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A STUDY ON FUNDAMENTAL ANALYSIS OF LARGE CAP VS SMALL CAP STOCKS

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Abstract: This study explores the fundamental differences between large-cap and small-cap stocks in the banking sector, focusing on their financial performance, risk factors, and market behavior. Large-cap banks, known for their stability and established market presence, typically offer lower volatility and steady returns. In contrast, small-cap banks, though riskier, present higher growth potential and greater price fluctuations. By analysing key financial metrics such as profitability, liquidity, and valuation ratios, this research aims to provide insights into the risk-return trade-offs associated with investing in different market capitalizations within the banking sector. The findings will help investors make informed decisions based on their risk tolerance and investment objectives. The banking sector plays a critical role in financial markets, with institutions of varying market capitalizations contributing to overall economic stability and growth. This study examines the fundamental differences between large-cap and small-cap banking stocks, focusing on key financial indicators such as profitability, liquidity, leverage, and valuation metrics. Large-cap banks, typically characterized by strong balance sheets, diversified revenue streams, and lower volatility, are often seen as safer investments with steady returns. Conversely, small-cap banks tend to exhibit higher growth potential but come with increased risk due to limited market presence, regulatory challenges, and greater sensitivity to economic fluctuations. This research employs a comparative analysis of financial performance, stock price movements, and market trends to assess the risk-return profile of both categories. Additionally, the study explores how macroeconomic factors, such as interest rate fluctuations, monetary policy, and credit cycles, influence the valuation and performance of banking stocks across different market capitalizations. The findings aim to provide investors with a deeper understanding of the trade-offs involved in selecting large-cap versus small-cap banking stocks, helping them align investment decisions with their risk tolerance and financial goals.

Index Terms - Banking sector, Financial performance, Stability, Stock price, Investment, Risk tolerance.

I. INTRODUCTION

The banking sector is a crucial pillar of the financial system, playing a significant role in economic growth through credit distribution, financial intermediation, and risk management. Investors in banking stocks often classify them based on market capitalization, broadly categorized into large-cap and small-cap stocks. Large-cap banking stocks represent well-established financial institutions with stable earnings, strong market credibility, and lower volatility, making them attractive to conservative investors. In contrast, small-cap banking stocks are typically emerging or regional banks that offer high growth potential but come with increased market risks and economic uncertainties. Given these differences, understanding the fundamental aspects of large-cap and small-cap banking stocks is essential for investors seeking to balance risk and return in their portfolios.

This study will provide valuable insights for investors, financial analysts, and portfolio managers by offering a data-driven comparison of large-cap and small-cap banking stocks through fundamental analysis. The findings will help investors make informed decisions based on financial stability, risk exposure, and market valuation. Moreover, the study will contribute to the academic understanding of stock market fundamentals in the banking sector.

Need of the study

- Despite the significance of these stock categories, there is limited research on how fundamental analysis can be applied differently to large-cap vs. small-cap stocks. This study aims to fill that gap.
- The study will provide insights into how investors can balance risk and return by considering the different financial profiles of large-cap vs. small-cap stocks.
- The research will offer evidence-based recommendations for investors, analysts, and portfolio managers, aiding in more informed decision-making.

II. OBJECTIVES OF THE STUDY

Primary Objective:

To study the fundamental analysis of large Cap and Small Cap stocks.

Secondary Objectives:

- To Study the impact of macroeconomic factors (e.g., interest rates, inflation, GDP growth) on large-cap and small-cap stocks.
- To Investigate sectoral distribution of large-cap vs. small-cap stocks and its influence on performance.

III. SCOPE OF THE STUDY

- The study will also evaluate the risk and volatility profiles of both stock types, with large-cap stocks typically being more stable and small-cap stocks generally more volatile. Growth potential will be compared, considering the scalability and market opportunities of large vs..
- The study will also investigate various investment strategies, such as growth and value investing, and analyze how regulatory and market conditions affect both types of stocks.
- Methodologically, the study will involve data collection from financial reports, stock data, and statistical comparison, complemented by case studies of representative large-cap and small-cap companies.

IV. INVESTMENT

Investment is to distribute money or time in the present with a hope of deriving some benefit in the future. Investment has many meanings and can be looked upon through different angles and sides. The two major and important characteristics of an investment are present offering and future benefit.

For instance, investment in **bonds, real states, valuable objects, insurance policies, etc.**

All these activities involve current sacrifice of consumption for a profit or gain in future. When we make our investment for a long period of time by confining our needs for the sake of benefits in the future, risks and the expected benefits and return on the invested or the allocated amount is uncertain. Therefore, the risk and the expected return from the investment are the two concerning factors of the entire investment process.

V. INVESTMENT

An investment is an important and useful factor in the context of present-day conditions.

Some factors are important. They are as outlined below:

Longer life expectancy or planning for retirement, Increasing rates of taxation, High interest rates, High rate of inflation, Larger incomes, Availability of a complex number of investment outlets.

VI. REVIEW OF LITERATURE

Sharma (2018) A study compares the performance of large-cap and small-cap banking stocks in India, emphasizing the role of fundamental analysis in stock selection. The study highlights that large-cap banks tend to show more stability and lower volatility, making them attractive to conservative investors. In contrast, small-cap banks exhibit higher growth potential but come with increased risk. The author notes that in times of economic uncertainty, large-cap banks outperform their smaller counterparts due to their diversified portfolios and robust financials. The research suggests that fundamental analysis, focusing on key metrics such as P/E ratio, ROE, and debt-equity ratio, can help investors navigate these differences effectively. However, the study also warns that while fundamental analysis is crucial, it should be complemented with technical indicators for better prediction accuracy. The findings are particularly relevant to investors looking to balance risk and return in the dynamic Indian banking sector. Furthermore, the paper stresses the importance of understanding macroeconomic conditions and regulatory changes, which can significantly impact both large-cap and small-cap stocks.

Gupta and Verma (2020) explore the role of financial ratios in evaluating the intrinsic value of banking stocks in India. They argue that fundamental analysis using financial ratios, such as Price-to-Book (P/B) ratio, Return on Assets (ROA), and Net Interest Margin (NIM), is critical for assessing the long-term viability of both large-cap and small-cap banks. The study reveals that large-cap banks in India, such as HDFC Bank and ICICI Bank, show better financial health and consistent profitability, which investors value. On the other hand, small-cap banks, although offering higher growth potential, may exhibit irregular earnings and higher risk. The authors conclude that while financial ratios offer deep insights into a bank's financial performance, investors must be cautious of overreliance on these figures alone. Market conditions, government policies, and global economic factors also play a vital role in determining stock performance. Therefore, the study recommends a holistic approach to fundamental analysis, integrating both qualitative and quantitative metrics.

Kumar (2019) investigates how stock returns of large-cap and small-cap banks behave over various market cycles in India. The paper argues that large-cap banks, being more established, show steadier growth patterns and lower risk, often yielding stable but lower returns in comparison to small-cap stocks. Conversely, small-cap banks may exhibit higher volatility but greater potential for rapid growth, particularly during market upturns. The study uses a combination of earnings reports, credit ratings, and debt levels to assess the intrinsic value of these stocks. Furthermore, the author discusses how external factors such as interest rates and inflation affect the valuation of banking stocks. According to the study, small-cap banks are more sensitive to these macroeconomic shifts due to their limited market presence and capital base. The findings emphasize that investors should use fundamental analysis to identify undervalued stocks and understand the financial risks involved with small-cap banks. The study concludes that while large-cap banks are generally safer investments, small-cap banks can offer superior returns if properly researched and analyzed.

Singh and Rao (2017) analyze the risk-return characteristics of large-cap and small-cap banking stocks in India. Their study finds that large-cap banks, with established market positions and diversified portfolios, offer lower risk and more stable returns. They argue that small-cap banks tend to be more volatile, which can

be advantageous for investors with higher risk appetites. The research uses financial metrics like Return on Equity (ROE), Capital Adequacy Ratio (CAR), and Non-Performing Assets (NPA) to evaluate the risk and growth potential of these stocks. The authors suggest that fundamental analysis plays a crucial role in managing the risk associated with small-cap stocks. For large-cap banks, the key focus areas are profitability ratios and efficiency metrics, while small-cap banks require more in-depth research into their growth prospects and management quality. Overall, the study advocates for a blended approach that combines fundamental analysis with a clear understanding of each stock's market risk.

Reddy and Chandra (2021) explore how investor sentiment, along with fundamental analysis, affects the valuation of banking stocks in India. They note that large-cap banks often enjoy strong investor confidence, which reflects in their stock prices. In contrast, small-cap banks are more susceptible to market sentiment and speculative trading, leading to greater price fluctuations. The study uses financial ratios like P/E ratio, Dividend Yield, and NIM to evaluate the intrinsic value of these stocks, emphasizing that sentiment-driven overvaluation or undervaluation can obscure the true financial performance of small-cap banks. The authors argue that while large-cap stocks may appear more stable, they are still influenced by macroeconomic conditions and policy changes. The research also suggests that fundamental analysis should be paired with sentiment analysis, as it can provide a more holistic understanding of a bank's stock price movements. The paper concludes that both large-cap and small-cap banks require diligent monitoring of financial health and market trends.

Chawla and Verma (2019) focus on the operational efficiency of large-cap and small-cap banks in India, emphasizing the importance of financial metrics in fundamental analysis. The study finds that large-cap banks such as State Bank of India (SBI) have more efficient cost management, better asset utilization, and higher profitability ratios compared to their smaller counterparts. Small-cap banks, however, are often more agile and can achieve higher growth rates, but they tend to have less operational efficiency and struggle with scale. The authors highlight the significance of metrics like Cost-to-Income Ratio (CIR), Asset Turnover Ratio, and Loan-to-Deposit Ratio (LDR) in determining the efficiency of these banks. They argue that while large-cap banks benefit from economies of scale, small-cap banks can still be appealing due to their potential for rapid market penetration and higher returns, provided they are thoroughly assessed using fundamental analysis. This comprehensive approach can guide investors in making more informed decisions.

Patel and Joshi (2018) focus on the challenges involved in the valuation of small-cap banking stocks in India. The study points out that small-cap banks often lack sufficient historical data and consistent financial performance, making them difficult to value through traditional fundamental analysis. The authors recommend a more nuanced approach, incorporating a combination of relative valuation techniques, such as P/E ratio and P/B ratio, alongside more subjective measures like management quality and market share growth. The research also stresses the importance of understanding macroeconomic factors such as interest rate fluctuations, inflation, and economic growth, which can disproportionately impact the performance of smaller banks. While large-cap banks tend to benefit from stable market conditions, small-cap banks are more sensitive to external market forces. The study concludes that small-cap banks require careful and thorough analysis, and investors should be cautious when using standard valuation models, given the volatility and unpredictability associated with these stocks.

Soni and Agarwal (2020) examine the link between fundamental analysis and the performance of banking stocks in India. The paper finds that fundamental factors like profitability ratios, capital structure, and asset quality have a significant influence on stock prices, particularly for large-cap banks that are closely followed by analysts and institutional investors. Small-cap banks, however, are often undervalued or overvalued by the market due to a lack of comprehensive analysis. The authors argue that investors must look beyond just financial ratios and also consider qualitative factors such as management expertise, market strategy, and competitive advantage. The research shows that large-cap banks benefit from more consistent earnings, which translate into stable stock prices, while small-cap banks exhibit higher volatility but offer higher potential returns. The paper concludes that fundamental analysis is essential for evaluating stock performance, but it must be complemented with an understanding of market sentiment and industry trends.

I. RESEARCH METHODOLOGY

This study adopts a quantitative and analytical research approach to compare the fundamental characteristics of large-cap and small-cap banking stocks. The research relies on secondary data analysis, focusing on key financial metrics, risk factors, and market trends to evaluate the investment potential of both categories.

3.1 Research Design

This research is **descriptive and comparative**, analyzing the fundamental financial indicators of large-cap and small-cap banking stocks over a specific period. The study applies **fundamental analysis principles** to assess financial performance, stability, and risk factors, helping investors understand their investment implications. According to Kiplinger "Research design is the place, structure and strategy the place is an outline of the research scheme on which the research is to work

3.2 Sample

Sample means "where only a small unit of population under study are considered for analysis".

For this study four BANKS were selected;

- IDBI BANK
- Equitas Small Finance Bank
- HDFC Bank
- ICICI Bank

IV. RESULTS AND DISCUSSION

4.1 Return on Equity

Return on equity (ROE) is a measure of financial performance calculated by dividing net income by shareholders' equity. Because shareholders' equity is equal to a company's assets minus its debt, ROE is considered the return on net assets. ROE is considered a measure of the profitability of a corporation in relation to stockholders' equity.

The formula used for the calculation of Return on equity ratio is :

$$\text{Return on Equity} = (\text{Net Profit} / \text{Shareholders Equity}) * 100$$

Table 4.1: Return on equity

YEAR	2020	2021	2022	2023	2024	AVG RATE
IDBI BANK	-42.86	4.85	7.69	10.21	14.19	-1.18%
Equitas Small Finance Bank	9.75	12.51	7.35	12.21	14.42	11.25
HDFC Bank	15.45	15.17	15.38	15.89	14.03	15.18
ICICI Bank	9.72	14.74	15.49	17.71	19.47	15.43

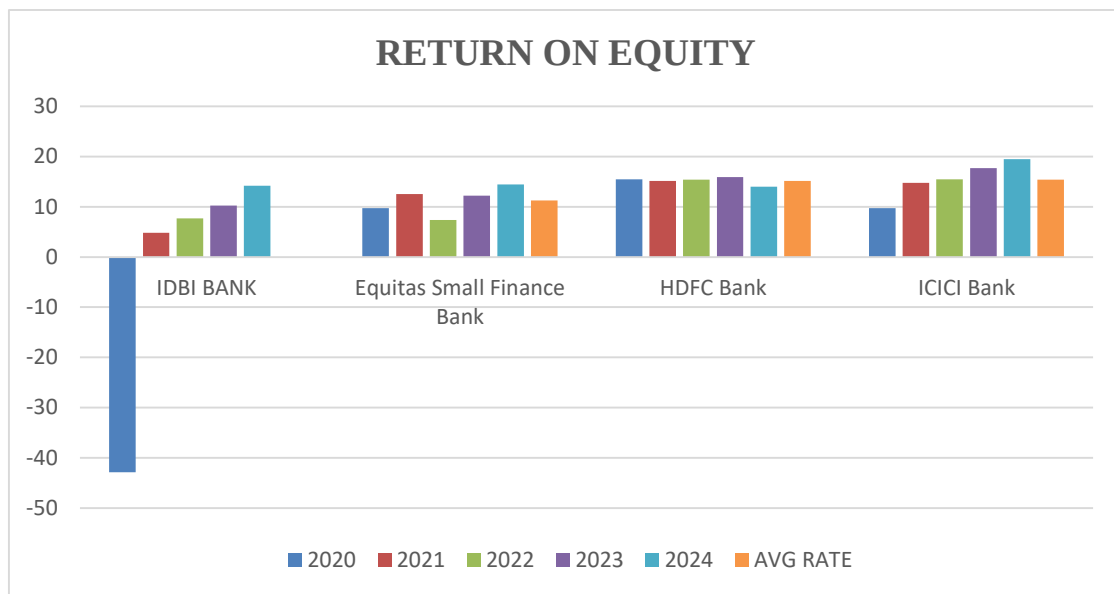


Chart 4.2.1 : Return on Equity

Analysis: The above graph shows that the Return On Equity of:

- **IDBI Bank:** Started with a **large negative ROE in 2020** (~-45%), but improved significantly over the years, turning positive by 2021 and reaching ~14% by 2024.
- **ii) Equitas Bank:** ROE remained fairly **stable** across years (~8%–14%).
- **iii) HDFC Bank:** Maintained **consistently high ROE** (~15%–16%) across all years.
- **iv) ICICI Bank:** Showed a steady increase from ~10% (2020) to ~19% (2024), with the highest average ROE.

Interpretation: IDBI Bank made a strong recovery from negative equity returns. HDFC and ICICI Banks maintained **high and stable ROE**, reflecting strong shareholder value creation. Equitas Bank remained **steady** with moderate returns.

4.2 Return On Capital Employed

Return on capital employed (ROCE) is a financial ratio that can be used in assessing a company's profitability and capital efficiency. In other words, this ratio can help to understand how well a company is generating profits from its capital as it is put to use.

The formula used for the calculation of Return on capital employed ratio is :

$$\text{ROCE} = \frac{\text{Earnings Before Interest and Taxes}}{\text{Overall Capital Employed}}$$

Overall Capital Employed = Short Term Debt + Long Term Debt + Equity.

Table 4.2 : Return on capital employed

YEAR	2020	2021	2022	2023	2024	AVG RATE
IDBI BANK	-7.96	7.38	7.04	11.37	15.68	6.70
Equitas Small Finance Bank	10.82	12.15	9.21	13.71	16.66	12.51
HDFC Bank	14.69	13.83	14.05	15.24	15.15	14.59
ICICI Bank	9.08	10.91	12.96	15.34	17.47	13.15

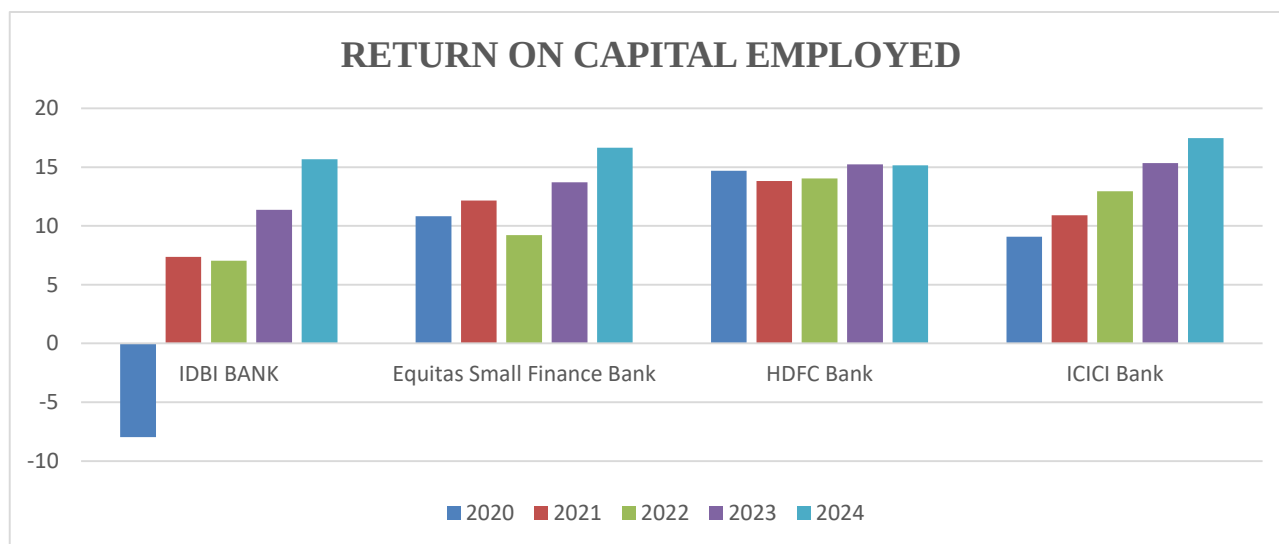


Chart 4.2 : Return on capital employed

Analysis: The above graph shows that the Return on Capital Employed Ratio of:

- **IDBI Bank:** Improved from a negative ROCE in 2020 (~-8%) to a strong 15% in 2024, showing a major turnaround.
- **Equitas Bank:** Steady growth from ~11% to ~17% across years.
- **HDFC Bank:** Consistently strong ROCE (~14%–15%), indicating efficient use of capital.
- **ICICI Bank:** Showed steady improvement, reaching the **highest ROCE (~18%) in 2024**.

Interpretation: All banks improved over time. ICICI and HDFC consistently used their capital efficiently. IDBI showed a strong recovery, while Equitas maintained steady growth in capital returns.

VIII.SUGGESTIONS

- Investment Decisions is all about investing in a Growing stock's for a long period of time due to Higher market returns.
- Investing in Large cap stocks has higher stability then investing in small cap stocks because when there is any market volatility ,market crash or market correction large cap recovers quickly then small cap.
- The risk level of large cap stocks is lower due to established operations and small cap stocks is higher due to market volatility and limited resources.
- The liquidity position of the large cap stocks is higher with active trading volume and small cap has lower liquidity position which may lead to price volatility

IX.CONCLUSION

This study has provided a comprehensive examination of the fundamental analysis of large-cap and small-cap stocks, highlighting their distinct characteristics, advantages, and challenges. Large-cap companies, with their substantial market capitalizations, offer investors stability and consistent performance. Their established market presence, robust financials, and regular dividend payouts make them attractive for risk-averse investors seeking steady returns. The extensive analyst coverage and transparency associated with these companies further aid in informed decision-making. In contrast, small-cap stocks present opportunities for significant growth, especially in emerging markets like India. Their agility and potential for rapid expansion can lead to substantial returns. However, they come with higher volatility, limited liquidity, and less public information, necessitating thorough fundamental analysis and due diligence. The limited analyst coverage in this segment can be advantageous for investors capable of identifying undervalued opportunities through meticulous research. Balancing investments between large-cap and small-cap stocks can optimize risk-adjusted returns. While large-caps provide a safety net during market downturns, small-caps can drive portfolio growth during bullish phases. A diversified approach allows investors to capitalize on the strengths of both segments, aligning with varying market conditions and individual risk appetites. This project

underscores the importance of a nuanced approach to stock analysis, considering both macroeconomic factors and company-specific fundamentals, to navigate the complexities of equity investment effectively.

X. Acknowledgment

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