggling:

- The initial costs of the startup's assets are offset by impairment costs and depreciation.
- The total value of physical assets is added to balance sheet values. This includes cash-on-hand and accounts receivables.
- Any outstanding debts or expenses will be subtracted from the total to give you the asset-based valuation.

The problem here is that this method considers the startup in its current state – not how it will be in the future. Investors are more interested in the latter, and so, as an asset-based valuation doesn't take that into account, this method has some limitations.

Method 7: Cost-to-Duplicate

Technology Developed	Angels, Seed VCs	$1m to $5m
Launch / Early Customer Traction	Seed VC, Series A VC	$5m to $15m
Scaling and Adoption (Cash Flow Negative)	Series A / B / C VC	huge variability: $15m to $30m (with outliers to $100m)
Rapid / Mass Expansion (Cash Flow Positive)	IPO or Exit (Public Co. or Strategic Acquirer)	huge variability: $100m to $1b (avg. IPO of $500m)

Source: Seed Stage Capital

In this method, you assess the physical assets of the startup and then figure out how much it would take to duplicate the startup elsewhere. No savvy investor would invest more than the market value of the assets, so it's useful to know this when looking for pre-revenue investors.

For example, a tech startup could consider the outlay on developing their prototype, patent protection, and research and development.

Unfortunately, in a similar way to the Asset-based method, this doesn't take the future potential into account, nor does it consider intangible assets such as brand value or the current hot trends in the market.

Therefore, as it is quite an objective approach, this is best used to get a lowball estimate of pre-revenue startup valuation.

COMMON STARTUP VALUATION MISTAKES

It's inevitable that you will make a few mistakes while discovering how to value a startup company with no revenue. Here is a heads up on two big pitfalls you should do your best to avoid.

Never Assume a Valuation Is Permanent

In the end, a startup will be worth whatever investors are willing to invest in it. As a business owner, you may not agree with every valuation your startup gets. Ultimately, you must remember the variables at play, and understand that no valuation, high or low, is ever permanent - or even correct.

Never Assume a Valuation Is Straightforward

In business, hardly anything is straightforward.

So, even when you get a pre-revenue startup valuation you are happy with, it's best to discuss things in great detail with potential investors just to make sure everyone is on the same page about how to proceed.

PREPARE TO IMPRESS PRE-REVENUE INVESTORS

By taking all factors into consideration, and experimenting with several methods, you will discover ways of adding value to your startup. This process allows you to cover the bases and prove to investors that your business is genuinely worth investing in.

How much is your startup worth?