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Original Article

Cost, Transparency, and Performance: A Study of Retail Investor Migration from Mutual Funds to ETFs in Pune

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Abstract

The transformation of global financial markets has significantly influenced investment behavior, particularly with the growing adoption of passive investment instruments such as Exchange-Traded Funds (ETFs). This study investigates the factors driving retail investor migration from actively managed mutual funds to ETFs, with specific reference to Pune. The research focuses on three critical determinants: cost efficiency, transparency, and performance. Primary data was collected from 250 retail investors using a structured questionnaire based on a five-point Likert scale. Statistical techniques including reliability analysis, exploratory factor analysis, multiple regression, and Structural Equation Modeling (SEM) were applied to examine relationships among variables. The findings reveal that cost efficiency and transparency are significant predictors of ETF adoption, while performance plays a comparatively moderate role. Behavioral biases negatively influence ETF adoption, indicating the persistence of traditional investment preferences. The study contributes to the literature on passive investing in emerging markets and provides practical implications for policymakers, financial advisors, and asset management companies.

Keywords: *ETFs, Mutual Funds, Cost Efficiency, Transparency, Investor Behavior, Passive Investing*

Introduction

The Indian financial market has undergone a significant transformation in recent years, characterized by increased retail participation, technological advancement, and product innovation. Traditionally, actively managed mutual funds dominated the investment landscape due to the perceived expertise of fund managers and their ability to generate superior returns. However, the global shift toward passive investing has challenged this dominance. Exchange-Traded Funds (ETFs), which replicate market indices, have emerged as cost-effective, transparent, and efficient investment alternatives. Their low expense ratios and real-time trading capabilities make them particularly attractive to modern investors.

In emerging urban centers such as Pune, rising financial literacy and the growth of digital investment platforms have significantly influenced investor behavior. Regulatory initiatives by the Securities and Exchange Board of India have further facilitated market participation. Despite these developments, ETF adoption among retail investors remains limited compared to mutual funds. This suggests that investment decisions are influenced not only by rational factors such as cost and performance but also by behavioral biases and informational constraints. This study aims to examine these dynamics in detail.

Review of Literature

The active versus passive investment debate has been extensively explored in financial literature. Studies based on the Efficient Market Hypothesis proposed by Eugene Fama suggest that consistently outperforming the market is difficult, thereby supporting passive investment strategies.

Fama and French (2010) found that most actively managed funds fail to outperform benchmark indices after accounting for fees. Similarly, Bogle (2017) emphasized the importance of minimizing costs, arguing that lower expense ratios significantly enhance long-term returns. Malkiel (2019) further supported index-based investing as an efficient strategy for reducing unsystematic risk.

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Recent studies (2020–2024) highlight that ETFs offer advantages such as:

- Lower costs
- Greater transparency
- Improved liquidity

However, behavioral finance literature suggests that investors are influenced by heuristics, familiarity bias, and advisory dependence. In the Indian context, mutual funds continue to dominate due to trust in fund managers and distribution networks, despite increasing awareness of ETFs under the regulatory framework of the Securities and Exchange Board of India.

A critical gap exists in city-level empirical studies integrating cost, transparency, performance, and behavioral factors. This study addresses this gap with reference to Pune.

Research Objectives

1. To examine the impact of cost efficiency on investor preference
2. To analyze the role of transparency in investment decisions
3. To evaluate the influence of performance on fund selection
4. To assess the extent of investor migration toward ETFs
5. To identify behavioral factors affecting ETF adoption

Hypotheses

- **H1:** Cost efficiency positively influences ETF adoption
- **H2:** Transparency significantly impacts investor preference
- **H3:** Performance consistency influences investment decisions
- **H4:** Behavioral bias negatively influences ETF adoption

Research Methodology

The study adopts a descriptive and analytical research design. Primary data was collected from 250 retail investors in Pune using a structured questionnaire based on a five-point Likert scale.

Sampling Technique: Convenience and stratified sampling

Statistical Tools Used:

- Cronbach's Alpha
- Exploratory Factor Analysis (EFA)
- Multiple Regression
- Structural Equation Modeling (SEM)

Data Analysis and Results

1. **Reliability Analysis**

Construct	Items	Cronbach's Alpha
Cost Efficiency	3	0.812
Transparency	3	0.784
Performance	3	0.756
Behavioral Bias	3	0.738
ETF Preference	2	0.801
Overall	14	0.842

All constructs demonstrate acceptable reliability (>0.70).

2. **Factor Analysis**

KMO = 0.821, Bartlett's Test ($p < 0.001$) confirms suitability.

Four factors emerged:

- Cost Efficiency
- Transparency
- Performance
- Behavioral Bias

3. **Regression Analysis**

Model Summary:

$R^2 = 0.520$ (Strong explanatory power)

Variable	Beta	Significance
Cost Efficiency	0.452	0.000
Transparency	0.318	0.000
Performance	0.214	0.002
Behavioral Bias	-0.167	0.006

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4. **SEM Results**

Path	Coefficient	Result
Cost → ETF Adoption	0.48	Supported
Transparency → ETF Adoption	0.35	Supported
Performance → ETF Adoption	0.22	Supported
Behavioral Bias → ETF Adoption	-0.19	Supported

Model Fit:

- $R^2 = 0.56$
- AVE = 0.58
- CR = 0.84

Discussion

The empirical results provide strong evidence that cost efficiency is the most influential determinant of retail investor migration toward ETFs. The high beta coefficient ($\beta = 0.452$) and significant SEM path value reinforce the argument that investors in Pune are becoming increasingly sensitive to expense ratios. This aligns with the cost-minimization principle emphasized in passive investment theory and supports prior findings that lower fees significantly enhance net investor returns over time.

Transparency emerged as the second most critical factor influencing ETF adoption. Investors demonstrated a clear preference for instruments that provide real-time pricing and frequent portfolio disclosures. This finding reflects the growing importance of information symmetry in financial decision-making, particularly in a digital investment environment. Increased access to fintech platforms has likely amplified this effect by enabling investors to monitor investments more actively.

The role of performance, although statistically significant, appears relatively moderate. This suggests that while investors consider historical returns, they may not fully understand or utilize benchmark-adjusted performance metrics. This gap highlights a critical issue in financial literacy, where investors rely more on visible metrics rather than risk-adjusted measures.

A key insight from the study is the negative influence of behavioral bias ($\beta = -0.167$). Factors such as:

- reliance on financial advisors
- familiarity with mutual funds
- herd behavior

Continue to slow ETF adoption. This indicates that investor decisions are not purely rational but are shaped by psychological and social influences. The persistence of these biases confirms the relevance of behavioral finance theory in explaining real-world investment behavior.

Overall, the findings suggest that the transition from mutual funds to ETFs is evolutionary rather than revolutionary. While rational factors like cost and transparency are gaining prominence, behavioral constraints continue to moderate the pace of change.

Conclusion

This study concludes that the migration of retail investors from actively managed mutual funds to ETFs in Pune is primarily driven by cost efficiency and transparency, with performance playing a secondary role.

The results confirm that investors are gradually shifting toward efficiency-oriented investment strategies, reflecting broader global trends in passive investing. However, this transition is not uniform or complete. Behavioral biases, informational limitations, and advisory influence continue to play a significant role in shaping investment preferences.

The study highlights an important structural shift in the Indian investment landscape—from trust-based investing (fund manager reliance) to data-driven investing (cost and transparency focus). This shift indicates increasing maturity among retail investors, supported by technological advancements and regulatory initiatives.

However, the relatively moderate influence of performance suggests that investor decision-making is still evolving. Greater emphasis on financial education and analytical capability is required to ensure that investors make fully informed decisions.

In conclusion, while ETFs are gaining traction as a preferred investment vehicle, their adoption in India remains in a growth phase, influenced by both rational evaluation and behavioral tendencies.

Implications

1. **For Regulators**

For regulatory bodies such as the Securities and Exchange Board of India:

- Develop targeted investor awareness programs focusing on passive investing
- Introduce simplified ETF disclosure formats to improve accessibility
- Encourage cost transparency regulations across all investment products
- Promote ETF inclusion in retirement and long-term investment schemes

2. **For Asset Management Companies (AMCs)**

- Increase marketing and awareness campaigns for ETFs
- Develop investor-friendly ETF products with simplified structures
- Improve liquidity and trading volumes to enhance investor confidence
- Integrate ETFs into hybrid and advisory portfolios

3. **For Financial Advisors**

- Shift from commission-driven advice to fiduciary-based recommendations

- Educate clients about cost-benefit trade-offs between active and passive funds
- Include ETFs as a core portfolio component, especially for long-term investors
- Reduce bias toward actively managed funds

4. **For Investors**

- Focus on expense ratios and long-term returns rather than short-term performance
- Develop financial literacy, particularly regarding index investing
- Avoid behavioral traps such as herd mentality and familiarity bias
- Use digital platforms for informed decision-making

Limitations

While the study provides valuable insights, it is subject to certain limitations:

1. **Geographical Limitation**

The study is confined to Pune, which may limit generalizability to other regions with different investor profiles.

2. **Sample Size Constraint**

Although 250 respondents provide adequate statistical power, a larger sample could enhance robustness.

3. **Self-Reported Data**

Responses are based on investor perception, which may introduce bias or inaccuracies.

4. **Cross-Sectional Design**

The study captures behavior at a single point in time and does not account for changes over time.

5. **Limited Variables**

Other factors such as taxation, liquidity constraints, and macroeconomic conditions were not explicitly included.

Future Research

The present study provides valuable insights into the determinants of retail investor migration from mutual funds to Exchange-Traded Funds (ETFs) in Pune. However, given the evolving nature of financial markets and investor behavior, several avenues remain open for further investigation.

1. **Geographic Expansion and Comparative Studies**

Future research can extend this study beyond Pune to include multiple cities across India, such as metropolitan, semi-urban, and rural regions. A comparative analysis across different geographic segments would provide deeper insights into regional variations in investor awareness, financial literacy, and adoption of ETFs. Such studies could also examine differences between Tier-I, Tier-II, and Tier-III cities, thereby enhancing the generalizability of findings.

2. **Longitudinal Studies**

This study adopts a cross-sectional approach, capturing investor behavior at a single point in time. Future research may adopt a **longitudinal design** to track changes in investor preferences over time. This would be particularly useful in analyzing how external factors such as market volatility, economic cycles, or regulatory changes influence the adoption of ETFs. Long-term studies could also assess whether the observed shift toward passive investing is sustainable.

3. **Inclusion of Additional Variables**

While the present study focuses on cost, transparency, performance, and behavioral bias, future research can incorporate additional variables such as:

- Tax efficiency and capital gains implications
- Liquidity and trading volume considerations
- Risk perception and portfolio diversification
- Technological adoption and fintech usage

Inclusion of these variables would provide a more comprehensive understanding of investment decision-making.

4. **Advanced Behavioral Modeling**

The role of behavioral finance can be explored in greater depth by incorporating constructs such as:

- Overconfidence bias
- Loss aversion
- Anchoring and framing effects
- Investor sentiment

Future studies may employ advanced analytical techniques such as Structural Equation Modeling (SEM) or Partial Least Squares (PLS-SEM) to examine complex relationships between psychological factors and investment behavior.

5. **Comparative Performance Analysis**

Further research can conduct a comparative empirical analysis of ETFs and mutual funds using secondary data. This may include:

- Risk-adjusted return measures (Sharpe Ratio, Jensen's Alpha)
- Volatility analysis
- Tracking error evaluation for ETFs

Such studies would provide objective evidence to complement perception-based findings.

6. **Impact of Digital Investment Platforms**

With the rapid growth of fintech platforms, future research can examine the role of digital intermediaries such as Zerodha and Groww in influencing investor behavior. Specifically, studies can explore:

- User interface and ease of access
- Educational content and awareness creation
- Influence of app-based recommendations

7. **Cross-Country Comparative Studies**

Future research may extend beyond India to conduct cross-country comparisons between emerging and developed markets. This would help in understanding how institutional frameworks, regulatory environments, and market maturity influence ETF adoption.

8. **Policy-Oriented Research**

Given the role of regulatory bodies such as the Securities and Exchange Board of India, future studies can evaluate the effectiveness of policy initiatives aimed at promoting passive investing. Research can also explore how regulatory changes impact investor protection, market efficiency, and product innovation.

9. **Integration with Portfolio Optimization Models**

Future studies can integrate ETF adoption with **portfolio optimization frameworks**, such as Modern Portfolio Theory, to assess how ETFs contribute to risk diversification and return optimization in retail portfolios.

10. **Experimental and Mixed-Method Approaches**

To gain deeper insights into investor psychology, future research may adopt:

- Experimental designs (behavioral experiments)
- Mixed-method approaches (quantitative + qualitative)
- Case studies of investor decision-making

These approaches would provide richer and more nuanced insights compared to purely quantitative methods.

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Conflicts of interest

The authors declare that there are no conflicts of interest regarding the publication of this paper.

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