International Journal of Multidisciplinary Horizon

ISSN: **3049-2017**
IJMH 2026; 3(5): 207-211
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www.themultijournal.com

Received: 28-09-2026
Accepted: 19-10-2026
Publish : 21-10-2026

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HIDDEN CAPITAL: WHY INDIA'S INTANGIBLES REMAIN UNDER REPRESENTED

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Abstract
India's shift toward a knowledge- and technology-driven economy has increased the economic significance of intangible capital, including software, intellectual property, data capabilities, brands, research and development, and human capital. Despite generating substantial future economic benefits, many of these resources remain inadequately represented in conventional financial statements. This paper examines the structural underrecognition of intangible capital in India from accounting, valuation, and financing perspectives. It highlights the recognition constraints under Ind AS 38, the dependence of traditional lending on physical collateral, and the difficulty of measuring rapidly evolving digital capabilities. The resulting disconnect between reported book values and underlying economic value can influence corporate valuation, investment decisions, and access to finance. The paper proposes enhanced intangible-related disclosures, technology-assisted valuation frameworks, and intellectual-property-backed financing to improve transparency and mobilize India's hidden knowledge wealth for sustainable economic growth.

Introduction
India is undergoing a fundamental transformation from a physical-asset-based economy toward one increasingly powered by knowledge, data, technology, and innovation. In this transition, intangible capital—including software, patents, algorithms, research and development (R&D), brands, organizational knowledge, data capabilities, and human capital—has become a critical source of productivity and competitive advantage. Yet a substantial portion of this wealth remains largely invisible within conventional accounting and economic measurement systems.



The recognition requirements of Ind AS 38 create an important reporting limitation, particularly for internally developed intangible resources. Expenditure on activities such as employee training, brand development, database creation, and exploratory innovation may generate substantial future benefits without appearing proportionately on the balance sheet. This can produce a persistent divergence between reported net assets and the economic capabilities that actually generate future cash flows.

The issue extends beyond financial reporting. Intangible-intensive firms often possess limited physical collateral, creating difficulties in accessing traditional bank finance. At the same time, investors may face challenges in assessing internally developed knowledge, technological capabilities, and innovation pipelines. Emerging technologies such as artificial intelligence, cloud computing, digital platforms, and proprietary

algorithms are further accelerating intangible accumulation while increasing the complexity of valuation.

Therefore, measuring intangible capital is not merely an accounting challenge but an economic and financing imperative. This paper examines India's hidden intangible wealth through accounting, valuation, and financing perspectives and proposes enhanced disclosure practices, technology-assisted valuation approaches, and intellectual-property-backed financing mechanisms to improve the visibility and productive use of intangible capital.

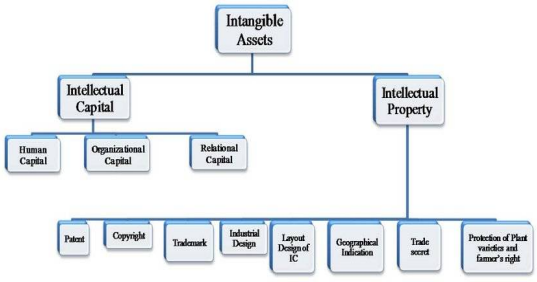
Meaning and Types of Intangible Assets

Intangible assets are non-physical, long-term resources that generate significant economic value and act as primary drivers of corporate growth. Unlike tangible assets such as machinery or real estate, they lack a physical form and derive their value from knowledge, innovation, technology, and relationships.

In India's knowledge-based economy, these assets represent a massive pool of "hidden capital." Because their value is inherently difficult to measure reliably, strict accounting standards restrict companies from recording internally generated intangibles on their balance sheets. This often leads to a massive underrepresentation of a company's true market worth in traditional financial statements.

The primary types of intangible assets include:

- Intellectual Property (IP): Legally protected creations like patents (exclusive rights to inventions), copyrights (software and original works), and brands or trademarks that create lasting customer recognition and trust.
- Goodwill & Customer Relationships: Typically recognized during corporate acquisitions, this captures unquantifiable advantages like a stellar industry reputation, established customer networks, deep loyalty, and high employee morale.



- Digital & Technological Assets: Proprietary software, complex algorithms, trade secrets, R&D innovations, and highly curated databases that power modern platforms.
- Intellectual Capital: The collective knowledge, skills, expertise, and innovative capabilities embedded within a company's workforce.
- Contractual Rights: Agreements such as franchises, licensing, and broadcasting rights that grant exclusive operational privileges.

The Rise of Intangible India

India's economy is shifting from physical assets to knowledge capital—software, data, brands, and human expertise—yet this wealth remains largely invisible on balance sheets and inaccessible to traditional finance. Bridging this gap requires reforms in accounting recognition, financing mechanisms, and valuation practices.

Accounting: The Recognition Gap

Under Ind AS 38, internally generated intangibles face stringent capitalization criteria. Research costs must be expensed, while development costs qualify only if six conditions are met: technical feasibility, intention to complete, ability to use or sell, probable future benefits, resource availability, and reliable cost measurement. Critically, internally generated brands, customer lists, and mastheads are prohibited from recognition, regardless of their economic value. This creates systematic underreporting: firms investing heavily in R&D, AI capabilities, or brand equity show lower book values despite stronger cash-flow potential, distorting financial ratios and investor perceptions.



Finance: Collateral Constraints and IP-Backed Lending

Traditional Indian bank lending relies on tangible collateral, excluding intangible-heavy firms from credit despite their growth potential. The RBI's August 2025 framework for non-fund-based credit aims to enable IP-backed financing, but barriers persist: valuation complexity, enforcement difficulties, and fragmented legal recognition of IP as security. Information asymmetry and lack of secondary IP markets further constrain adoption. Expanding IP securitization, patent collateralization, and government-backed guarantee schemes can unlock capital for innovation-driven enterprises, aligning finance with India's knowledge economy trajectory.

Valuation: Technology-Assisted Frameworks

Valuing intangibles requires moving beyond historical cost to forward-looking, technology-enabled methods. Standard approaches include Relief-from-Royalty, Multi-Period Excess Earnings (MPEEM), and real-options modelling for R&D pipelines. AI and data analytics can enhance accuracy by tracking real-time usage, customer engagement, and competitive positioning of digital assets. Under Ind AS 38 and IBBI Valuation Standards, identifiable intangibles in business combinations must be measured at fair value, yet internally developed assets remain expensed. Integrating dynamic valuation frameworks into disclosures can bridge the gap between book value and economic reality, improving investment decisions and capital allocation.

The Accounting Gap in Intangible Assets

In today's knowledge-based economy, businesses derive massive value from intangible resources—such as software, proprietary data, algorithms, brands, and human capital. However, the "accounting gap" refers to the significant difference between this true economic value and the value formally recognized in a company's financial statements. As economies, particularly rapidly digitizing ones like India, shift toward technology and service-centric models, traditional balance sheets increasingly present an incomplete picture of corporate wealth.

Why the Gap Exists?

The gap primarily stems from the strict recognition criteria of frameworks like IAS 38. For an intangible asset to be capitalized, it must be identifiable, controlled by the business, and have a reliably measurable cost. This creates several structural accounting challenges:

❖ **Internally Generated vs. Acquired**

When a company purchases a brand or customer list, it has a clear transaction price and is recognized as an asset. Conversely, internally developing a brand requires expensing the associated costs immediately. Similarly, research expenditure must be expensed as incurred, while development costs can only be capitalized if specific, stringent conditions are satisfied

❖ **Measurement Uncertainty**

The value of organizational knowledge, customer loyalty, or a new digital platform is highly subjective and subject to rapid technological shifts, making reliable financial valuation incredibly difficult.

❖ **Human Capital and Data**

Employees and digital databases are crucial value drivers in sectors like IT, pharmaceuticals, and consulting. Yet, human capital cannot be capitalized, leaving it largely invisible in conventional accounting frameworks.

Financial Consequences

This inconsistent treatment profoundly impacts financial reporting. Two economically similar companies can report vastly different asset values simply because one grew organically while the other grew through acquisitions. Furthermore, immediately expensing long-term intangible investments depresses current profits and widens the disconnect between a company's book value and its market capitalization. This forces investors to increasingly rely on non-financial indicators and subjective market valuations.

Bridging the Divide

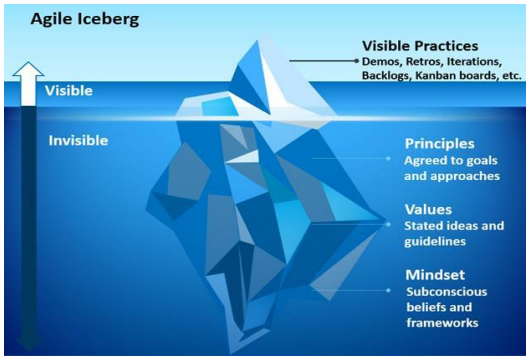
The accounting gap does not mean traditional standards are flawed; they purposefully protect stakeholders from overly optimistic, subjective valuations. However, addr-essing this gap requires a balanced evolution. Moving forward, companies must provide robust, standardized disclosures regarding their R&D pipelines, digital infras-tructure, and workforce capabilities. By pairing rigorous accounting principles with greater transparency in management commentary, stakeholders can better assess the invisible engines driving modern business growth Ind AS 38 and India's Intangible Accounting Treatment India's transition towards a knowledge-driven economy has increased the importance of intangible assets such as software, brands, data, intellectual property, and research and development (R&D). However, Ind AS 38 – Intangible Assets follows a relatively conservative recognition approach, resulting in significant intangible value remaining outside corporate balance sheets.

Ind AS 38 distinguishes between acquired and internally generated intangible assets. Acquired assets, including software, patents, and licences, are generally recognized at cost and subsequently amortized over their useful lives. In contrast, internally generated intangible assets are subject to stricter recognition requirements. Expenditure incurred during the research phase is recognized as an expense. Development expenditure can be capitalized only when specific conditions are satisfied, including technical feasibility, intention and ability to complete the asset, probable future economic benefits, availability of adequate resources, and reliable measurement of costs.

A major limitation is that internally generated brands, customer lists, mastheads, and similar items are not recognized as intangible assets. Consequently, substantial investments in brand development, digital platforms, artificial intelligence, and customer relationships may remain unreported as assets despite their economic significance.

Recognized intangible assets are generally measured at cost less accumulated amortization and impairment losses. Finite-life assets are amortized over their useful lives, whereas indefinite-life assets are subject to regular impairment testing.

The Invisible Balance Sheet: Why Ind AS 38 Fails India's Tech and Consumer Giants?



India's modern economy relies heavily on brands, algorithms, and software. Yet Ind AS 38 prevents companies from recognizing the true value of these intangible assets, keeping them entirely off corporate balance sheets.

1. Brands: The Recognition Ban

Under Paragraph 63 of Ind AS 38, companies are strictly prohibited from listing internally generated brands, customer lists, or publishing titles as assets.

The Challenge: The standard states that brand-building costs—marketing, advertising, sponsorships—cannot be reliably separated from everyday business expenses. As a result, firms spending crores to build market reputation must expense these costs immediately. The brand remains invisible on the books unless acquired in a business combination.



2. Algorithms: The Capitalization Hurdle

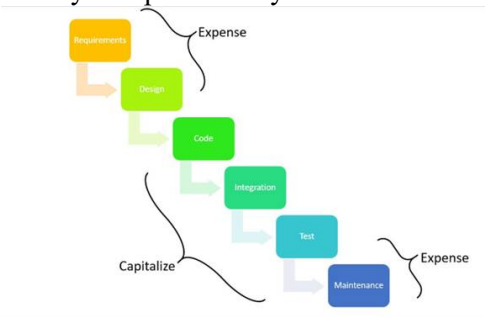
To record proprietary algorithms as capital assets, businesses must clear six strict criteria, including proving technical feasibility and tracking costs accurately.

The Challenge: Algorithm development is highly iterative. The line between exploratory research (expensed) and active development (capitalizable) is deeply blurred. Tracking engineer salaries, data acquisition, and compute infrastructure costs requires exhaustive project accounting that most tech firms struggle to maintain.

3. Software: Proving Market Viability

Software development costs face a rigid phase split: early-stage research and design are expensed; coding and testing can be capitalized only after a working prototype proves viable.

The Challenge: Firms must demonstrate how the software will generate future economic benefits. Startups with evolving or unproven revenue models fail this test, forcing them to fully expense massive tech investments and report artificially low profitability.

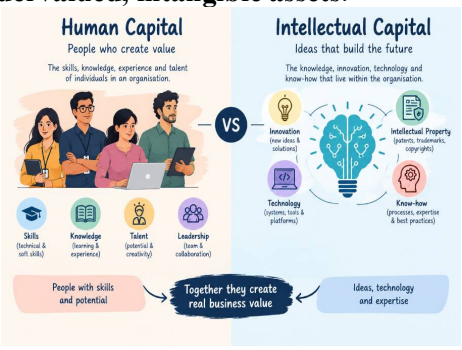


investments and report artificially low profitability.

The Economic Fallout

These constraints create systematic underreporting. High-growth startups and brand-heavy consumer firms show low book values despite strong cash-flow potential. This structural mismatch leaves investors struggling to value companies accurately, while banks remain hesitant to lend against unrecognized intangibles.

Traditional financial frameworks struggle to measure India's true wealth, which is powered by two vital, yet undervalued, intangible assets.



Intellectual Capital

India's digital and pharmaceutical sectors thrive on proprietary software, life-saving patents, and deep organizational knowledge. However, because these innovations lack physical form, strict accounting rules require them to be expensed rather than capitalized. This structural gap hides massive research investments from balance sheets, obscuring the technological prowess and intrinsic market value of India's knowledge-driven corporations.

Human Capital

A highly skilled, youthful workforce is India's greatest competitive advantage, driving its immense IT, consulting, and research industries. Yet, despite generating extraordinary economic value through creativity and complex problem-solving, employees cannot be formally recognized as assets because companies do not "own" them. This accounting limitation leaves the core wealth-generating resource of India's most successful enterprises entirely off-book. To fully unlock India's vast economic potential, stakeholders must look beyond physical assets, reform intangible asset disclosure, and invest consistently in education, healthcare, and robust intellectual property protection.

Example: TCS's market value far exceeds its book value because accounting rules don't capture intangibles like human capital, software, algorithms, and knowledge. Training and internal development costs are expensed, leaving financial statements underrepresenting the company's true economic worth

Book Value VS Market value

Technical Parameter	Book Value (Accounting Value)	Market Value (Economic Valuation)
Treatment of Research Costs	**Must be expensed immediately** in the profit and loss account; it cannot be added to the asset's book value.	**Capitalised by the market** via higher stock prices based on the future commercial potential of the research.
Development Phase Expenses	Capitalised **only if strict criteria are met** (technical feasibility, intent to complete, and clear future economic benefits).	Assessed **probabilistically by investors** who price in the project's success long before commercial production begins.
Organic Goodwill	**Completely barred from the balance sheet** under Ind AS 38 as it lacks a physical purchase transaction.	**Continuously reflected** in the company's valuation as a premium for brand reputation and customer loyalty.
Acquired Intangibles	Recorded strictly at **acquisition cost** (Ind AS 103) and systematically reduced via amortization or impairment (Ind AS 36).	Re-valued in real-time based on **strategic synergy**, current competitive advantages, and market demand.

CASE STUDIES

INFOSYS – INTELLECTUAL CAPITAL & HUMAN KNOWLEDGE

Focus:

Patents, software, employee expertise, R&D and organisational knowledge.

Why it is powerful:

Infosys is a strong example of how an IT company's real competitive strength comes from knowledge and intellectual capital. Much of this internally developed knowledge is difficult to recognise as an asset under traditional accounting.

Infosys

1. JIO – DATA, ALGORITHMS & DIGITAL CAPITAL

Focus:

Artificial intelligence, algorithms, data, digital platforms, patents and technology ecosystem.

Why it is powerful:

Jio represents the new generation of intangible capital. Its competitive advantage is not limited to telecom infrastructure. Its digital ecosystem, technology, data capabilities and algorithms also create significant economic value.

Jio

1. ASIAN PAINTS – BRAND & RELATIONSHIP CAPITAL

Focus:

Brand value, customer relationships, retailer network, innovation and distribution ecosystem.

Why it is powerful:

Asian Paints demonstrates that a company's strength can come from brand reputation, customer relationships and its distribution ecosystem, rather than only from physical assets such as factories and machinery.

asianpaints

Infosys → People & Knowledge
Jio → Data, Algorithms & Technology
Asian Paints → Brand & Relationships

Future Challenges of Hidden Intangible Capital in India

AI, Data and Software

Ind AS 38 may not fully capture AI, algorithms, proprietary data and software because their ownership, useful life and future benefits are difficult to measure reliably.

Human Capital

Employee expertise and organisational knowledge contribute greatly to business value but remain largely absent from balance sheets because they cannot be controlled or measured accurately

Startup Valuation

Startups often possess valuable intellectual property, brands and growth potential despite having few physical assets, making their financial position difficult to assess.

Technological Obsolescence

Rapid innovation can make software, patents and algorithms outdated quickly, creating uncertainty in useful-life estimates and impairment testing.

Crypto and Digital Assets

Cryptocurrencies, blockchain systems and tokenized intellectual property create legal, regulatory and valuation challenges because their prices and underlying rights can change rapidly.

Need for Reform

India needs standardized disclosures, improved valuation methods and flexible accounting guidance to reveal hidden intangible capital while maintaining reliability and comparability.

Recommendations and Possible Solutions for Intangible Accounting

1. Improve Intangible Asset Disclosure
2. Develop Better Valuation Methods
3. Strengthen Regulatory Standards
4. Use Technology in Measurement
5. Strengthen Internal Reporting
6. Encourage Professional Collaboration

Conclusion

India's economic narrative omits a critical component by failing to fully measure intangible assets such as proprietary software, brand equity, and human capital. Updating accounting frameworks to recognize these invisible drivers is essential for closing the valuation gap and unlocking the nation's full economic potential on the global stage.