WHAT IS LARGE, MID AND SMALL CAP FUNDS?

Chapter 22

Difference between large-cap, mid-cap and small-cap stocks

Large-cap stocks are the first class in market capitalization. As the name suggests, these are stocks of well-established companies that have been around for years.

Based on their current market capitalization, stocks are classified into large-cap, mid-cap, and small-cap. Market capitalization of a company refers to the total number of its outstanding shares in the market multiplied by the current price per share. It provides the investor with an estimated valuation of the company. For instance: Suppose a company has 10,000 outstanding shares in the market, and each of them is priced at Rs10. Thus, its market capitalization will be: outstanding shares * price per share.

10,000*10 = Rs. 1,00,000 (Market cap of the company)

Here's a brief description of the types of market capitalization:

1. **Large-cap stocks:** These stocks are the first class in market capitalization. As the name itself suggests, these are stocks of well-established companies that have been around for years. The market capitalization of these companies is very high – above Rs. 20,000 cr.

Large-cap companies have strong market presence and their stocks are generally considered to be very safe (low risk). Most of these companies regularly disclose information through media, such as newspapers. In other words, information on large-cap companies is very readily available.

In India, examples of large-cap companies include Wipro, TCS, and Infosys, among others.

2. **Mid-cap stocks:** Mid-cap companies can be considered to border large-cap and small-cap companies on both ends of the market capitalization spectrum. Typical, their market capitalization lies between Rs5,000-20,000cr. Mid-cap companies are considerably smaller than large-cap companies in all fields of comparison – revenue, profitability, employees, client base, etc.

What attracts investors to mid-cap stocks is the possibility of investing in a company that could become an overnight success. Mid-cap companies have a tremdendous scope for growth and can potentially give higher returns in the 3-5-year investment horizon.

Unlike in the case of large-cap companies, a lot of information on mid-cap companies isn't publicly available. This makes it difficult for an investor to judge the stock – which is why one hardly sees conservative investors investing in mid-cap stocks.

3. **Small-cap stocks:** Small-cap stocks lie at the other end of the market capitalization spectrum. Most small-cap companies are either start-up enterprises or companies in the development stage. Understandably, they have low revenues and a small number of employees and clients. Information on these companies isn't easily available to all.

This is exactly what makes small-cap stocks a big winner for investors with a long investment horizon and a moderate-to-high risk appetite – not a lot of people know about the stock! However due to their nature, small-cap stocks are considered to be a highly risky investment.

One must conduct thorough research into the company of choice before even considering investing in it. A few basic things you should analyze include the short-term and long-term plans of the company, the revenue model, profitability, outside investments, goodwill of the promoters, and financial strength to withstand difficult times, among a few other parameters.

The key is Diversification

Now that you know exactly how companies are classified based on their market capitalization, it is time to do your own homework. Most financial advisors swear by one rule of investment – diversification. We recommend that you don't park all your funds in large-cap stocks because of fear and lack of knowledge.

Analyse your risk profile and investment horizon before planning to invest. Make sure you diversify your investments properly. If you’re a beginner, we recommend you diversify with the help of a financial advisor.

Sum up:

Classifications such as large-cap, mid-cap and small-cap are only approximations and may change over time. It is based on Market capitalization of the company. Market capitalization of the company is defined as:

Market Capitalization = Share Price X Number of shares outstanding

Small cap is a term used to classify companies with a relatively small market capitalization. A company’s market capitalization is the market value of its outstanding shares. In US, the company is classified as small cap if its market capitalization is less than $2 billion and in India, normally a company below market capitalization of Rs.5000 crores is classified as small cap company.

A mid-cap company is a company with a market capitalization between $2 billion and $10 billion in US. In India, normally a company with market capitalization above Rs.5000 crores and less than Rs.20000 crores is considered as midcap company. As the name implies, a mid-cap company falls in the middle of the pack between large-cap and small-cap companies.

Large cap (sometimes “big cap”) refers to a company with a market capitalization value of more than $10 billion. Large cap is a shortened version of the term “large market capitalization.” In India, normally companies with the market capitalization higher than Rs.20,000 crores is considered as Large cap companies.

The amount used for the classifications “large cap,” mid cap” or “small cap” are only approximations that change over time.