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LEARNING
EDGE



WHITEOAK
CAPITAL MANAGEMENT

THE ART AND SCIENCE OF INVESTING

CONCEPTOPEDIA

Free Float Market Capitalization

Learning Objectives

- Describe Market Capitalization.
- Define and describe Free Float Market Capitalization.
- Outline the importance of using Free Float Market Capitalization Methodology.
- Recognize linkage between Free Float and Volatility.
- Differentiate characteristics of large, mid, and small-cap stocks.
- Did you Know – Few facts about Sensex and indices.

What is Market Capitalization?

- Market Capitalization refers to the market value of a firm's outstanding shares.
- Formula:- Market price of the company's stock * Outstanding shares
- Example:- Assume the market price of a company's share is Rs. 100 and it has 1 lac (1,00,000) shares outstanding, then the market capitalization is $100 * 1,00,000 = 1,00,00,000 = \text{Rs. } 1 \text{ cr.}$

What is Free Float Market Capitalization?

- Free-float market capitalization takes into consideration only those equity shares issued by the company that are readily available for trading in the market.
- Differential Voting Rights (DVR) shares are not considered in the calculation of free-float market capitalization.
- It excludes shares held by promoters and promoter entities; shares held by Government as promoters; Strategic stakes by private corporate bodies/ individuals etc.
- Free Float helps distinguish between strategic (control) shareholders, whose focus is to maintain control rather than make returns when compared to normal investors.
- Formula:- Outstanding shares – Strategic shares (promoter's shares etc.)
- Example:- Taking the earlier example, assume out of 1 lac (1,00,000) shares outstanding, 30,000 shares are held by promoters, then the balance 70,000 shares ($1,00,000 - 30,000$) are freely available for trading. The free-float market capitalization of the company is $100 * 70,000 = 70,00,000 = \text{Rs. } 70 \text{ lacs.}$





Importance of Free Float Market Capitalization



Helps in classifying a company as large-cap, mid-cap, and small-cap.



Provides insights into the true size and market value of the company and helps in making informed decision.



Provides more accurate picture of market movement and stocks.



Free Float Methodology is widely used for constructing indices around the world. E.g.:- NSE and BSE indices, MSCI indices, S & P indices etc. are based on free float methodology.

Linkage between Free Float Market Capitalization and Volatility



Free-float shares of a company is inversely correlated to volatility.



Companies with larger free float are less volatile, as due to large number of freely available shares, more investors are willing to invest in them.



Companies with smaller free float equates higher volatility, as few investors are willing to invest due to lesser number of freely available shares.



Most institutional investors prefer investing in companies with a larger free-float, because they can buy or sell a larger number of shares without having a significant impact on the price.



Characteristics of Large, Mid and Small-cap stocks

S.I	Large-Caps	Mid-Caps	Small-Caps
1	Well established and stable businesses.	Companies offering high growth potential. Can turn into large-caps in the long run.	Companies having significant growth potential.
2	Companies with market cap of Rs. 49,687 crores or more.	Companies with market cap above Rs. 17,409 crores but less than Rs. 49,687 crores.	Companies that have a market cap of less than Rs 17,409 crores.
3	Less Volatile compared to mid and small caps.	Tend to be more volatile.	Tend to be highly volatile.
4	Stable investment option for the long term.	Relatively higher growth potential.	Highest growth potential but tend to be highly risky.
5	High liquidity.	Lower liquidity.	Least liquidity.
6	Large research coverage by analysts.	Moderate research coverage by analysts.	Low research coverage by analysts.

Disclaimer:- The above examples are for illustrative purposes and for educational purposes only and should not be considered as an investment advice.



DID YOU KNOW

Securities and Exchange Board of India (SEBI) had issued a mandate in 2013, whereby all listed companies need to have at least 25% of the shares as free float.

Before September 2003, Sensex was using full market capitalization methodology, however in September 2003, Sensex and other indices started using the free-float method.

S&P BSE Teck was India's first free float index, followed by the BSE Bankex.

Source:- [De-jargoned: Free float | Mint \(livemint.com\)](#)

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