# Valuation of Service Sector Companies, Startup Companies and E-commerce in India

Service Sector entities are a nebulous block consisting of various different kinds of industries. Each industry would have its own nuance and would also have its own issues which play an important role in evaluating the company that belongs to that particular industry. Few common features of service sector companies include:  
a. Lack of tangible physical assets  
b. Dependency on key management team  
c. Lesser upfront capex  
d. Lack of strictly comparable peers  
e. Dependencies on a platform or a technology  
f. Enhanced subjectivity in valuation assessment  
g. Fast changing and evolving  
h. Certain industry specific issues encountered while doing valuation in service industries:

I. Software Industry

Regardless of which market segment your software company is in, these key factors make the major difference to its value:  
**a) Earnings growth prospects**  
Earning growth prospects is a key parameter that determines the value of the software company. Because of a high-dependency on this parameter, it becomes extremely important to correctly assess the Earnings growth prospects of the entity. A key issue in evaluating the Earning growth prospect is to also understand the technology curve that is currently underway and the changing behavioural patterns. Software products can be highly profitable if focused on the right market segment with significant demand. Product firms especially can experience significant revenue growth quickly with the right product mix.

**b) Profitability**  
Usually software companies have a better profitability margins as compared to traditional sectors. Key cost for software companies include a) Development Costs and b) Marketing Costs. Both of these are predominantly people costs that for a part of the employee benefit costs for an entity. The firms that manage growth while keeping their cost from escalating are far more valuable than their unprofitable counterparts.

**c) Stability of earnings**  
Maintaining consistent level of sales and profitability can be very difficult especially for pure product software companies. Competition can introduce an alternative product and sudden market changes can make a star product obsolete very quickly.  
This is where the service companies tend to do better – the customer loyalty tends to translate into repeat business, stable prices and steady earnings. The costs of entering the new market segments are also lower for software services companies as they tend to rely on existing customers and referrals to do so.  
**d) Changing technology and obsolescence**  
A key feature to be considered in valuing software companies, is the dependency of the company on a particular technology or a particular channel. Empirical evidence suggests that technology companies perish significantly faster than brick-and-mortar business, one of the reasons for such sudden perish ability is the pace of change in technology or dependency on a particular mode of service delivery.

# Valuation for Startup Companies in India

Investor invests to earn return of their equity and they risk high on startups because early stage startups have no business experience, no established brand of their products and services, No Human Resources, illiquid Investments etc. The Future of Startups are uncertain, so valuing a startup can be little bit tricky.

Here we will discuss startup valuation at pre-revenue stage or revenue generation just commenced and gradually being scaled up.

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* [Minimum Requirements for Startup Valuation and Stake Diversion – Procedure](https://fastlegal.in/blog/investment/how-to-do-startup-valuation-for-startup-companies-in-india/#Minimum_Requirements_for_Startup_Valuation_and_Stake_Diversion_Procedure)
* [Expected Investment by Venture Capitalist or Angel Investor :](https://fastlegal.in/blog/investment/how-to-do-startup-valuation-for-startup-companies-in-india/#Expected_Investment_by_Venture_Capitalist_or_Angel_Investor)
* [Expected Profits by Startup Company will earn](https://fastlegal.in/blog/investment/how-to-do-startup-valuation-for-startup-companies-in-india/#Expected_Profits_by_Startup_Company_will_earn)
* [Expected Return on Equity Investor expects from Startup entity](https://fastlegal.in/blog/investment/how-to-do-startup-valuation-for-startup-companies-in-india/#Expected_Return_on_Equity_Investor_expects_from_Startup_entity)
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The Scorecard method uses a combination of industry data and weighted percentages based on detailed quantitative analysis to come up with a realistic valuation. The method is split into four steps which we’ll look at individually.

### Step 1: Determine the average industry pre-money valuation

Before doing anything else you need to establish a pre-money valuation for existing businesses in the same location and sector. Both of these factors can have a significant effect on the overall value of the business.

### Step 2: Determine the individual weighted averages

Now you need to compare your startup with the perception of other startups in the same industry and region. Payne recommends the following factors are assessed and weighted.

#### Strength of the Management Team (0-30%)

The management team should be complete and consist of experienced, knowledgable and coachable people. A better management team would lead to a higher valuation of your startup.

#### Size of the Opportunity (0-25%)

The size of the market should be assessed and realistic market share targets should be set. If the size of the market is too low, it would have a negative impact on your startup valuation.

#### Product/Technology (0-15%)

The intellectual property (IP) and traction of the company should be well defined. Some investors put traction (the ability and speed with which you can generate new customers) ahead of IP when evaluating startups. If your product has a clear competitive edge and you can demonstrate the ability to generate traction – you can raise your startup funding at a better valuation.

#### Competitive Environment (0-10%)

The competitive environment should also be thoroughly analysed. The barriers to entry, average operating profits for the industry and the projected growth of the industry should all be assessed. If the barriers to entry in your market are low, this will have a negative impact on your startup valuation.

#### Marketing/Sales Channels/Partnerships (0-10%)

The company should have detailed marketing plans along with identified sales channels and partnerships which can be leveraged to create new business. If you can demonstrate that you have already worked out your sales channels and developed relevant partnerships – you can increase your valuation by 10%.

#### Need for Additional Investment (0-5%)

Will the company require any additional investment from Angel investors or Venture Capitalists? If yes, this should be assessed and the amounts required should be factored into the valuation. The money you raise should be able to take you to the next round.

#### Other (0-5%)

You should also take into account any other factors which may influence the valuation. The geographical location, the maturity of the market and any feedback from early adopters or beta users fall into this category.

### Step 3: Calculate percentage weights

Now we need to bring everything together and calculate the percentage weights for our business and compare them with a percentage for a business in the same sector and preferably location. Payne devised the following table which we have filled in with speculative data to show how this is done.

|  |  |  |  |
| --- | --- | --- | --- |
| **Comparison Factor** | **Weight %** | **Comparison %** | **Factor = (WxC)** |
| Strength of team | 30% | 100% | 0.3000 |
| Size of opportunity | 25% | 125% | 0.3125 |
| Product/technology | 15% | 150% | 0.2250 |
| Competitive environment | 10% | 75% | 0.0750 |
| Marketing/sales/partnerships | 10% | 100% | 0.1000 |
| Need for additional investment | 5% | 100% | 0.0500 |
| Other factors | 5% | 125% | 0.0625 |
| SUM |  |  | 1.1250 |

In the above example, the management team has been assessed to be strong and weighted with the full percentage (30%). The market opportunity is also seen to be favourable and this has also been given the full percentage (25%). However, the company is also competing in a highly competitive environment (10%) which could restrict growth and put pressure on margins.

### Step 4: Multiply the sum of the factors

Finally, we are ready to get a valuation for our business. Take the sum of the factors from the table above (1.1250) and multiply it by the industry average pre-money valuation identified in step one ($1.5 million). The resulting valuation for our startup is $1.6875 million.

While the Scorecard method still requires a degree of subjectivity on behalf of the investor it does provide a solid foundation for the valuation of pre-money startups. The method also ensures founders carry out good industry research and commit to an honest and introspective understanding of their own abilities before seeking capital.

# Valuation of  E-commerce businesses:

## Valuation principles in the e-commerce sphere: Traditionally, tried and tested methods such as discounted cash flow, growth and risk estimation have consistently been applied across various retail sectors to value the worth of a business. While these methods continue to be relevant today, it appears that such established fundamentals have been disregarded in the domain of e-commerce valuation.  Increasingly, valuations in respect of e-commerce “shops” are moving away from such established methods towards a consideration of a plethora of factors which vary widely, lack consistency and persons valuing such companies frequently “cherry-pick” the favourable factors to push up valuations.

Factors which are considered nowadays for valuations of e-commerce companies include sales, number of transactions, active users, “hits”, the future state of the industry, and potential market size. There seems to be less emphasis on the historical or current profits of a company. The markets also seem to base such valuations on expected growth, market share, extremely optimistic revenue growth and not necessarily profitability. Furthermore, they seem to exclude certain vital data components including qualified human resources, logistics costs, advertising, percentage of orders refused/returned and shopping cart abandonment rate.

## What Is a Conglomerate?

A conglomerate is a corporation made up of a number of different, seemingly unrelated businesses. In a conglomerate, one company owns a controlling stake in a number of smaller companies which conduct business separately.