

Always sell stock at the highest valuation...right?

It would seem obvious that all companies, whether startups or late stage, should always seek the highest valuation for every round of financing. After all, higher valuations reduce the dilution impact from any financing and generally reflect a validation of the success of the company.

That said, raising capital at the highest valuation possible can sometimes have unintended negative impacts on a company. This article discusses some of those consequences that entrepreneurs may want to consider as they seek those higher valuations.

Valuation considerations in fundraising

Raising capital at the highest valuation from some investors does not mean that other investors will accept the valuation. As a result, setting a high valuation may inhibit a company's ability to raise the full amount of capital that it requires. This is particularly the case for early stage companies that may be able to raise financing from angels at a high valuation that others will not support. Whatever valuation is used, it is important that, at a minimum, it supports raising the full amount of financing that is required. Moreover, even if a company is able to raise the full amount it seeks in a round, raising capital at a high valuation may make it more difficult to raise subsequent rounds if potential investors do not accept the earlier valuation.

Raising capital at the highest valuation may also preclude raising capital from the investors that can most contribute to a company's success. The capital that an investor provides should be only part of the contribution that they make. Constructive board participation and providing assistance with the building of the company (eg, hiring, customer and strategic contacts) are critical contributions that value-add investors provide. Likewise, the ability and willingness of investors to stand by the company and continue to fund the company (particularly in troubling times) varies significantly by investor. If raising capital at a high valuation means partnering with an investor who is less likely to make these other contributions, the benefits of the higher valuation may be illusory.

Impact of valuation on exit

Raising capital at the highest valuation may also inhibit an exit transaction and as a result change the strategic direction of the company. Investors expect minimum returns on their investment and the valuation at which the last round is raised can impact the investors' willingness to entertain an exit transaction that might otherwise be deemed desirable by earlier investors and founders. In particular, later stage companies raising capital at higher valuations often must agree to provide the latest round investors special rights to block exits or improved conversion rights or liquidation preferences.

The above is not to say that companies should not generally try to raise capital at the highest valuation, but rather that companies should understand that there are tradeoffs that should be carefully considered.

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