SCORECARD VALUATION METHOD

In simple terms, the scorecard company valuation helps angel investors find an average valuation for startups that are able to grow, but with no revenue yet. This method uses **weighted percentages** and **market data** to determine an acceptable average**.**

WHAT IS THE SCORECARD VALUATION METHOD?

Also known as the **Bill Payne valuation method**, the scorecard valuation method is a widely preferred method by angel investors. In this method, the target startup seeking investment is compared with other similar funded startups. The scorecard valuation model **compares these companies** on the basis of several factors like stage, market, and region. These factors have a direct impact on the valuation of the company. Factors as such also affect the average valuation of the company.

The scorecard method is used to **compare the target company** to other similar **companies in the industry**. The basis on which they compare the companies are the stage of development, business sector, and geographic location. Before adjusting the median of the appraisal, the target company will be compared with others by the investor for several factors. This will value the company level and help them decide the amount they would invest in the company.

HOW SCORECARD VALUATION HELPS ANGEL INVESTORS AND EARLY-STAGE COMPANIES?

Scorecards are usually used in sports so that the fans, players, and the coach can break down and understand the factors that led to them winning or losing. This is important as this information will help them determine the strengths and weaknesses of the team. Similarly in the business world, scorecards are mostly used the same way as they are a handy tool for investors. The scorecard valuation model helps **determine the average value of the target company**.

When a startup approaches angel investors for financing, investors use this method as a way to determine the value of a startup. Factors that make the startup more or less valuable are highlighted in these scorecards. The main factors that affect the investor’s decision are the **quality of the management team**, **market size**, and **the industry sector**.

It is essential to know why entrepreneurs and investors find company valuation so essential. There are two main types of valuation, before the investment, or **"pre-money"** and after the investment, or **"post-money"**.

There are times the company does a valuation to determine how much they are willing to let go in order to raise capital. On the other hand, angel investors use the company valuation method regularly. The reason for this is that their calculation plays a huge role in the success of the investment. When they are comfortable with the **pre-money scorecard valuation model**, they will invest in a company.

HOW DOES A SCORECARD VALUATION WORK?

Valuing a startup is quite interesting, as a majority of startups do not have revenue. Inherently, investors valuing established companies are vastly dissimilar to the valuation of startups. Established companies not only have operating expenses, but also **generate income** and **incur losses at times**.

Investors always tend to put a **higher value on the management team** and the entrepreneur of the company. They do so because financial projections and quantitative analysis do not always predict the future of a company in its initial stages.

For the valuation of pre-money, there is more than one way to derive the amount for a startup. This is why it is essential to gather information and in-depth knowledge about the **valuation methodologies**. The best way to do so is by contacting other angel investors and entrepreneurs. Pre-money valuation is the value of the startup before it gets any investment from outside sources.

To determine a scorecard company valuation, the investors keep these things in mind while comparing the company to others in the industry. After evaluating the target company, an angel investor looks at the potential of the company, and if they can make a profit from their investment.

DETERMINE THE AVERAGE PRE-MONEY VALUATION FOR PRE-REVENUE STARTUPS

Determining the median of the pre-money valuation using the scorecard valuation method is the first step of this process. We use the pre-revenue company's pre-money valuation in the same business sector and region of the target company to derive the median. The pre-money valuation of companies in the US are different depending on the geographic location, as the **region also affects the competitive environment** of the startup venture.

We use the same region as in the majority of them; the pre-money valuation is only slightly different from one business sector to another. If local data available is insufficient, the investor can read the Angel Capital Association's most recent national study in the **"Angel Funders Report"**.

Let us take an example*: In* ABC *Ltd., the* ***seed stage deal is $8 million****, and the* ***pre-seed deal is $6 million****. In this case, the pertinent median for the local* ***pre-money valuation is $7 million****. This is so because we assume the median to be the midpoint between the pre-seed and the seed stage deals. Additionally, the strengths and weaknesses of the target company are considered, and the starting point is further adjusted in the scorecard valuation method.*

DETERMINING FACTORS

To determine the pre-money valuation of pre-revenue businesses, the next step involves comparing the target company using the scorecard valuation method to the **deals done that are the same in your region**.

The scorecard method is the most popular way to derive a pre-money value. **The main criteria for the scorecard method in order are**:

- Board, entrepreneur, the management team – 25%
- Size of opportunity – 20%
- Technology/Product – 18%
- Marketing/Sales – 15%
- Need for additional financing – 10%
- Others – 10%

These percentages can be adjusted according to the **investor's preferences**, but the important part is the potential of the startup. The above criteria are ranked in a subjective manner, for startup ventures, this is the typical order for an investor appraisal. One point that often catches many off-guard is that investors rank the technology and product below the size of the opportunity, and both of them are below the management team.

While **building a business**, the quality of the management team complements the success of the product and the company. A great management team will work on fixing all early flaws in the product. Scalability is essential as it is directly related to the **returns of the investor**. In a company, having intellectual property and a good product is essential, but more important is the **quality** and **skills of the management team** as it is key to the success of the product.

CALCULATE THE VALUATION

Calculating the valuation of a company is not a complicated task. To understand it better, let's take an example.

Using the same example as above, **ABC Ltd. is looking for angel investors** to raise capital for the company. The interested investor drafts a scorecard company valuation for the target company.

Let us assume that ABC Ltd. has:

- Large market opportunity (100%)
- A strong team (130% of norm)
- An average technology and product (100%)

When we take a look at ABC Ltd's strength of market competition, it is weaker compared to others at 80%. The early feedback from customers for the offering product is excellent. Therefore:

- Other (100%)

On the other hand, management was facing problems with their sales channels. They need to work on establishing **better sales channels** and **also build their partnerships** (80%). All these data will be compiled and put into a table, giving a short summary of the company.

Using the data of ABC Ltd., we can derive the **pre-money valuation of the company**:

Comparison facts	Target Company	Range	Factor
Size of Opportunity	140%	20%	0.28
Strength of Team & Entrepreneur	130%	25%	0.325
Product & Technology	100%	20%	0.2

Comparison facts	Target Company	Range	Factor
Sales/Market/Partnership	90%	11.50%	0.1035
Competitive Environment	80%	11.50%	0.092
Need For Additional Investment	100%	6%	0.06
Other Factors	100%	6%	0.06
SUM			**1.1205**

Using the previous example: if we **multiply the median of the pre-money valuation by the sum of factors**, we get the target company's pre-valuation.

= 1.1205 x $7,000,000

= **$7,843,500**

The pre-money valuation of the target company **ABC Ltd. is $7.843 million**. This valuation is not only used as the current value of the business before revenue and investment, but it is also used to calculate the value of the company's shares.

HOW TO USE THE SCORECARD VALUATION METHOD FOR YOUR STARTUP?

It is essential to have a good understanding of the scorecard valuation method. This method provides data that assists angels in adjusting the **median valuation of targeted startups** in a similar business sector. It offers factors and issues to consider while judging the company's value. And with outside investment, a startup should also have a good understanding of their share ownership and cap table.