**8 Things VCs Think About When Valuing Your Startup**

Before you take money from a [venture capital](http://mashable.com/2013/05/13/startup-valuation/?goback=%2Egde_39259_member_240474055) firm, you'll agree to a valuation — how much your startup is worth. That valuation will also affect how much of your company you own. Optimizing for a higher valuation can sometimes mean owning less of your company, so strategies for each founder can vary widely.

How a valuation is determined, investors say, is more an art than a science. There are standard factors that will be considered before putting a price tag on a startup, but the biggest factor turns out to be demand — how many other investors are vying to put money into your company. That said, there's a lot an entrepreneur can do to influence valuation (aside from, you know, building something that's valuable). The more investors you pitch to and the better you are at telling your story, the more interest you'll generate, which will drive up your price.

As a rule of thumb, the valuation will generally be set in line with the return the investor wants — if the seed round is $1 million and your investors want a 10x return, the valuation will likely be set at $10 million.

But investors are far from arbitrary with valuations. "You're buying part of the company as an investor," says [Caitlin Strandberg](http://www.flybridge.com/team/Caitlin-Strandberg/detailed-bio) of [Flybridge Capital Partners](http://www.flybridge.com). "The investor wants it to be as accurate as possible."

That said, the seemingly "over the top" valuations on the market are a result of investors believing they've found an outlier. These big, fast-growing opportunities are few and far between, so when a someone thinks they've found one, the valuation can jump.

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"I'm seeing a rationalization of valuations right now," says [Jalak Jobanputra](http://www.linkedin.com/in/jalak), managing partner at [FuturePerfect Ventures](http://www.futureperfectventures.com/index.html). "We're seeing a slowdown — more diligence being done."

Here are eight things investors analyze when making a valuation.

**1. Competition, or Demand**: If you've heard a VC compare [fundraising](http://mashable.com/2013/05/13/startup-valuation/?goback=%2Egde_39259_member_240474055) to dating, it probably sounded cliche — but it's true. VCs are highly competitive and will perceive an [investment](http://mashable.com/2013/05/13/startup-valuation/?goback=%2Egde_39259_member_240474055) as valuable if the other VCs on the block show interest. While understanding how VCs work is essential to raising money in the first place, it also is the most important factor that will influence valuation. It goes back to basic economics — only so many investors can get in on a startup's round of fundraising, so the more who desire it will result in a higher valuation.

**2. Growth**: It's been said that the defining factor of a startup is growth. At the fundraising stage, some companies will just pitch the potential for growth, such as a large market, but others will already be able to show traction. The month-over-month active users or paying customers is rising fast. Since a growth metric can allow for revenue predictions, it will play a part in defining a company's value.

**3. Opportunity**: Of course, it's the hard-to-quantify factors like this that make valuations a bit of a mystery. But consider the example of a startup with no competition, because they're attempting something everyone else thinks is impossible. These are the big payoffs VCs are looking for, and they'll will slap a huge valuation on when they find it.

**4. Revenue**: Valuations always include a bit of mystery, but those more mathematically inclined will appreciate adding revenues to the equation.

"The moment you have revenues, the financial literature has a lot of different tools you can use to value something," says [Dustin Dolginow](http://www.linkedin.com/in/dolginow) of [Atlas Ventures](http://www.atlasventure.com).

But revenue is still only one piece, and at an early stage, revenues won't tell you everything about a startup's potential.

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"At some point it has to be profitable revenue," Strandberg says, "and repeat customers."

**5. Founders**: A successful startup often has more to do with the founders' ability to execute rather than starting with a truly brilliant idea. Where the founders have worked, on what projects and previous exits will influence valuation.

**6. Other Investors**: A deal is never just between a startup and a VC. The terms will be agreed on by all parties, and a few VC firms and sometimes an angel investor will contribute to a round as a group. A VC's job is not just finding the right startups to invest in, but also building relationships with other firms that invest in similar industries or stages. Other investors in the round might also get a seat on the startup's board and provide strategic direction, so knowing the startup's other investors are solid will indeed increase its value.

**7. Accelerators or Incubators**: Many accelerators that have a few years of experience will publish the success rates of startups they've been involved with. All startups in the incubator or accelerator have access to similar resources and mentorship. Not surprisingly, a VC can run some numbers and decide startups that go through the program in the future have a good probability of a good exit. This time of assurance will influence a startup's value.

**8. Story**: Some components of a valuation are tangible, and some are not tangible, Strandberg notes. Team chemistry is difficult to put on paper, but VCs know it when they see it, and some will have founders undergo some sort of analysis to gauge how they'll work together. The potential of a market also cannot always be documented, especially if there's a lot of change underway.

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"It's kind of like making a stew, you put all these pieces in, it stews for awhile in the market and then you get this result," says Dolginow.

As with any imperfect art, the more pieces you include will improve your chances of getting it right, or at least remarkably close. And like true artists, investors might each have their own secret sauce or instincts that they've perfected over time as they set valuations.

Have you seen startup valuations you felt were unfair or irrational? What factors do you find important in setting a good valuation?