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GROWTH AND EVOLUTION OF PASSIVE FUNDS IN INDIA: TRENDS, PERFORMANCE AND INVESTOR PERSPECTIVES

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Abstract

Passive investing has emerged as one of the most significant developments in the modern financial system. The increasing awareness among investors regarding cost efficiency, transparency, diversification, and benchmark-linked performance has contributed to the rapid expansion of passive investment products across the world. In India, passive funds including Index Funds, Exchange Traded Funds (ETFs), and Fund of Funds (FoFs) have witnessed remarkable growth in assets under management (AUM) and investor participation during the last decade. This article examines the growth, structure, categories, and investment potential of passive funds with specific emphasis on the Indian market. The study relies on secondary data extracted from the Tata Passive Fund Brochure (2026) and industry statistics related to passive investing. The paper analyses global trends, Indian market expansion, historical growth in index funds and ETFs, and the role of passive investment strategies in portfolio diversification. The findings indicate that passive investing is gradually transforming from a niche investment avenue into a mainstream wealth creation strategy. The article further highlights the benefits and limitations of passive investing and discusses its future prospects in the Indian financial ecosystem.

Keywords: *Passive Funds, Index Funds, ETFs, Fund of Funds, Mutual Funds, AUM, Passive Investing, India.*

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1. INTRODUCTION

The investment management industry has undergone a substantial transformation during the last two decades. Traditional actively managed mutual funds, which rely heavily on fund managers' stock selection abilities, have increasingly been challenged by passive investment products. Passive investing refers to an investment approach where the portfolio aims to replicate the performance of a market index rather than outperform it.

The growth of passive funds globally demonstrates a shift in investor preference toward simplicity, low cost, and transparency. Passive funds primarily include Index Funds, Exchange Traded Funds (ETFs), and Fund of Funds (FoFs). These investment products mirror benchmark indices such as Nifty 50, BSE Sensex, NASDAQ-100, or sectoral indices.

The primary objective is not to beat the market but to capture market returns efficiently. Unlike active funds, passive funds follow rule-based investing with minimal portfolio churn, resulting in lower expense ratios and better tax efficiency. The Indian financial market has recently experienced a sharp increase in passive fund adoption.

According to the Tata Passive Fund Brochure (2026), passive assets under management represented nearly 18 percent of the total mutual fund industry AUM by December 2025. The growth is driven by rising financial literacy, digital investment platforms, increasing investor trust in index-based investing, and the broader availability of passive investment products.

This article aims to examine the evolution of passive funds in India, assess their categories and growth patterns, and discuss their implications for investors and financial markets. The article also compares global and Indian passive investment trends while highlighting opportunities and challenges in the sector.

2. CONCEPTUAL FRAMEWORK OF PASSIVE FUNDS

Passive funds are investment vehicles designed to replicate the performance of a predefined benchmark index. These funds do not rely on discretionary stock selection. Instead, they follow predetermined index allocation rules and invest in securities in the same proportion as the benchmark index. The three major categories of passive funds are:

1) Index Funds – Mutual funds that replicate benchmark indices.
2) Exchange Traded Funds (ETFs) – Market-traded investment funds that track indices, commodities, or debt instruments.
3) Fund of Funds (FoFs) – Funds that invest in other mutual fund schemes, including passive products.

Passive investing operates on the Efficient Market Hypothesis, which suggests that markets quickly incorporate available information into asset prices. Therefore, consistently outperforming the market becomes difficult for active managers over long periods. Passive investing instead focuses on achieving market-linked returns with lower costs and reduced risks associated with active decision-making.

The simplicity of passive funds has made them highly attractive to retail as well as institutional investors. The transparency of holdings, diversification benefits, and lower operating costs contribute significantly to their growing popularity. Moreover, passive funds reduce behavioural biases in investment decisions because they follow predefined index rules rather than subjective fund manager opinions.

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Vol: 63 | Issue: 07 | 2026

3. GLOBAL GROWTH OF PASSIVE FUNDS

The global investment landscape has experienced a dramatic increase in passive investing over the last two decades. In the United States, passive fund AUM has overtaken active fund AUM, reflecting a structural change in investor behaviour.

Similar trends are observed in Europe and China. The Tata Passive Fund Brochure (2026) notes that passive equity AUM in Europe accounts for nearly one-fourth of total industry assets, while China has witnessed passive equity assets overtaking active equity assets.

Table 1: Growth of Passive AUM in India

Period	Passive AUM (Rs. lakh crore)
Mar 2018	0.8
Mar 2024	9.08
Mar 2025	10.66
Dec 2025	14.19
March 2026	14.11 – 14.84

Source: SEBI Annual Report, AMFI data shows ₹14.11 lakh crore, while NSE Indices reported ₹14.84 lakh crore due to commodity ETF volatility. Mirae Asset estimates ~₹16.1 lakh crore, including broader ETF categories.

Table 2: Categories of Passive Funds

Category	Features	Benefits
Index Funds	Replicate benchmark indices	Low cost and diversification
ETFs	Traded on exchanges	Liquidity and transparency
FoFs	Invest in other funds	Convenience and diversification

Several factors explain the rise of passive investing globally. First, lower expense ratios make passive products more attractive than actively managed funds. Second, the under-performance of many active managers against benchmark indices has encouraged investors to adopt index-based strategies. Third, advancements in technology and online investment platforms have improved accessibility and reduced transaction costs.

Institutional investors such as pension funds, sovereign wealth funds, and insurance companies increasingly allocate assets to passive products because of their long-term stability and cost efficiency. In addition, the emergence of smart beta and thematic ETFs has expanded passive investing beyond traditional market-capitalization indices.

Global passive investing also reflects a broader transformation in investor philosophy. Investors are focusing more on long-term wealth creation and disciplined investing rather than short-term speculative gains. As a result, passive funds have become central components of modern portfolio management strategies.

4. INDIAN LANDSCAPE OF PASSIVE FUNDS

India has emerged as one of the fastest-growing passive investment markets among emerging economies. According to industry estimates, passive AUM increased nearly eighteen times between 2018 and December 2025. The total passive fund AUM increased from approximately Rs. 0.8 lakh crore in 2018 to Rs. 14.19 lakh crore by December 2025.

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Performance Analysis of Passive Investment Indices

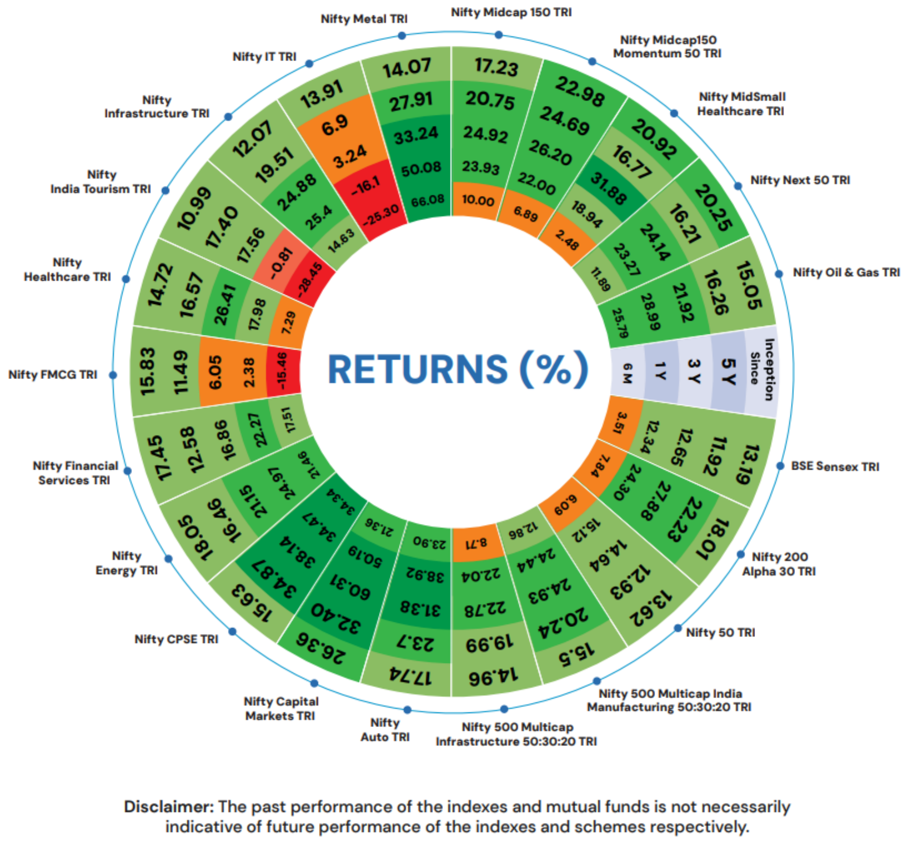

Exhibit 1 – Total Returns on the Passive Investments in Indian Capital Market

Source: Capital Market Passive Fund Returns Data.

The above exhibit represents the total returns (%) generated by various passive investment indices across different investment horizons of 6 months, 1 year, 3 years, and 5 years. The data reveal significant variation in performance among sectoral and thematic indices, highlighting the impact of market trends and sector-specific growth on passive investment outcomes. Among the indices, the Nifty Midcap 150 TRI and Nifty Midcap 150 Momentum 50 TRI demonstrated superior performance across most time periods, particularly over the 3-year and 5-year horizons, indicating the strong growth potential of mid-cap and momentum-based investment strategies. The Nifty India Tourism TRI, Nifty Capital Markets TRI, and Nifty Auto TRI also recorded impressive long-term returns, reflecting the post-pandemic recovery and expansion of these sectors.

Sector-focused indices such as Nifty Healthcare TRI, Nifty IT TRI, and Nifty Metal TRI generated competitive returns, although their short-term performance exhibited greater volatility. Conversely, broad market benchmarks including the Nifty 50 TRI, BSE Sensex TRI, and Nifty Next 50 TRI delivered relatively stable and consistent returns, reinforcing their role as core passive investment options for risk-conscious investors. The exhibit further indicates that certain thematic indices experienced negative returns during shorter periods, emphasizing the cyclical nature of sectoral investments and the importance of investment horizon in passive fund performance evaluation. Overall, the analysis suggests that passive funds tracking mid-cap, momentum, tourism, and capital market indices have outperformed traditional benchmark indices over the long term, offering attractive opportunities for investors seeking higher returns through passive investment strategies.

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The rapid expansion of passive funds in India can be attributed to multiple factors:

a) Increased investor awareness regarding financial planning and mutual fund investing.

b) Growth of digital investment platforms and fintech applications.

c) Regulatory support from SEBI and AMFI

d) Increasing dissatisfaction with underperforming active funds.

e) Growing interest in long-term, low-cost investing strategies.

Indian investors increasingly recognise the advantages of diversification and benchmark-based investing. Passive products have also become popular among first-time investors because of their simplicity and lower costs. The Indian mutual fund industry has responded to this trend by launching a wide variety of passive investment products covering broad market indices, sectoral themes, smart beta strategies, debt indices, and international indices. This product innovation has expanded investment choices and encouraged broader market participation. Another important factor is the increasing role of institutional investors. Employee provident funds, pension funds, and corporate treasury operations have shown greater preference for passive investment products, especially ETFs and debt index funds.

5. GROWTH OF INDEX FUNDS IN INDIA

Index funds have become one of the most preferred passive investment avenues in India. These funds seek to replicate benchmark indices such as Nifty 50, Sensex, Nifty Next 50, and sector-specific indices. The total AUM of index funds increased significantly from approximately Rs. 2,452 crore in March 2017 to more than Rs. 3,25,449 crore by December 2025.

The number of index funds has also grown rapidly. Industry data indicates that the number of index funds increased from 21 in 2017 to 352 by December 2025. The expansion reflects increasing investor demand as well as the willingness of asset management companies to diversify their passive product offerings.

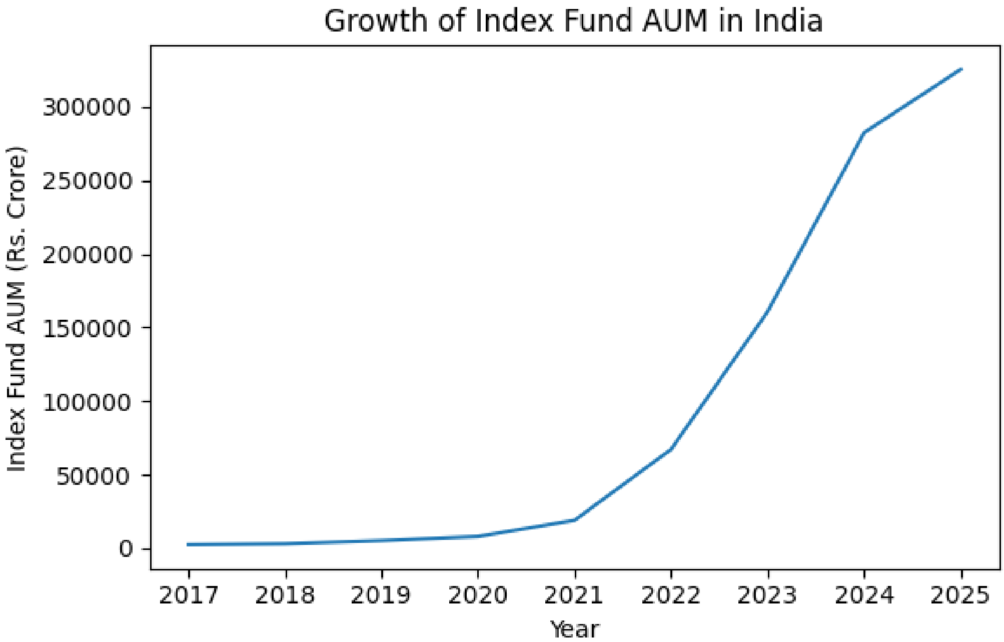

Figure 1: Growth of Index Fund AUM in India

DOI: 10.5281/zenodo.21254660
Vol: 63 | Issue: 07 | 2026

Index funds offer several advantages:

i. Low expense ratios compared to actively managed equity funds.

ii. Automatic diversification across multiple securities.

iii. Transparent investment structure.

iv. Reduced dependence on fund manager performance.

v. Ease of investment through SIPs and online platforms.

Broad market index funds continue to dominate the segment. However, thematic, factor-based, and sectoral index funds are also gaining traction. International index funds have become particularly popular among investors seeking geographical diversification beyond India. Debt index funds are another emerging category. These funds provide exposure to government securities and fixed-income instruments while offering stable and predictable returns. As interest in debt diversification increases, debt index funds are expected to become important components of conservative portfolios.

6. EXCHANGE TRADED FUNDS (ETFs) AND MARKET EXPANSION

Exchange Traded Funds represent another major segment of passive investing. ETFs combine features of mutual funds and equity shares because they are traded on stock exchanges throughout the trading day. This provides investors with liquidity and real-time price discovery. The Indian ETF market has witnessed extraordinary growth during the last decade. Total ETF AUM increased from approximately Rs. 50,211 crore in March 2017 to more than Rs. 10,94,329 crore by December 2025.

Similarly, the number of ETFs increased from 63 to 311 during the same period. Equity ETFs account for the largest share of ETF assets in India. Debt ETFs, gold ETFs, and silver ETFs are also expanding steadily. Government initiatives and institutional participation have contributed significantly to ETF growth.

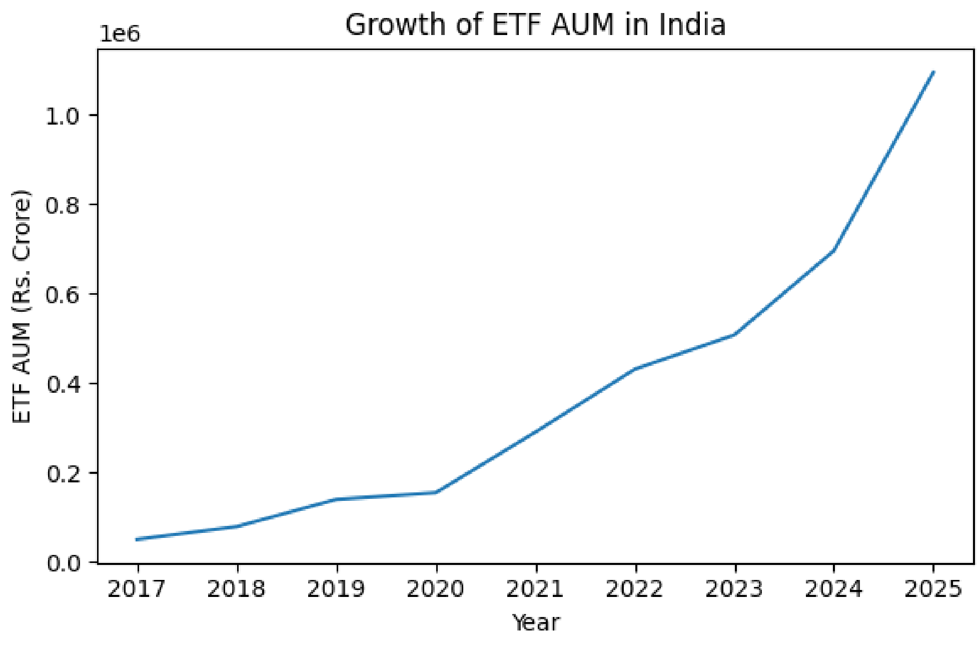

Figure 2: Growth of ETF AUM in India

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Vol: 63 | Issue: 07 | 2026

ETFs possess several unique characteristics:

a. Intraday tradability.

b. Lower expense ratios.

c. High transparency.

d. Liquidity and operational flexibility.

e. Suitability for tactical asset allocation.

Thematic and factor-based ETFs are gaining investor attention because they allow exposure to sectors such as banking, technology, healthcare, manufacturing, and ESG-focused companies. Commodity ETFs, especially gold ETFs, have become popular among investors seeking inflation protection and portfolio diversification.

Despite their growth, ETF adoption among retail investors remains lower than in developed markets. Challenges such as limited awareness, trading account requirements, and liquidity concerns continue to affect penetration. However, increasing financial literacy and digital brokerage platforms are expected to accelerate ETF adoption in the coming years.

7. FUND OF FUNDS (FoFs) AND DIVERSIFICATION

Fund of Funds (FoFs) are investment schemes that invest in other mutual fund schemes instead of directly investing in securities. FoFs provide investors with diversified exposure to multiple funds through a single investment product. FoFs are particularly useful for investors who prefer professional asset allocation without managing multiple fund investments individually. Passive FoFs often invest in ETFs or index funds and provide easy access to passive investment strategies.

The key advantages of FoFs include:

a) Diversification across asset classes and fund categories.

b) Simplified investment process.

c) No requirement for demat accounts.

d) Better portfolio management for retail investors.

However, FoFs may involve an additional layer of expenses because investors bear both FoF expenses and the expenses of underlying schemes. Nevertheless, the convenience and diversification benefits often outweigh these limitations for long-term investors. International FoFs have also gained popularity in India. These products allow Indian investors to participate in global equity markets through professionally managed structures. The increasing globalization of investment portfolios is likely to support future growth in this category.

8. PERFORMANCE TRENDS AND INVESTMENT OPPORTUNITIES

One of the most important aspects of passive investing is long-term performance consistency. Historical data indicates that several passive indices have delivered competitive long-term returns. The Tata Passive Fund Brochure (2026) highlights strong performance across multiple indices, including Nifty Midcap 150 TRI, Nifty IT TRI, Nifty Auto TRI, and thematic infrastructure indices. Passive investing emphasizes “time in the market” rather than “timing the market.” This philosophy encourages disciplined investing and reduces emotional decision-making during periods of market volatility.

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Investment Opportunities of Passive Investment Eco system:

1) Broad Market Exposure – Investors can gain diversified exposure to the Indian economy through indices such as Nifty 50 and Sensex.
2) Sectoral Opportunities – Sector-specific ETFs and index funds provide targeted exposure to industries such as banking, healthcare, information technology, and manufacturing.
3) International Diversification – Global index funds and ETFs allow investors to participate in foreign markets.
4) Smart Beta Strategies – Factor-based investing combines passive structures with strategic selection criteria such as momentum, value, alpha, and low volatility.
5) ESG and Sustainable Investing – ESG-focused passive funds align investments with sustainability objectives.

The long-term success of passive investing depends on investor discipline, market participation, and portfolio diversification. Investors who remain invested during market cycles are more likely to achieve sustainable wealth creation over time.

9. CHALLENGES AND LIMITATIONS OF PASSIVE FUNDS

Although passive funds offer numerous advantages, they are not free from limitations. One of the primary criticisms of passive investing is that passive funds cannot outperform benchmark indices because their objective is merely to replicate market performance. Another concern relates to market concentration. Market-capitalization-based indices allocate higher weights to larger companies, which may increase concentration risks. In addition, passive funds are exposed to overall market declines during bearish phases because they remain fully invested according to index rules.

Tracking error is another important challenge. Tracking error refers to the difference between fund returns and benchmark index returns. Expense ratios, liquidity constraints, and operational inefficiencies may contribute to tracking differences. In the Indian context, limited investor awareness and inadequate understanding of ETFs continue to affect market penetration. Retail investors often prefer actively managed funds because of the perception that active management can generate superior returns. Furthermore, excessive growth in passive investing has raised concerns among market analysts regarding price discovery and market efficiency. If a significant proportion of market assets become passively managed, the role of active investors in identifying mispriced securities may decline. Despite these challenges, passive investing continues to expand because of its long-term efficiency, cost-effectiveness, and simplicity.

10. CONCLUSION

Passive investing has become one of the most transformative developments in the global and Indian financial markets. The rapid increase in passive fund assets under management demonstrates growing investor confidence in index-based investing strategies. India, in particular, has emerged as a high-growth market for passive products because of increasing financial literacy, digital investment adoption, and supportive regulatory frameworks. Index funds, ETFs, and FoFs collectively provide investors with diversified, transparent, and cost-efficient investment opportunities. The expansion of thematic, international, ESG-focused, and factor-based passive products has further broadened investment choices for retail and institutional investors.

The study reveals that passive investing is no longer limited to broad market index replication. Instead, it has evolved into a comprehensive investment ecosystem offering exposure across sectors, asset

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Vol: 63 | Issue: 07 | 2026

classes, investment themes, and geographical regions. While passive investing faces challenges related to tracking errors, market concentration, and limited retail awareness, its long-term growth prospects remain highly promising. As Indian capital markets mature and investor education improves, passive funds are expected to play an increasingly important role in wealth creation and portfolio management. The future of passive investing in India will depend on continued product innovation, investor awareness campaigns, regulatory support, and technological advancements. Overall, passive funds represent an efficient and sustainable approach to long-term investing in modern financial markets.

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