WHITEOAK LEARNING EDGE

WHITEOAK CAPITAL MANAGEMENT

THE ART AND SCIENCE OF INVESTING

CONCEPTOPEDIA

Free Float Market Capitalization

Learning Objectives

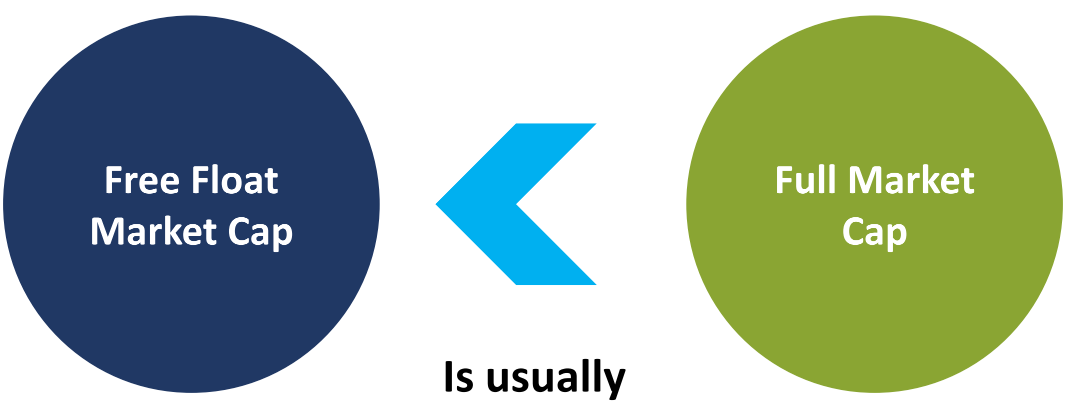
- Describe Market Capitalization.
- Define and describe Free Float Market Capitalization.
- Outline the importance of using Free Float Market Capitalization Methodology.
- Recognize linkage between Free Float and Volatility.
- Differentiate characteristics of large, mid, and small-cap stocks.
- Did you 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 = Rs. 1 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 = Rs. 70 lacs.



Source: BSE

WHITEOAK LEARNING EDGE

WHITEOAK CAPITAL MANAGEMENT
THE ART AND SCIENCE OF INVESTING

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.

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)

WHITEOAK LEARNING EDGE

WHITEOAK CAPITAL MANAGEMENT

THE ART AND SCIENCE OF INVESTING

Thank You!

www.whiteoakindia.com