

## **Climbing up the Market Cap Ladder - A few do, most don't!**





There is huge dispersion of returns among stocks within a single index. Below is the data on BSE 100 Index which depicts the huge variation of returns across stocks. We can see that while strong companies are able to generate wealth for investors, weaker companies destroy a significant amount of investor's wealth.

	<b>% CAGR (CY 04-14)</b>
BSE 100 index	15
Top quartile	26.2
Bottom quartile	-3.6

Source: Bloomberg, ACEMF

A few questions that arise here are: Does high risk equal to high returns? Can size of a company explain the risk that they carry? In search of answers, we have done some analysis on historical index data and how have stocks moved over the last 10 years. While there is no defined cutoff for size or market capitalization to call a company large, mid or small, here we will consider top 100 companies by market cap as large cap companies, next 300 companies as midcap companies and the rest as small cap companies.

For our study, we have taken Nifty 500 Index current data and 10 years back data. Some of the key findings from the table below are as follows:

- Within the large cap companies in 2005, only half of the companies remained large while very few companies (6%) have grown to become giant (market cap became more than 10x)
- Close to 10% of the large cap companies are now small caps or have got either acquired or delisted
- 35% of the large cap companies in 2005 are now categorized as midcaps
- Only 8% of the midcap companies in 2005 have grown to become large caps in last 10 years
- Close to half of the midcap companies in 2005 have either got acquired, delisted or are small caps in the current scenario

**Large cap companies in 2005 that are by now:**

	No of companies	% of companies
Became Giant (> 10 times the market cap)	6	6%
Large Caps	50	50%
Midcaps	35	35%
Small Caps	3	3%
Got acquired or delisted	6	6%
<b>Total</b>	<b>100</b>	<b>100%</b>

**Midcap companies in 2005 that are by now:**

	No of companies	% of companies
Large Caps	23	8%
Midcaps	131	44%
Small Caps	118	39%
Got acquired or delisted	28	9%
<b>Total</b>	<b>300</b>	<b>100%</b>

**Small cap companies in 2005 that are by now:**

	No of companies	% of companies
Large Caps	0	0%
Midcaps	4	5%
Small Caps	60	78%
Got acquired or delisted	13	17%
<b>Total</b>	<b>77</b>	<b>100%</b>

Source: Bloomberg, NSE. Above illustration includes data for all listed companies only. As on 30th Nov 2005, Top 100 companies by market cap are considered as large cap companies, next 300 companies as midcap companies and the rest as small cap companies.

If we look at the performance of the above companies over the last 10 years, we realize that size of companies have reflected in volatility of their returns. Smaller the size, higher the volatility! Although mid and small sized companies give bigger opportunity to gain higher returns in rising markets, their downfall is also steep in falling markets. Below table shows the range of returns with large caps and mid & small caps over a 10 year period.

	CAGR Return (2005 - 2015)*	
<b>Large caps in 2005</b>	Min	-15.1%
	Max	33.6%
	Avg	11.0%
<b>Mid &amp; Small caps in 2005</b>	Min	-33.5%
	Max	63.9%
	Avg	9.3%

Source: Bloomberg, NSE. \*CAGR return is from 30th Nov 2005 – 30th Nov 2015



**Past performance may or may not be sustained in future**

In the overall performance of market indices also, while large cap index (Nifty 50 ) has generated 11.6% return over last 10 years\*, Midcap index (Nifty Midcap 100) has outperformed large caps by delivering 13.2% over the same period. It shows that importance of active management is relatively higher in mid and small sized companies than larger established names.

## Conclusion:

From the above findings, we can understand that linear extrapolation of stocks from mid-caps to large-caps is more an exception rather than a rule. There is high level of attrition in the names that are being categorized within market cap buckets from time to time. It indicates that it is not only difficult to enter into an elite group of companies but it is almost as difficult to remain in that group. Many companies get benefitted when overall markets are rising. However, in tough times, only a few companies can sustain their position in the market and keep generating returns for their investors.

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\*'Buy' means purchase and 'Sell' means redemption of units of Axis Mutual Fund schemes.

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Data updated as on 30th Nov 2015.