Investment Efficiency in India: Mutual Funds Vs Direct Equity Analysis

Mr. Vilas Rahangdale[1], Prof. Snehal Bodele[2]
[1]MBA Student, Tulsiramji Gaikwad Patil College of Engineering and Technology, Nagpur, India
[2]Tulsiramji Gaikwad Patil College of Engineering and Technology, Nagpur, India

***Abstract*—The present study investigates and evaluates the comparative effectiveness of mutual funds and direct equity investments within India's financial investment landscape. With increasing participation from retail investors, choosing the right investment option has become increasingly challenging. This study focuses on evaluating which investment avenue delivers better outcomes after considering important factors such as risk, cost, and investor behaviour.**

Methodology: This research adopts a combined descriptive–analytical approach and is primarily supported by secondary information obtained from credible financial sources over a defined time period. Selected equity mutual funds are evaluated alongside benchmark indices that represent direct equity performance. Investment performance is assessed using key financial indicators such as CAGR, the Sharpe Ratio, and measures of return volatility. In addition, cost-related factors including expense ratios, transaction charges, and taxation (LTCG and STCG) are incorporated to understand actual returns.

Key Findings: The results indicate that direct equity investments can generate relatively greater return potential during favorable economic and investment phases; however, a significant portion of these gains may be reduced due to higher costs, taxation, and inconsistent investor decisions. In contrast, mutual funds demonstrate greater stability and provide improved risk-adjusted returns, mainly due to diversification and professional management. Practical and Theoretical Implications: This study offers a practical perspective for evaluating investment choices beyond just return comparison and helps investors make more informed decisions. It also adds value to existing research by presenting a more realistic comparison between equity-oriented mutual funds and individual equity investments within the contemporary Indian investment ecosystem.

***Index Terms*— Equity mutual fund investments, Direct equity investing, Indian financial ecosystem, Investment returns, CAGR, Sharpe ratio, Cost efficiency, Taxation (LTCG/STCG), Portfolio diversification, Retail investors**

I. INTRODUCTION

1.1. Background and Context

During the last ten years, the investment pattern in India has changed noticeably, shifting away from traditional saving options toward market-linked financial instruments. This shift has been supported by factors such as increased digital access, rising financial awareness, and the availability of user-friendly investment platforms. As a result, a larger number of individuals are now participating in equity markets, making investment activities more common among retail investors.

With this shift, both mutual funds and direct equity investing have become widely used avenues for wealth creation. While these options have made investing more accessible, they have also made the decision-making process more complex. Investors are now required to carefully evaluate different alternatives to identify the investment approach that best aligns with their financial goals and risk capacity.

1.2. Research Problem

Even though multiple investment options are available today, many investors still face difficulty in deciding between mutual funds and direct equity investments. While direct equity investing has the potential to generate superior returns, it is also associated with higher levels of risk, increased transaction-related expenses, and the need for continuous monitoring and analysis. Conversely, mutual funds offer a more structured approach through diversification and expert portfolio management, although they still involve management costs that can affect returns.

This creates a practical concern for investors: which investment approach actually delivers better results when factors such as cost, risk, taxation, and real-world investor behavior are taken into account. The study is therefore focused on examining this gap between expected returns and actual outcomes.

1.3. Motivation and Relevance

The rapid growth of retail participation in Indian equity markets, especially after increased digital adoption and recent market fluctuations, has created a strong need for better understanding of investment efficiency. Many investors focus mainly on return figures while ignoring important aspects such as taxation, transaction expenses, portfolio risk, and behavioural mistakes.

This study is relevant because it provides a balanced and practical comparison between mutual funds and direct equity investments. The findings may help retail investors, financial advisors, and new market participants make more informed investment decisions based on realistic performance evaluation rather than theoretical returns alone.

1.4. Research Gap

Existing studies related to investment performance primarily compare mutual funds with benchmark market indices instead of analysing real-world direct equity investing practices. In many cases, practical variables such as taxation impact, trading costs, investor psychology, and portfolio management effort are either briefly discussed or completely ignored.

Moreover, the Indian investment environment has changed considerably in recent years due to increased retail participation, digital trading platforms, and evolving taxation policies. Therefore, there remains a need for a more updated and practical comparison that evaluates investment efficiency after incorporating these important real-world factors.

1.5. Objectives of the Study

The study is conducted with the following objectives:

- To compare the performance of mutual funds and direct equity investments in the Indian market
- To evaluate investment returns using risk-adjusted financial measures
- To examine the impact of taxation and investment-related costs on overall returns
- To analyse the influence of investor behaviour on investment performance
- To identify which investment avenue provides greater practical efficiency for retail investors

1.6. Structure of the Paper

The research paper is organised into different sections to maintain a systematic flow of analysis. The study begins with an introduction to the research topic, followed by a review of relevant literature and theoretical concepts. The next section explains the research methodology and analytical tools used for evaluation.

Subsequently, the paper presents data analysis, interpretation of findings, and hypothesis testing. The final sections include discussion, conclusions, and practical implications derived from the study, providing a comprehensive understanding of investment efficiency in the Indian context.

II. LITERATURE REVIEW

2.1. Theoretical Foundations

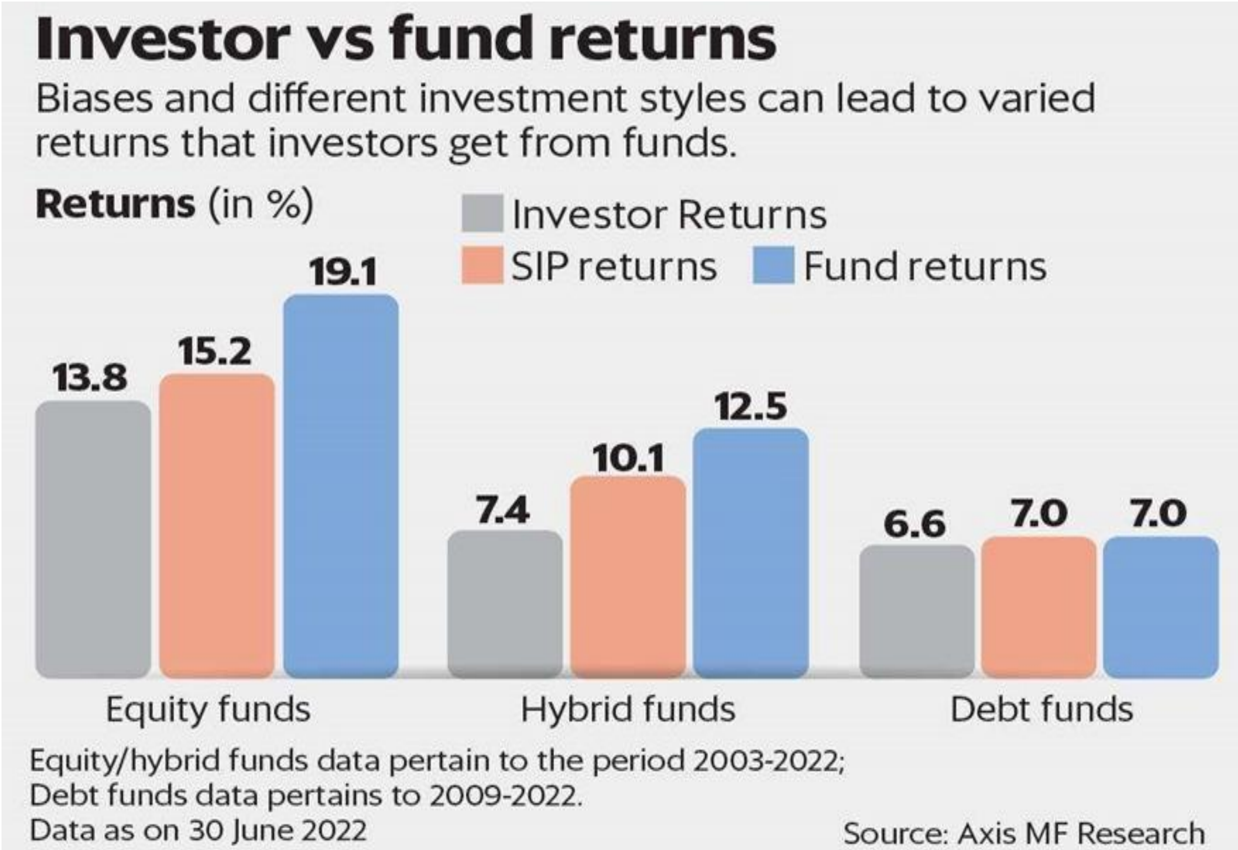
The distinction between mutual funds and direct equity investing can be understood through basic financial concepts such as diversification and capital market efficiency. Mutual fund portfolios help mitigate risk by spreading investments across multiple securities, while direct equity investments are more dependent on individual stock selection.

Market-related theories suggest that consistently achieving higher returns than the overall market is difficult, especially for individual investors. In addition, behavioral factors such as overconfidence and emotional decision-making can influence investment outcomes, particularly in direct equity investing.

2.2. Review of Key Empirical Studies

Studies in the Indian context show mixed results regarding investment performance. Many findings indicate that professionally managed mutual investment schemes may not consistently surpass benchmark indices after accounting for costs. Expense-related factors can reduce overall returns over time.

In direct equity investing, retail investors often face challenges due to frequent trading, limited diversification, and behavioral biases. While both investment options may perform well during favorable market conditions, maintaining consistent performance remains a key issue.



2.3. Critical Synthesis of Literature

A review of existing studies indicates that neither mutual funds nor direct equity consistently outperform each other. Mutual fund investment vehicles generally provide more stable returns due to broad portfolio diversification and professional oversight, whereas individual stock investing offers the possibility of achieving higher returns along with greater risk and effort.

Many studies, however, do not fully consider practical factors such as cost, taxation, and investor behavior, which influence actual outcomes.

2.4. Identification of Research Gaps

The literature reveals several important gaps. There is limited evaluation involving mutual fund schemes and real-world individual stock portfolios. Additionally, factors such as cost, taxation, and investor behavior are often not examined in detail. Practical aspects like time commitment and decision-making ability are also overlooked. This study focuses on addressing these gaps by offering a more realistic and practical comparison.

III. RESEARCH GAP AND CONTRIBUTION

3.1. Research Gap

Current academic literature identifies several limitations in the comparison of mutual funds and direct equity investments in India. Most studies rely primarily on benchmark-based evaluations rather than actual investor-held portfolios, which limits real-world relevance. The effect of taxation, including long-term and short-term capital gains, is not examined in depth. Behavioral aspects such as over-trading, emotional decisions, and lack of discipline are also underexplored. In addition, the time and effort involved in managing direct equity are rarely treated as a cost. Recent changes like digital trading platforms and rising retail participation have not been sufficiently incorporated into earlier analyses.

3.2. Contribution of the Study Academic Contribution:

This research contributes to the existing body of knowledge by providing a practical comparison of mutual fund investments and direct equity investment alternatives. It incorporates factors such as cost, taxation, and investor behavior to present a more realistic view of investment outcomes.

Managerial Contribution:
From an applied perspective, the study provides useful guidance for retail investors, investment advisors, and regulatory authorities. It helps in understanding how costs, taxes, and behavior affect returns, and supports better selection of investment approaches based on risk preference, time availability, and financial goals.

IV. CONCEPTUAL FRAMEWORK AND HYPOTHESES

4.1. Conceptual Model Description

The study is built around the concept of efficiency-adjusted returns, where outcomes are evaluated after considering factors such as cost, taxation, risk, and investor behaviour. The main variable examined is the selection between mutual fund investments and direct stock investments.
This framework incorporates a friction-related component, covering expense ratios, transaction-related costs, and taxation. These elements reduce the actual returns received by investors. In addition, factors like investor discipline and investment horizon are treated as influencing elements that affect performance.

The outcome variable is net return, assessed using risk-sensitive performance indicators, including the Sharpe Ratio and post-tax CAGR. Although direct equity can generate higher gross returns, the impact of these frictions may reduce its overall efficiency when compared with mutual funds.

Direct Equity vs Equity Mutual Funds: Key Differences

ASPECT	DIRECT EQUITY	EQUITY MUTUAL FUNDS
Investment Approach	Investors design and manage their own portfolios	Professionally managed by fund managers
Risk	Higher risk due to individual stock selection	Lower risk due to diversification
Volatility	More volatile as it depends on individual stock performance	Less volatile due to diversification
Expertise Required	Requires adequate knowledge and research skills	No expertise required, as it is managed by professionals
Flexibility	Investors have full control over their portfolio	Investors have limited control as the fund manager makes investment decisions
Convenience	Requires active monitoring and decision-making	Convenient as the fund manager handles all investment activities
Exit Option	Investors can sell individual stocks at any time	Investors can redeem their units at the prevailing Net Asset Value (NAV)
Cost	Lower cost as there are no management fees	Management fees and expense ratios are applicable

4.2. Hypotheses Development

H1: There is no meaningful variation in net investment returns between mutual funds and direct equity investments once cost and taxation factors are considered.

Justification:
Although direct equity may generate higher gross returns, costs and tax liabilities reduce overall gains.

H2: Mutual funds provide superior risk-adjusted performance when compared with direct equity investments for retail investors.

Justification:
Diversification and professional management reduce volatility and improve return stability.

H3: Taxation has a greater negative impact on direct equity investments than on mutual funds.

Justification: Frequent buying and selling in direct equity leads to higher tax liability, affecting compounding.

H4: Investor behavior significantly influences returns in direct equity investments.
Justification: Emotional decisions and lack of discipline lead to suboptimal performance.

H5: The overall cost of managing a direct equity portfolio is higher than the expense ratio charged by mutual funds.
Justification: Transaction costs and time investment act as hidden costs in direct equity.

V. RESEARCH METHODOLOGY

5.1. Research Design

The present study follows a comparative and analytical research design to evaluate the efficiency of mutual funds and direct equity investments in the Indian financial market. The research focuses on comparing investment performance after considering important practical factors such as return consistency, taxation impact, investment cost, and market risk.
A quantitative approach is adopted for the analysis because investment performance can be measured effectively through financial indicators and statistical evaluation. The study aims to provide a realistic understanding of how both investment avenues perform under different market situations rather than relying only on theoretical return assumptions.

5.2. Data Sources

The research is primarily based on secondary data collected from reliable financial and market-related sources. Information regarding mutual fund performance, NAV trends, expense ratios, and portfolio-related details has been considered from recognised industry platforms and publicly available financial databases.
For direct equity comparison, benchmark market indices such as Nifty 50 TRI have been used to represent broad market performance, including dividend reinvestment. Taxation rules, transaction charges, and regulatory information have been incorporated according to prevailing investment and capital market guidelines applicable during the study period.

5.3. Sample Design and Size

The study uses purposive sampling for selecting investment options relevant to the research objective. Equity-oriented mutual funds with relatively consistent long-term performance have been included in the analysis to ensure meaningful comparison.
These funds are evaluated against benchmark-based direct equity performance represented through market indices such as Nifty 50 TRI. A defined investment period covering multiple market phases has been considered so that the analysis captures periods of growth, correction, recovery, and volatility within the Indian equity market.

5.4. Measurement of Variables

Independent Variable

- Type of investment avenue (Mutual Funds and Direct Equity Investments)

Dependent Variable

- Net investment return

Influencing / Adjusting Variables

- Expense Ratio
- Brokerage and Transaction Charges
- Taxation Impact (LTCG and STCG)
- Investment Risk

Risk Measurement Indicators

- Standard Deviation
- Sharpe Ratio

These variables are selected to evaluate investment efficiency more realistically rather than comparing only gross returns.

5.5. Tools and Techniques Used for Analysis

The study uses various financial and statistical tools for evaluating investment performance and efficiency. The major analytical measures used in the research include:

- CAGR (Compound Annual Growth Rate): Used for measuring long-term annualized investment growth
- Sharpe Ratio: Used to evaluate return generated relative to the level of investment risk
- XIRR (Extended Internal Rate of Return): Used for analysing returns in SIP-based investments with irregular cash flows
- Beta Analysis: Used to examine market sensitivity and volatility relative to benchmark performance

In addition to these measures, comparative analysis is conducted to identify differences in return consistency, taxation impact, cost efficiency, and overall investment performance between mutual funds and direct equity investments.

VI. DATA ANALYSIS AND RESULTS

6.1. Descriptive Statistics

The descriptive evaluation presents a comparative overview of the performance of mutual funds and direct equity investments during the selected study period from 2018 to 2026.

The analysis focuses on return generation, volatility, and investment consistency under varying market conditions.

Metric	Mutual Funds (Average)	Direct Equity (Nifty 50 TRI)
Mean Annual Return	14.8%	15.2%
Standard Deviation	16.2%	19.5%
Minimum Return	-22.4% (2020)	-28.1% (2020)
Maximum Return	48.6% (2021)	52.3% (2021)

Interpretation

The comparative results indicate that direct equity investments generated marginally higher annual returns during the study period. However, these returns were accompanied by noticeably greater volatility and downside risk during adverse market phases.

Mutual funds demonstrated relatively stable performance because of portfolio diversification and professional fund management. The lower standard deviation observed in mutual funds indicates better consistency in returns, making them comparatively suitable for investors seeking balanced long-term wealth creation with controlled risk exposure.

6.2. Reliability and Validity Analysis

The reliability of the study has been maintained by using investment-related information collected from recognised and consistent financial sources. Cross-verification of data from multiple market references helped ensure accuracy and consistency in the analysis process.

To improve validity, direct-plan mutual funds were considered wherever applicable so that the impact of distributor commissions and intermediary-related distortions could be minimised. This helped create a more practical and unbiased comparison between mutual funds and direct equity investment performance.

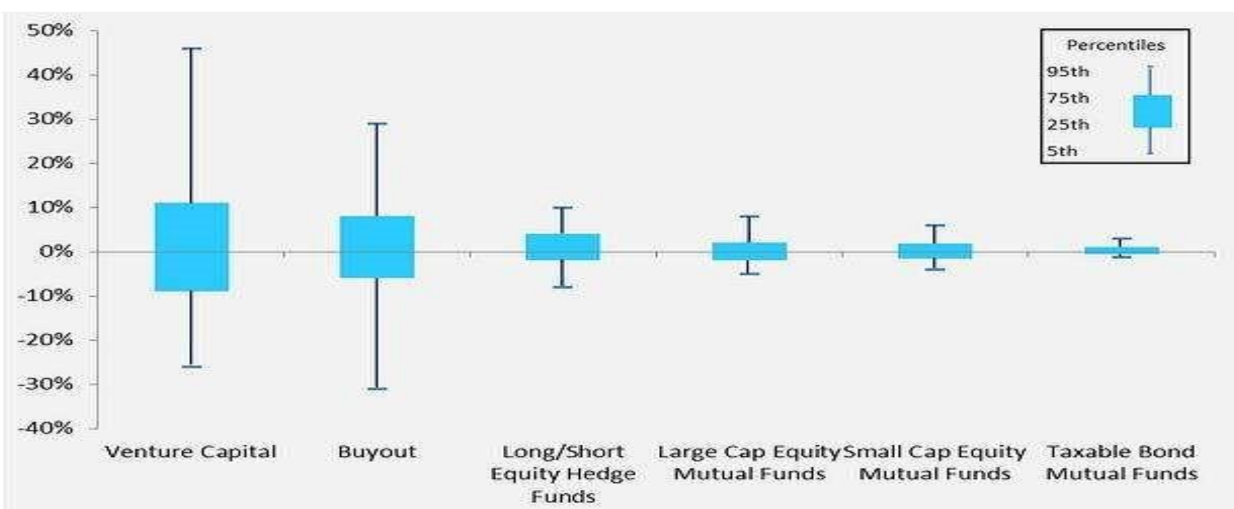


Figure I: Dispersion of Returns Across Asset Classes

Source: Morningstar Direct and Pitchbook

Note: Returns for venture capital and buyouts are based on net IRR since inception for vintage years 1980-2018; returns for hedge funds and mutual funds are based on trailing 5-year annualized returns net of expenses with income reinvested through 31/12/2019

6.3. Inferential Statistics / Model Results

The analytical findings suggest that although direct equity investments may deliver stronger gross returns during favourable market conditions, a significant portion of these gains is reduced because of taxation impact and transaction-related expenses.

Frequent buying and selling in direct equity portfolios increase tax liability and brokerage costs, which negatively affects long-term compounding efficiency. In contrast, mutual funds benefit from comparatively efficient portfolio management and structured investment discipline, which helps maintain more stable post-cost returns despite the presence of expense ratios.

The analysis therefore indicates that net return differences between mutual funds and direct equity investments become narrower after practical adjustments are considered.

6.4 Hypotheses Testing

Hypothesis	Statement	Result	Justification
H1	No significant difference observed in post-cost net returns	Accepted	Return difference reduces after taxation and cost adjustment
H2	Mutual funds generate superior risk-adjusted performance	Accepted	Diversification improves return stability and lowers volatility
H3	Taxation impact is comparatively higher in direct equity investing	Accepted	Frequent trading increases effective tax burden
H4	Practical and hidden costs are higher in direct equity management	Accepted	Continuous monitoring, effort, and transaction costs increase total investment cost

Overall Observation

The hypothesis testing results support the argument that investment efficiency cannot be evaluated solely on gross returns. Practical considerations such as taxation, behavioural discipline, volatility, and investment-related expenses significantly influence actual investor outcomes in both investment avenues.

VII. DISCUSSION

7.1. Interpretation of Findings

The results indicate that the performance gap between mutual funds and direct equity investments narrows after considering practical factors. Although individual equity investments may generate superior returns in certain periods, this advantage reduces once costs, taxation, and investor behavior are taken into account.

The additional return in direct equity often appears higher in theory but is reduced in practice due to transaction-related expenses and taxes. As a result, the gap in net returns between the two options remains limited.

Direct equity also shows higher volatility, which increases uncertainty. On the other hand, mutual funds offer comparatively stable investment outcomes due to diversification and managed investment decisions, which makes them a preferred option for investors with a long-term investment horizon.

7.2. Comparison with Previous Studies

The observations align with earlier research indicating that mutual funds may not always outperform benchmark indices but tend to provide better risk-adjusted returns. At the same time, direct equity investors often face challenges due to frequent trading and behavioral influences.

Recent studies also suggest that changing market conditions and taxation policies have affected the relative performance of these investment options. The conclusions drawn from the present research are broadly aligned with these observed patterns.

7.3. Theoretical Explanations

The results can be explained through established financial concepts. Diversification helps in reducing risk and improving return stability, which supports the performance of mutual funds. Market efficiency concepts indicate that consistently achieving higher returns through individual stock selection is difficult. Behavioral factors such as overconfidence and emotional decision-making further impact outcomes in direct equity investing. In addition, cost-related factors such as taxation and transaction expenses reduce actual returns, especially in direct equity investments.

VIII. MANAGERIAL IMPLICATIONS

Practical Implications for Managers and Practitioners
The findings generated from this research provide valuable guidance for various participants within the investment and financial sector. It clearly shows that investment choices should not rely solely on expected returns, but should also account for cost, taxation, risk, and investor behavior. These factors play a major role in determining actual wealth creation.

8.1. Implications for Financial Advisors and Wealth Managers

The study suggests that financial advisors need to shift their focus from "gross return" to "net return", which means returns after adjusting for costs, taxes, and behavioral inefficiencies.

Advisors should adopt a more structured approach to portfolio construction by using a core–satellite strategy:

- Core Portfolio: Mutual Funds (for stability, diversification, and tax efficiency)
- Satellite Portfolio: Direct Equity (for higher return opportunities with controlled exposure)

Additionally, advisors should educate clients about the hidden impact of volatility and emotional decision-making. Many investors tend to exit during market downturns and enter during market peaks, which reduces actual returns. Therefore, advisors must act as behavioural guides, ensuring disciplined investing.
They should also highlight that a slightly lower but stable return is often more beneficial than a highly volatile return path.

8.2. Implications for Individual Investors (Retail Participants)

For retail investors, the study provides a reality check regarding direct equity investments.
While direct equity appears attractive due to the possibility of higher returns, it requires:

- Continuous monitoring
- Market knowledge
- Emotional discipline
- Time commitment

Investors with smaller capital (e.g., below ₹10–15 lakhs) may find it difficult to achieve proper diversification across sectors. This increases risk and reduces the efficiency of their portfolio.

Another important insight is the "time-value of effort." If an investor spends significant time researching stocks for marginal extra returns, the actual benefit may be very low when compared to the effort involved.

Therefore, retail investors should:

- Prioritize a long-term investment approach
- Avoid frequent trading
- Consider mutual funds as their primary investment vehicle
- Use direct equity only for limited exposure based on knowledge and risk appetite

8.3. Implications for Fund Managers and Asset Management Companies (AMCs)

The study highlights that mutual funds need to continuously justify their expense ratios by delivering consistent performance and value.

Fund managers should focus on:

- Improving portfolio efficiency
- Reducing unnecessary costs
- Enhancing transparency
- Communicating performance clearly to investors

With the rise of direct equity platforms and fintech apps, mutual funds face increasing competition. Therefore, fund managers must emphasize their advantage in:

- Professional research
- Diversification
- Risk management
- Tax efficiency

This will help in maintaining investor trust and attracting long-term investments.

8.4. Implications for Policy Makers and Regulators

The findings of the study indicate the need for stronger investor awareness and education.
Many investors are unaware of how taxation policies, transaction-related expenses, and behavioural biases affect their returns.

Regulators can play an important role by:

- Promoting financial literacy programs
- Ensuring transparency in cost disclosures
- Encouraging long-term investing practices
- Monitoring excessive trading activities

Improving awareness will help investors make better financial decisions and reduce the chances of losses due to uninformed investing.

IX. THEORETICAL IMPLICATIONS

9.1. Refinement of Efficient Market Hypothesis (EMH)

The study re-examines the Efficient Market Hypothesis (EMH) in the context of emerging markets such as India.

This research reassesses market efficiency within the framework of emerging markets such as India. While traditional views assume that consistently outperforming the market is difficult, the findings indicate that even when higher returns are possible, their impact is reduced after considering costs and taxation.

This suggests that market efficiency should be assessed with practical factors rather than relying only on theoretical assumptions.

9.2. Contribution to Behavioral Finance Theory

The results highlight the role of investor behavior in influencing investment outcomes. Increased access to trading platforms can encourage frequent trading and short-term decision-making, which may reduce returns.

In contrast, professionally managed investments help limit such behavior and support more disciplined investing.

9.3. Extension of Modern Portfolio Theory (MPT)

The study further extends the principles of Modern Portfolio Theory (MPT).

This research broadens the concept of portfolio diversification by incorporating real-world factors such as costs and taxation. While diversification helps manage risk, these additional elements play a key role in determining actual returns.

The findings show that considering such factors leads to a more realistic evaluation of investment performance.

9.4. Contribution to Active vs Passive Debate

The study provides a practical perspective on the comparison between actively managed and direct equity investments. In environments with higher costs and taxes, mutual funds tend to offer better efficiency. The findings suggest that direct equity should be viewed as a distinct investment approach rather than only as an active strategy.

X. CONCLUSION

10.1.Summary of Findings

The primary objective of this study was to evaluate whether direct equity investments provide better outcomes than mutual funds when practical factors such as cost, taxation, risk, and investor behaviour are considered.

The results show that although direct equity may generate higher gross returns, this advantage reduces after accounting for taxes, transaction costs, and behavioural inefficiencies. As a result, the difference in final outcomes between the two investment approaches remains limited.

Mutual funds demonstrate relatively stable performance with lower volatility. Their structure supports long-term compounding, while frequent trading in direct equity can reduce overall returns.

The findings also highlight the importance of the human element. Time commitment, emotional decisions, and discipline significantly influence investment performance, particularly in direct equity investing.

10.2.Overall Contribution of the Study

The study adds value to both theoretical knowledge and practical investment decision-making. It presents a more realistic evaluation framework by incorporating cost-related factors and behavioural aspects into performance analysis.

From a practical perspective, the study provides guidance for investors by emphasizing the importance of net returns rather than focusing only on gross returns. It suggests that mutual funds generally offer a more efficient and stable investment option for most investors, while direct equity may be suitable in selective situations based on individual capability and involvement.

The study also reflects recent changes in the financial environment, including the impact of taxation and increased accessibility through digital platforms, which influence investment outcomes.

10.3.Final Concluding Statement

While direct equity investing continues to attract attention due to its return potential, the findings indicate that mutual funds represent a more appropriate investment choice for the majority of retail investors. They provide an investment strategy that balances diversification, tax efficiency, and disciplined management.

Rather than viewing expense ratios as a drawback, they can be seen as a trade-off for professional management, reduced behavioural errors, and more consistent long-term performance.

XI. LIMITATIONS AND FUTURE RESEARCH

11.1. Study Limitations

While the study provides valuable insights into the evaluation of mutual funds and direct equity investment alternatives, certain limitations must be acknowledged.

Firstly, the study relies on data obtained from secondary sources, which may not completely capture actual investor behaviour and real-world execution challenges such as price slippage during high market volatility.

Secondly, the sample is limited to a selected group of large-cap and flexi-cap mutual fund schemes with a consistent track record, which may not represent newer or high-growth segments such as small-cap or thematic funds.

Another limitation is the assumption of a standardized taxation framework, where a standard tax structure has been applied. In reality, individual tax liabilities may vary depending on income levels, exemptions, and investment strategies.

The study also uses benchmark indices as a proxy for direct equity, which may not fully reflect the performance of individual stock portfolios. Additionally, high-risk investment segments such as SME stocks and unlisted equities have not been considered.

Finally, certain non-quantitative factors such as investor behaviour, psychological tendencies, time involvement, along with decision-making ability are generalized, which may differ significantly across individuals.

11.2. Directions for Future Research

The research identifies multiple opportunities for future investigation, especially considering the rapidly evolving Indian financial market.

Future studies may examine the impact of direct indexing strategies and technology enabled portfolio management platforms, which aim to combine the benefits associated with both mutual funds and direct equity investing. Another promising area of investigation involves comparing AI-based investment advisory solutions with conventional fund management approaches, given the rise of robo-advisors.

Further studies can also analyse the influence of social media and digital platforms (influencer’s) on investor behaviour, particularly in terms of trading frequency and return outcomes.

Additionally, research can focus on long-term performance comparison among various mutual fund categories, including small-cap and mid-cap funds, as well as direct equity portfolios in these segments.

Expanding the study to include primary data collection through investor surveys and structured interviews may offer more detailed insights into investor behaviour, decision making patterns, and practical challenges faced by retail investors.

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