

Jean-Baptiste Flanc

Valuation of Internet Start-ups

An Applied Research on
How Venture Capitalists value Internet Start-ups



Anchor Academic Publishing

disseminate knowledge

Flanc, Jean-Baptiste: Valuation of Internet Start-ups: An Applied Research on How Venture Capitalists Value Internet Start-ups. Hamburg, Anchor Academic Publishing 2014

Buch-ISBN: 978-3-95489-082-8

PDF-eBook-ISBN: 978-3-95489-582-3

Druck/Herstellung: Anchor Academic Publishing, Hamburg, 2014

Bibliografische Information der Deutschen Nationalbibliothek:

Die Deutsche Nationalbibliothek verzeichnet diese Publikation in der Deutschen Nationalbibliografie; detaillierte bibliografische Daten sind im Internet über <http://dnb.d-nb.de> abrufbar.

Bibliographical Information of the German National Library:

The German National Library lists this publication in the German National Bibliography. Detailed bibliographic data can be found at: <http://dnb.d-nb.de>

All rights reserved. This publication may not be reproduced, stored in a retrieval system or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior permission of the publishers.

Das Werk einschließlich aller seiner Teile ist urheberrechtlich geschützt. Jede Verwertung außerhalb der Grenzen des Urheberrechtsgesetzes ist ohne Zustimmung des Verlages unzulässig und strafbar. Dies gilt insbesondere für Vervielfältigungen, Übersetzungen, Mikroverfilmungen und die Einspeicherung und Bearbeitung in elektronischen Systemen.

Die Wiedergabe von Gebrauchsnamen, Handelsnamen, Warenbezeichnungen usw. in diesem Werk berechtigt auch ohne besondere Kennzeichnung nicht zu der Annahme, dass solche Namen im Sinne der Warenzeichen- und Markenschutz-Gesetzgebung als frei zu betrachten wären und daher von jedermann benutzt werden dürften.

Die Informationen in diesem Werk wurden mit Sorgfalt erarbeitet. Dennoch können Fehler nicht vollständig ausgeschlossen werden und die Diplomica Verlag GmbH, die Autoren oder Übersetzer übernehmen keine juristische Verantwortung oder irgendeine Haftung für evtl. verbliebene fehlerhafte Angaben und deren Folgen.

Alle Rechte vorbehalten

© Anchor Academic Publishing, Imprint der Diplomica Verlag GmbH
Hermannstal 119k, 22119 Hamburg
<http://www.diplomica-verlag.de>, Hamburg 2014
Printed in Germany

Abstract

This book deals specifically with the valuation of Internet start-ups after the burst of dot-com bubble. The objective is to contribute to the development of this field of study by filling some of the existing gaps. Indeed, it is a relatively recent subject, and the research devoted to it is still limited.

It has been found that the valuation of an Internet start-up does not only depend on its stage of development, but also on five qualitative factors: the team, the business model, the market, the risk, and the exit options. In fact, venture capitalists base their valuation on the perceived growth potential of the company.

Subsequently, this book addresses the issue of intangible assets. In fact, an Internet company derives most of its value from its intellectual capital, brand equity, and website. These intangible assets, as well as their accounting treatment, are deeply analyzed. It has been noticed the misclassification of their expenses can have a considerable impact on the valuation of the company.

The discounted cash flow valuation method, which is based on financial projections, and the relative valuation method, which is based on comparables, are identified and examined in-depth. Their analysis is crucial to determine how to properly value an Internet start-up.

Ce livre traite le sujet de la valorisation des start-up Internet, et ce, après l'éclatement de la bulle du secteur. L'objectif est de contribuer au développement de ce champ d'étude, qui est relativement récent, et dont les travaux de recherche sont limités.

Il a été constaté que la valeur d'une start-up Internet ne dépend pas seulement de son stade de développement, mais également de cinq critères qualitatifs: l'équipe, le modèle d'entreprise, le marché, les risques, et les options de sortie. Il s'avère en effet que les capital-risqueurs évaluent une entreprise en fonction de son potentiel de croissance.

Une société Internet tire l'essentiel de sa valeur de ses immobilisations incorporelles : son capital intellectuel, sa marque, et son site. Le traitement comptable de ces immobilisations est donc analysé en détail. Il a notamment été remarqué qu'une mauvaise classification des dépenses liées à ces immobilisations peut avoir un impact considérable sur la valorisation de l'entreprise.

La méthode d'évaluation par l'actualisation des flux de trésorerie et la méthode d'évaluation par comparaison sont étudiés dans ce livre. Leur analyse permet de déterminer la meilleure façon d'évaluer la juste valeur d'une start-up Internet.

Acknowledgements

I hereby first and foremost express my great gratitude to Won Kim for its guidance and support. He was always available for discussions and suggestions about the different factors that could enter in the determination of the valuation of Internet start-ups.

I am very grateful to the venture capitalists who gave me relevant information on how they value this specific kind of companies.

Finally, I express my gratitude and thanks to my friends and family for their help and encouragement throughout the development of this book.

Table of Contents

1.	Introduction	1
1.1.	Topic.....	1
1.2.	Research Objectives	2
1.3.	Research Design.....	3
1.4.	Structure	4
2.	Overview and Definitions.....	6
2.1.	The New Economy	6
2.1.1.	Birth and Growth	6
2.1.2.	Pure Play Companies	10
2.1.3.	Winner-Take-All Competition.....	10
2.2.	The Development of Start-ups	11
2.2.1.	Stages of Development	11
2.2.2.	Funding Rounds and Sources.....	13
2.2.3.	Introduction to Valuation.....	15
2.3.	The Venture Capital Funding.....	17
2.3.1.	Venture Capital	17
2.3.2.	Investment Criteria.....	19
2.3.3.	Ownership Dilution.....	27
3.	Dealing with Intangibles Assets.....	30
3.1.	Identification	30
3.1.1.	Intellectual Capital	30
3.1.2.	Brand Equity	32
3.1.3.	Website.....	34
3.2.	Expenses Misclassification and Other Characteristics.....	35
3.2.1.	R&D Expenses.....	36
3.2.2.	Marketing and Advertising Expenses	37
3.2.3.	Other Characteristics.....	38

3.3.	Accounting Treatment.....	39
3.3.1.	Recognition.....	39
3.3.2.	Fair Value Determination.....	40
3.3.3.	Goodwill	40
4.	Financial Valuation Methods	42
4.1.	Discounted Cash Flow Valuation Method	43
4.1.1.	Forecasting Cash Flows	43
4.1.2.	Discounting Cash Flows	44
4.1.3.	Pros and Cons	46
4.2.	Relative Valuation Method	47
4.2.1.	Identifying Peer Companies.....	48
4.2.2.	Comparing Multiples	49
4.2.3.	Pros and Cons	50
4.3.	Other Valuation Methods.....	51
4.3.1.	Probabilistic Methods	51
4.3.2.	First Chicago Method.....	52
4.3.3.	Real Options Method	53
	Conclusion.....	54
	List of References	56

List of Tables

Table 1: Internet Start-ups' Standard Correlation.....	14
Table 2: Balance Sheet after Seed Round	27
Table 3: Balance Sheet after Angel Round	28
Table 4: Balance Sheet after Series A Round	29
Table 5: Example of Relative Valuation for Internet Start-ups	50

List of Figures

Figure 1: Number of Internet Users from 2001 to 2011	7
Figure 2: Global Number of Internet Users from 2001 to 2011.....	8
Figure 3: Early Stages of Development of Traditional Start-ups.....	12
Figure 4: Qualitative Factors in Valuation.....	19