

Two Sides of the Same Coin: The Direct Relationship between Valuation and Dilution in Pricing Venture and Growth Equity Deals

2H 2023

Two concepts that venture capital and growth equity investors often grapple with are “valuation”, the agreed-to dollar value of the target company, and “dilution,” the nexus between an investor’s *expected* ownership percentage of the target company post-investment and such investor’s *actual* ownership percentage of the target company. Understanding the relationship between these concepts is crucial to achieving successful outcomes when planning and negotiating these investments. Although they may seem distinct on their face, valuation and dilution are in fact two expressions of the same mathematical principle.

Very simply, the effective (post-money) valuation of a company implied by an investment is the dollar amount of the investment divided by the percentage received. If an investor makes a \$1mm investment and receives 10% of the company (i.e., $\$1\text{mm} / 0.10$), the company is being valued at \$10mm on a post-money basis (and \$9mm on a pre-money basis) (see the article [Simple Cap Table Analysis](#)).

If, however, there is also an expansion of the option pool representing \$1mm worth of shares (see the article [Avoiding Hidden Dilution in Growth Equity and Venture Capital Investing](#) for a more in-depth discussion of the types of dilution investors can experience) and the investor agrees that it will bear its pro-rata share of the corresponding dilution, an investment of \$1mm at a pre-money valuation of \$9mm would instead result in a post-money ownership percentage of 9.09% (i.e., $\$1\text{mm} / (\$9\text{mm} + \$1\text{mm} + \$1\text{mm})$), rather than 10%. Practically, this result is the same as if the original investment were made based upon a pre-money valuation of \$10mm (i.e., $\$1\text{mm} / (\$10\text{mm} + \$1\text{mm})$) with no increase to the unallocated option pool.

Net, an equivalent sized investment purchasing a smaller percentage of the Company because such investment bears dilution, is the same mathematical result as making the investment at a correspondingly greater valuation.

If you have any questions, please contact your primary attorney at Seward & Kissel LLP or Gary Anderson at anderson@sewkis.com or Eric Buchanan at buchanan@sewkis.com.



Gary Anderson

Partner, Business Transactions Group
anderson@sewkis.com
(212) 574-1687



Eric Buchanan

Associate, Business Transactions Group
buchanan@sewkis.com
(212) 574-1651