Knowledge and Risk Management

By Mark W. McElroy

Despite rumors to the contrary, momentum behind knowledge management (KM) is growing, not declining. The reasons for this, however, are new and under-reported. While it's true that KM can enhance innovation, knowledge sharing, and performance in business, its greatest value may lie elsewhere – *risk managemen*t.

Should we be surprised by this? Not really. After all, misconduct or mistakes made in business are arguably nothing more than *bad knowledge in use*, while desirable or laudable behaviors are just *good knowledge in use*. If what we want is more good behaviors and less bad ones, what we need is a new kind of quality control system – a *knowledge* quality control system. Knowledge management is tailor made for this. How so, you ask?

Most KM theorists and practitioners agree that organizational knowledge is a socially constructed thing. People co-create their knowledge through a kind of social knowledge production system that many refer to as *knowledge processing*. Knowledge processing includes things like problem detection, problem solving, learning, training, innovation; as well as forming, testing and evaluating new ideas.

Once produced in these ways, shared knowledge in organizations, like businesses and non-profits, eventually shows up in use in the form of behaviors. Outcomes of all kinds then follow, some good and some bad.

Behavior in business, then, is nothing more than socially constructed knowledge in use. So if the knowledge processing system in place at, say, Enron is dysfunctional, closed, or hidden from view, bad ideas there might survive longer than they should – even at stakeholders' expense.

Where things really get interesting, then, is in how different organizations socially construct their knowledge according to local knowledge processing rules, policies, and practices. Not all knowledge processing systems are the same, and some fetch better results than others.

When viewed from this perspective, cases like Enron, WorldCom, Tyco and the rest can be seen as organizations whose managers not only committed misconduct, but whose knowledge processing climates made it possible for them to do so. As a result, it is the new KM idea of intentionally shaping knowledge processing systems in order to correct such flaws that now puts KM squarely in the risk management space and back in the limelight – *a way of helping us to kill our worst ideas before they kill us!*

A New Fiduciary Duty

That knowledge management is evolving into a form of risk processing is becoming increasingly clear. Three new books, in particular, offer vivid testimony to this, including one co-authored by myself and Dr. Joseph M. Firestone entitled, *The Open Enterprise – Building Business Architectures for Openness and Sustainable Innovation* (KMCI Online Press, 2003). The other two, *The Naked Corporation*, by Don Tapscott and David Ticoll

(Free Press, 2003) and *Managing Corporate Reputation and Risk*, by Dale Neef (Butterworth-Heinemann, 2003) also argue persuasively for a new focus in management that Firestone and I call *transparency management*.

In *Managing Corporate Reputation and Risk*, Neef goes so far as to say that *"a company can't manage its risk today without managing its knowledge."* And since managing risk is arguably a fiduciary duty of corporate boards, Firestone and I believe that guarding the sanctity of knowledge processing has become a board level issue – a view that KM should exist outside and above the control of the executive function and the sub-functions that lie beneath it.

For all of the same reasons we look to boards for oversight in financial management, so should we look to the same boards for oversight of *knowledge* management. To place the responsibility for ensuring the integrity of knowledge processing anywhere else is to invite conflicts of interest between the duties of those who would *have it* and their own behaviors. Financial management and knowledge management both require independent oversight and should report to the board accordingly. But how, you ask?

Recently, the Institute of Internal Auditors (IIA) published a recommended reporting structure for financial management and internal auditing (see Figure 1). According to the IIA (in its response to Sarbanes-Oxley), every board of every publicly traded company should have an audit committee to which the internal audit function directly reports along with external auditors.

My colleagues and I at the Knowledge Management Consortium International (KMCI) propose a similar structure for KM (see Figure 2). According to our view, KM should oversee, manage, and enhance the quality of knowledge processing, while assuring the system is sufficiently open and transparent. And because maintaining the integrity of knowledge processing is important to the protection of shareholder value, we believe knowledge management should report directly to the board, and only indirectly or administratively to the CEO.

All of this argues for a more broadly defined risk management function in business, some elements of which, if not all, are clearly board level issues. In this regard, then, managing corporate knowledge processing should be seen as a form of risk management, very much akin to the treatment of concerns related to social responsibility, sustainability and the environment, employee and product safety, quality, regulatory compliance, audits, governance, and ethics.

In the end, excelling in knowledge management may very well be the strategy that matters most in business, for if behavior in organizations is nothing more than shared knowledge in use, everything else pales in comparison to the urgency of enhancing the quality of knowledge processing. Even strategy depends on it.

<u>About the Author</u>

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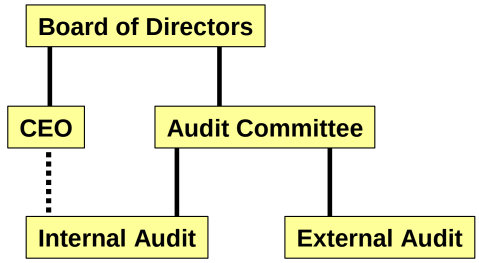

Figure 1 – Model for Financial Reporting and Control
As Proposed by the Institute of Internal Auditors

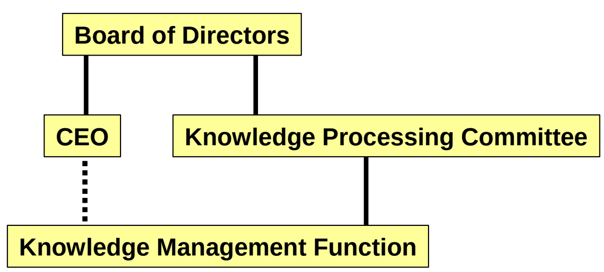

Figure 2 – Model for Corporate Knowledge Processing Control
As Proposed by the Knowledge Management Consortium International (KMCI)