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- Dictionary
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2. Stock Picking
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- Chalk Talk
- Investing Basics
- Stocks
- Options/Futures
- FOREX
- Bonds
- Trading
- Mutual Funds
- Personal Finance
- Retirement
- Young Investors
- Professional Education
- Financial Careers
- FAQs

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- Tutorials
- Ask Us
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What Is A Small Cap?

by Rick Wayman ([Email](#) | [Biography](#))

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The meanings of "big cap" and "small cap" are generally understood by their names: [big-cap stocks](#) are shares of larger companies and [small-cap stocks](#) are shares of smaller companies. Labels like these, however, are often misleading. If you don't realize how big "small-cap" stocks have become, you'll miss some good [investment opportunities](#).

Small-cap stocks are often cited as good investments due to their low valuations and potential to grow into big-cap stocks, but the definition of small cap has changed over time. What was considered a big-cap stock in 1980 is a small-cap stock today. This article will define the "caps" and provide additional information that will help investors understand terms that are often taken for granted.

First, we need to define "cap", which refers to [market capitalization](#) and is calculated by multiplying the price of a stock by the number of shares outstanding. Generally speaking, this represents the market's estimate of the "value" of the company; however, it should be noted that while this is the common conception of market capitalization, to calculate the total market value of a company, you actually need to add the market value of any of the company's publicly traded bonds.

Big-cap stocks refer to the largest publicly traded companies like General Electric (NYSE: GE) and IBM (NYSE: IBM). These are also called the [blue chip](#) stocks. "Big" has also been believed to have less risk while "small" has implied more risk, but, as evidenced by Enron (NYSE: ENE), this is not a good assumption to make. It is true, however, that the bigger they are, the harder they fall.

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The definition of big/large cap and small cap differ slightly between the brokerage houses and have changed over time. The differences between the brokerage definitions are relatively superficial and only matter for the companies that lie on the edges. The classification is important for borderline companies because [mutual funds](#) use it to determine which stocks to buy.

The current approximate definitions are as follows:

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- Big Cap - Market cap of \$10 billion and greater
- Mid Cap - \$2 billion to \$10 billion
- Small Cap - \$300 million to \$2 billion
- Micro Cap - \$50 million to \$300 million
- Nano Cap - Under \$50 million

These categories have increased over time along with the market indexes. In the early 1980s, a big-cap stock had a market cap of \$1 billion. Today that size is viewed as small. It remains to be seen if these definitions also deflate when the market does.

The big-cap stocks get most of Wall Street's attention because that is where the lucrative investment banking [business](#) is. These, however, represent a very small minority of publicly traded stocks. The majority of stocks are found in the smaller classifications, and this is where the values are. To prove this we examined Baseline's database of 10,721 stocks and found that 88% of the stocks were in the smaller classifications. Note the new category that shows how big "big" has become.

Mega Cap:	10	0.1% (over \$200 billion)
Big Cap:	374	3.5%
Mid Cap:	794	7.4%
Small Cap:	1888	17.6%
Micro Cap:	2015	18.8%
Nano Cap:	1699	15.8%

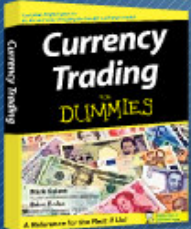
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The big and small labels are also attached to the major stock exchanges and indexes, which also leads to confusion. The [Dow Jones Industrial Index](#) is viewed as consisting of only big-cap stocks while the [Nasdaq](#) is often viewed as being comprised of small-cap stocks. These perceptions were generally true prior to 1990, but have since changed. Since the tech boom, the market caps of the stock exchanges and indexes vary and overlap. The average market cap for the Dow, however, remains much larger than the average market cap for the Nasdaq 100.

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Conclusion

Here are some main [points](#) to keep in mind:

- Labels such as big and small are subjective, relative and change over time.
- Big does not always mean less risky, but the big caps are the stocks most closely followed by Wall Street analysts.
- This attention, however, generally means that there are no value plays in the big-cap arena.

by **Rick Wayman** ([Email](#) | [Biography](#))

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