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RESEARCH ARTICLE

THE RISE OF PASSIVE INVESTING: EXAMINING INDEX FUND ADOPTION AMONG INDIA'S RETAIL INVESTORS GROWTH, STRUCTURAL INCENTIVES, AND THE GAP BETWEEN HEADLINE NUMBERS AND RETAIL PARTICIPATION

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Abstract

Passive investment products, index funds and exchange-traded funds that track a market benchmark rather than relying on active stock selection, have grown sharply in India over the past several years, with industry assets under management rising more than sixfold since 2019. Survey evidence suggests retail investor awareness and stated adoption of passive products has grown substantially in parallel. This paper reviews the scale of that growth using Association of Mutual Funds in India data and industry survey findings, and then examines a structural tension largely absent from the growth narrative: despite rising retail interest, retail investors' actual share of total passive fund assets under management remains small, a gap this paper argues is best explained by distributor incentive structures that continue to favour actively managed products. The paper concludes that the passive investing story in India is one of genuine but structurally constrained retail participation, rather than a straightforward account of retail investors abandoning active management.

Introduction:-

For most of its history, India's mutual fund industry has been dominated by actively managed equity funds, where a fund manager selects individual securities in an attempt to outperform a market benchmark. Passive funds, which instead simply track an index such as the Nifty 50 or a specific sector or asset benchmark, have historically occupied a small niche. That has changed markedly in recent years. This paper examines the scale of that shift, what is actually driving it, and a structural gap between stated retail enthusiasm for passive products and the smaller share of passive assets retail investors actually hold, which complicates a simple narrative of a retail-led shift toward passive investing.

The Scale of Growth:-

According to data published by the Association of Mutual Funds in India, total passive fund assets under management stood at approximately ₹14.12 lakh crore as of March 2026, representing 23.08 percent year-on-year growth. Passive fund folios, a more direct measure of the number of individual investor accounts rather than the rupee value invested, grew even faster, up 37.7 percent over the same period, with total passive folios reaching 502.35 lakh by the end of December 2025, a 29.07 percent year-on-year increase. Since 2019, passive fund AUM

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has grown roughly 6.4-fold, from approximately ₹1.91 lakh crore to over ₹12 lakh crore, a compound annual growth rate of approximately 36 percent.

Survey evidence corroborates this growth in investor-facing terms. Motilal Oswal Mutual Fund's Passive Survey 2025, conducted in August and September 2025 across more than 3,000 investors and 120 distributors, found that 68 percent of surveyed investors now hold at least one passive fund, up from 61 percent in 2023, and that 76 percent of investors reported awareness of index funds or ETFs. Ninety-three percent of surveyed distributors indicated they intended to increase client allocation to passive products in the following financial year.

What Is Driving Adoption:-

The survey data points to two dominant reasons investors give for choosing passive products: cost efficiency, cited by 54 percent of respondents, and diversification combined with simplicity and transparency, cited by 46 percent each. These reasons track closely with the structural case for passive investing generally, lower expense ratios compared to actively managed funds, and a straightforward, rules-based investment logic that does not require an investor to evaluate a fund manager's ongoing stock-picking decisions. The growth has not been confined to equity index products. Gold ETF folios grew 77.88 percent year-on-year to 1.24 crore in the year to March 2026, and silver ETF folios grew 710.85 percent over the same period, reflecting a sharp rally in precious metal prices, gold rose from roughly ₹90,000 to ₹1,52,000 per 10 grams over the period, that appears to have pulled a wave of new retail participation specifically into commodity-linked passive products rather than equity index funds alone.

The Structural Gap: Retail Enthusiasm Versus Retail Ownership:-

The growth figures and survey findings above describe rising awareness, adoption, and stated preference. They do not, on their own, describe how much of the passive fund industry's assets retail investors actually own. That figure tells a more constrained story. Data tracked since September 2022 shows that while total passive fund AUM has more than doubled, retail investors' collective share of that AUM grew only from 4.01 percent to 7.1 percent over a comparable multi-year period, a meaningful increase in relative terms, but one that leaves retail investors owning a small fraction of an asset class they are reportedly adopting in large numbers.

A structural explanation for this gap lies in mutual fund distribution economics rather than investor preference. Distributors and financial advisors, who remain the primary channel through which most Indian retail investors access mutual funds, earn substantially higher commissions from selling actively managed schemes than from passive products, which by design carry lower fees and therefore lower distributor payouts. This creates a structural bias in which the sales channel that dominates investor acquisition has a direct financial incentive to steer investors toward products other than the ones survey data suggests investors say they prefer. This helps explain an otherwise puzzling pattern: strong stated investor interest in passive products, alongside AMFI's own fiscal 2025 annual report noting that a large portion of passive fund assets originates from the Employees' Provident Fund Organisation's mandated passive allocation rather than from direct retail choice, with the remaining retail-driven portion, while growing quickly in percentage terms, still starting from a small base.

Discussion:-

The evidence assembled here resists a simple headline. It is true that passive investing in India has grown at a genuinely remarkable pace, and true that retail investor awareness and stated adoption have grown alongside it. It is also true that a structural feature of how mutual funds are actually sold in India, commission-driven distribution, continues to direct a disproportionate share of retail capital toward actively managed products regardless of what investors report preferring in surveys. India's overall mutual fund penetration, at approximately 19.9 percent of GDP as of March 2025, also remains well below levels seen in many developed markets, suggesting that the passive investing story described here is unfolding within a broader market that is itself still maturing. Whether India's passive fund industry converges toward the retail ownership share seen in more mature markets, or whether distribution economics continue to constrain that convergence even as awareness keeps rising, is the open question this data raises rather than resolves.

Conclusion:-

India's passive fund industry has grown at a pace and scale that would have seemed unlikely a decade ago, and rising retail awareness and stated adoption are a genuine part of that story. But the gap between how much retail investors say they value passive products and how much of the passive fund industry they actually own points to a market still substantially shaped by distribution incentives rather than by unconstrained investor choice. A complete account of passive investing's rise in India has to hold both of these facts at once: real, fast-growing retail interest, operating inside a distribution system that has, so far, only partially caught up with it.

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