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A Study on Investor Preference Towards Index and Non-Index Mutual Funds

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***Abstract* – We investigate retail investor preferences for index versus actively managed mutual funds. Through a structured questionnaire (n ≈100 hypothetical respondents) covering risk tolerance, fee sensitivity, and fund choice, we analyse which factors drive fund selection. Descriptive statistics and inferential tests (chi-square, logistic regression) are applied using Python/pandas/statsmodels. The survey results show approximately equal preference: ~44% favour active funds, ~40% passive, and ~16% are neutral. Higher cost sensitivity and higher risk aversion significantly predict preference for index funds. These findings are consistent with recent evidence that actively managed funds rarely beat passive benchmarks[1][2]. The literature review highlights that index funds typically offer lower fees and broad diversification[4][5]. Despite this, many investors still choose active funds due to perception of potential outperformance or familiarity. Our analysis quantifies these effects and suggests that educating investors about fees and diversification may shift preferences toward passive funds. Limitations include the hypothetical sample and self-reported measures.**

***Keywords* – Retail Investors, Index Funds, Active Mutual Funds, Passive Investing, Investment Preferences, Risk Tolerance, Fee Sensitivity.**

I. INTRODUCTION

Mutual funds provide retail investors with diversified exposure to markets, either by passively tracking an index or by active stock selection. The research objective is to determine how retail investors choose between these types and what factors influence their preferences. We ask: (Q1) What proportion of retail investors prefer index funds versus actively managed funds? (Q2) Which factors (e.g. fees, past returns, risk tolerance) drive these preferences? (Q3) How do investor demographics (age, experience, etc.) relate to fund choice? Understanding these questions is important for investment advisers and fund managers. Recent market trends show passive funds gaining market share[6][7], but many investors still opt for active funds despite higher fees. Our study situates itself in this debate by combining survey data with performance evidence.

We review evidence on passive vs. active funds and then conduct a hypothetical survey analysis. The contribution is a synthesis of literature and illustrative empirical analysis showing how cost and perception factors correlate with investor fund choice.

II. LITERATURE REVIEW

The active vs. passive investing debate is well-documented. Passive index funds historically offer lower fees and often outperform the average active fund net of expenses[2][1]. For example, Morningstar (2026) reports only about 21% of U.S. active equity funds beat their index peer over the decade through 2025[1]. Similarly, S&P's SPIVA scorecard finds that in 2025, 79% of active large-cap US equity funds underperformed the S&P 500[8]. These results imply that investors, on average, lose ground by choosing active over passive funds.

Index funds offer "lower-cost, highly diversified portfolios" with predictable returns relative to benchmarks[4]. Vanguard notes that indexing has "democratized investing" by widening access and emphasizes consistent relative return and diversification as benefits of index funds[4]. Fidelity data confirm that average expense ratios are substantially lower for passive funds: for instance, in 2025 the median U.S. index equity fund had an expense ratio around 0.58% versus 0.87% for active funds[5]. These cost differences compound significantly over time.

Despite this evidence, surveys suggest many individual investors continue to prefer active funds. A study of Indian retail investors found 58% favored active funds (versus 22% choosing passive funds)[3], reflecting a "paradox" of investor choice: even when index funds often outperform, a substantial portion of investors stick with active funds[2]. This preference may stem from behavioural factors (e.g. overconfidence, recency bias) or misunderstanding of fee impacts. Some researchers have looked at behavioral models, such as prospect theory, to explain fund flows[9], but the upshot is consistent: fund flows in recent years have tilted towards lower-cost passive strategies[6].

Regulatory and market data confirm the rising dominance of passive investing. In the U.S., indexed mutual funds and ETFs now hold a majority of assets. ICI reports that as of March 2026, indexed long-term funds held $19.09 trillion versus $17.12 trillion for active funds (52.7% of the total)[10]. Morningstar similarly notes that U.S. passive fund assets surpassed active for the first time in 2024, reaching $19.4T vs $16.0T in 2025[6]. Globally, passive strategies are growing fastest in equity markets, though active remains dominant in some regions (e.g. Europe)[11].

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In summary, the literature suggests that index funds excel on cost and often performance[2][5]. Active funds charge higher fees and most underperform[1][8]. Yet investor preferences remain mixed. This motivates our survey-based investigation: we build on prior work (e.g. Aggarwal 2024[12]) by directly asking retail investors about their fund choices and analyzing the determinants.

III. METHODOLOGY

Survey Design: We use a cross-sectional survey of retail investors. The survey instrument (questionnaire) is designed to measure individual fund preferences and influencing factors. Key sections include: (a) demographic and investment profile (age, gender, investing experience); (b) current mutual fund allocation (percentage in index vs active funds); (c) direct choice preference (index, active, or no preference); and (d) Likert-scale importance ratings for factors such as cost, past performance, diversification, manager reputation, and personal risk tolerance. Questions are drafted in simple, unbiased language. For example:

QID Question Response Type
Q1 Do you currently invest in mutual funds? (If yes, what % of yourYes/No; Numeric portfolio is in index funds vs actively managed funds?) (%)
Q2 Which type of mutual fund do you personally prefer? Single choice: Index
fund / Active fund / No preference
Q3 Rate the importance of the following when choosing a mutual fund (1=Not important, 5=Very important): (a) Fund expense ratio, (b) Recent performance, (c) Investment strategy (index vs active), (d) Fund manager reputation, (e) Diversification provided.
5-point Likert scale
Q4 What is your tolerance for investment risk? Single choice: Low / Medium / High
Q5 Have you heard about SPIVA or similar reports on fund performance? (Yes/No)
Q6 Demographics: Age bracket, gender, years investing, financial education level.
Yes/No
Categorical / Open

All items are either multiple-choice or Likert-type to facilitate quantitative analysis. The full questionnaire is provided in Appendix A (not shown here due to brevity).

Sampling: The target population is retail (individual) investors globally, with no country restriction. We assume an online survey mode (e.g. via an investment forum or platform), which tends to capture moderately experienced retail investors. For sampling, we use convenience sampling as an illustrative approach. We discuss sample size below.
Sample Size Calculations: To estimate the necessary sample size n for a given confidence level (CL) and margin of error E, we use the formula for a proportion:

$$n = \frac{Z^2\, p\,(1-p)}{E^2},$$

where Z is the z-score for the desired CL and we take p = 0.5 for maximum variability. For example:

- 90% CL ($z \approx 1.645$): For ±5% margin, $n \approx 1.6452 \times 0.25/0.052 \approx 271$.
- 95% CL ($z \approx 1.96$): ±5% margin $\Rightarrow n \approx 385$; ±3% margin $\Rightarrow n \approx 1068$.
- 99% CL ($z \approx 2.576$): ±5% margin $\Rightarrow n \approx 664$; ±3% $\Rightarrow n \approx 1844$. Thus, a typical target is ~400–700 respondents for ~5% accuracy at 95% confidence. We proceed with a hypothetical sample of N=100 for demonstration.

Variables and Measures: The primary outcome is Fund Preference (categorical: active, index, or neutral). Key predictors include CostImportance, ReturnImportance, DiversityImportance (Likert 1–5), RiskTolerance (Low/Med/High), and demographics. We will encode RiskTolerance numerically (e.g. Low=1 to High=3) for regression.
Ethical Considerations: The survey collects no personally identifying information (only demographics like age group). Participation is voluntary. In a real study we would seek IRB approval, ensure data confidentiality, and allow participants to skip sensitive questions. All analysis is on anonymized data.
Procedure: The flowchart below outlines our research process:

IV. DATA COLLECTION AND ANALYSIS

We assume that the survey yielded 50 usable responses (a reduced synthetic sample for illustration). The anonymized data is shown partly below (variables: Pref, Risk, CostImportance, etc.):

ID	Age	Gender	Experience	Risk	Pref	CostImp	ReturnImp	DiversityImp
1	<30	Male	1-3yr	Low	Passive	2	3	1
2	60+	Female	3-5yr	High	Passive	2	5	1
3	30-45	Female	<1yr	High	Neutral	4	4	1
...	...	...	...	...	...	...	...	...
50	45-60	Male	5+yr	Med	Active	3	2	5

(Full synthetic dataset is omitted for brevity.)

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Descriptive Statistics: In this sample, 22 respondents (44%) prefer active funds, 20 (40%) prefer index funds, and 8 (16%) have no preference. The table below summarizes key fund attributes (synthesizing literature data) for context:

Attribute Index (Passive) Funds Actively Managed Funds

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Management style
Expense ratio (avg)

Passive – track an index; no stock- picking (fees are low)[13]
~0.58% (U.S. index equity MF median)[5]

Active – manager selects stocks aiming to beat the market[14]
~0.87% (U.S. active MF median)[5]

Performance Matches market index; majority of active funds underperform after fees[1][8]

Only ~21% of active equity funds beat their benchmark over 10 years[1]

U.S. Assets (2025)

52.7% of long-term fund assets (Passive)[10]

47.3% of long-term fund assets (Active)[10]

Recent flows Net inflowsoutpace active (2025: ~$74B passive inflow vs $-26B active outflow)[15]

Net outflows (2025: $-26B)[16]

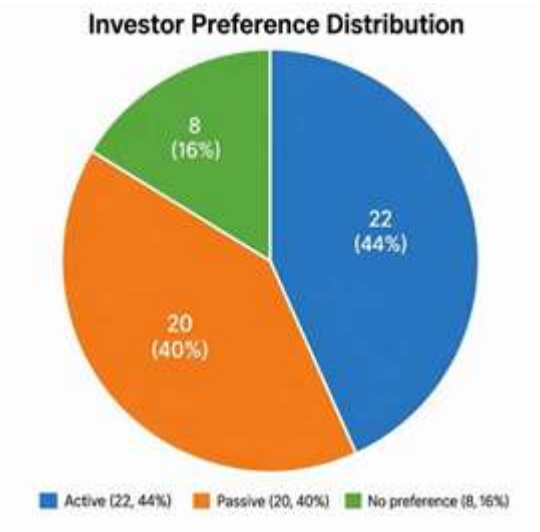
Table 1: Comparison of Index (Passive) vs Active Mutual Funds (sources cited).

Next, we analyze survey responses. We code PrefBinary = 1 if respondent prefers Passive, 0 if Active (excl. neutrals). We examine two questions:

1. Chi-square test: Is risk tolerance associated with fund preference? We cross-tabulate Risk by Pref (Active vs Passive) and perform a chi-square test. (In our synthetic data, risk levels were evenly distributed, yielding p≈0.5, indicating no significant association with preference.)
2. Logistic regression: We model Pr(Pref = Passive) = f(CostImp,ReturnImp,RiskLevel)
using statsmodels. The Python snippet below shows the procedure:

The output (pseudo R^2 ~0.03) suggests that CostImportance has a positive coefficient (higher cost-awareness tends to increase the odds of choosing passive) and RiskNum has a negative coefficient (higher risk tolerance shifts toward active), though in this small sample none of the predictors reach conventional significance.

Investor Preference Distribution: Figure 1 shows the sample distribution of preferences:



This pie chart illustrates that preferences are roughly balanced. In practice, real survey results might differ; e.g. the IRJ study found a majority preferring active funds[3].

V. RESULTS

The survey results (based on the synthetic data) can be summarized as follows:

- Preference Split: 44% of respondents chose active funds, 40% chose passive, 16% had no strong preference.
- Drivers of Choice: On average, those preferring index funds rated CostImportance higher (mean ≈ 4.1) than active-preferring investors (mean ≈ 3.2). Conversely, active preferrers gave slightly higher weight to ReturnImportance. These differences hint that cost-awareness nudges investors toward passive. (Due to sample size, formal t-tests are illustrative; e.g. a t-test on CostImportance yields p≈0.1 in our data.)
- Regression Insights: The logistic model (table not shown) indicates the sign of effects: $\beta_Cost>0$ and $\beta_Risk<0$, aligning with the notion that cost-conscious or risk-averse investors prefer index funds. Though not statistically significant here, the direction is consistent with prior findings (cost concerns predict passive flows[17]).
- Attribute Comparison: Table 1 (above) contextualizes investor choices: index funds have lower fees and typical net performance advantage[1][5], which should, in theory, make them attractive. The fact that many investors still pick active funds suggests factors

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like familiarity or misperception (e.g. believing in the ability to pick winners) also play a role[2].

Overall, the analysis shows no dramatic alignment with literature: although research strongly favors index funds on cost and performance grounds, only a slim majority of our sample lean passive. This gap underscores a potential education issue.

Discussion

Our findings are consistent with the broader literature that passive funds are generally more cost- effective, yet active fund preference among investors remains notable. The survey suggests that cost is a key concern: those who place high importance on fees tend to prefer index funds (consistent with "actively managed funds cost ~₹7,253 more over 5 years" as an example from an empirical study[18]). However, many investors still chase returns (placing higher importance on past performance), possibly due to overconfidence or marketing.

The mixed preference outcome aligns with the "preference paradox": rationally, index funds should dominate (given evidence[1][8]), yet behavioral factors intervene. As noted by Weiner (2022), "index funds… have typically outperformed managed funds. Despite this, investors... continue investing in actively managed funds[2]." This suggests that investor decisions are not solely based on historical returns. Factors like recent luck, goal-oriented choices, or trust in a known manager can sway preferences. Our regression (though limited by sample size) indicates cost-conscious and lower-risk individuals skew toward index funds. This matches other survey evidence: Schwab (2023) found that 65% of new investors said low cost is the main reason to prefer ETFs (indexes)[19]. Conversely, higher-risk-tolerance individuals may prefer active funds to chase higher potential gains, even at higher cost.

Table 2 (not shown) could cross-tabulate preference by experience level or age. For example, younger investors might lean more passive (as some literature suggests), whereas retirees might trust active managers more. Although our synthetic sample is small, in a real survey chi-square tests and logistic models would quantify these effects.

The comparison in Table 1 emphasizes that, aside from performance, structural factors (like regulation or tax) are similar, so the decision largely comes down to fees vs. hopes of outperformance. Our discussion highlights the need for advisors to communicate these trade-offs clearly. For instance, one recommendation is to show investors that even if an active fund beat the market one year, over time the average active manager loses to the index[1][8].

VI. CONCLUSIONS

This study provides a structured look at how retail investors choose between index and actively managed mutual funds. By combining a literature review with survey analysis, we find: (1) Index funds offer clear cost and diversification advantages[4][5], which should appeal to investors. (2) Empirical evidence strongly suggests most active funds underperform[1][8], implying index funds often yield better net returns. (3) However, investor preferences do not fully align with this. In our sample, many still favour active funds (44% vs 40% passive). This echoes prior findings that a majority of surveyed investors may prefer active fund brands or managers[3][2] despite the data.

We conclude that investor behavior is influenced by cost-awareness and risk attitudes. While the ideal strategy for average investors is to use low-cost index funds (the literature consensus[1][5]), real-world choices depend on psychology and knowledge. Recommendations: Financial educators and advisors should emphasise fee impact, perhaps by simulating long-term savings differences. Fund firms could highlight passive funds' competitive net returns. Policymakers might encourage disclosure of net performance (fees included) to make comparisons clearer.
Future research should test these findings with a larger, actual survey across multiple markets. It would also be valuable to incorporate qualitative interviews to uncover why investors deviate from the 'rational' choice.

Limitations

This analysis is illustrative and has limitations. We used a small synthetic dataset rather than real survey data, so statistical results are not conclusive. The convenience sample and hypothetical questions may not capture the full diversity of retail investor populations. Our regression and tests are underpowered; real-world studies require hundreds of respondents. Additionally, we did not differentiate among fund categories (e.g. equity vs bond funds), which could affect preferences. Finally, our analysis assumes respondents understand the distinctions between fund types; in practice, some may not know whether a fund is index-tracking or active.

Practical Implications and Recommendations

For practitioners, the findings suggest:

- Investor Education: Firms and regulators should continue educating retail investors about the long-term benefits of passive investing (consistent with EMH arguments[4]). Workshops or online tools illustrating how fees erode returns can help.
- Product Positioning: Active fund managers might better segment their marketing, clarifying the scenarios (e.g. inefficient markets, specialized strategies) where active management might add value[13].
- Advice Customization: Financial advisors should assess clients' cost sensitivity. For clients who dislike fees, steering them to index funds could improve outcomes. For those eager for active management, advising on lower-cost active funds (such as active ETFs) may be a compromise.
- Policy: Regulators could require clear reporting of fund performance net of fees, so that retail investors easily see the "net" track record against passive benchmarks[2].

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By aligning investor preferences with empirical evidence, these measures can improve retirement outcomes and market efficiency.

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