

## Character-driven knowledge exchange: Overcoming the problem of moral hazard in knowledge exchange

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### Abstract

### Introduction

The exchange of knowledge between the Higher Education sector and industry is increasingly being seen as a vital component of economic growth by bodies such as the CBI and the UK Government (CBI, 2015; House of Commons Science and Technology Committee, 2013). However, such relationships present a series of challenges. These include challenges relating to the initiation of a knowledge exchange including the identification of appropriate academic expertise and the incentivisation of academics to engage in knowledge exchange (Jacobson, Butterill & Goering, 2004; CBI, 2015). They also include challenges related to the translation of academic research into commercial application such as the stickiness of knowledge (Arnett & Wittman, 2014; Blackman & Benson, 2012; House of Commons Science and Technology Committee, 2013). There is a further complexity of needing to clarify the exact nature of the knowledge exchange activity since it ranges from the traditional 'blue sky' research through development to innovation as perceived by the recipient of the 'new' knowledge (Rogers, 1962) and (Davis and Hobday, 2005). Finally, there are challenges related to managing the inter-personal relationships involved in knowledge exchange such as the need to build trust and social capital (Alexopoulos & Buckley, 2013; Dowling, 2015). One of the more overlooked challenges is that of 'moral hazard' – the counterintuitive phenomenon of increased risk sharing leading to a decrease in the incentives to avoid unnecessary risks (Baker, 1996). This developmental paper explores that challenge and points to Aristotle's intellectual virtue of phronesis as a potential way to overcome such hazards.

### The Problem of Moral Hazard in Knowledge Exchange

The concept of moral hazard in its modern usage derives from economics. There, moral hazard concerns the counter-intuitive tendency, "...for insurance against loss to reduce incentives to prevent or minimize the cost of loss." (Baker, 1996, p.239). To provide an example take property damage from fire. Here, fire insurance may reduce the incentives to prevent fire damage (by continually checking for fire hazards) or to minimize the costs of fire damage (by maintaining fire alarm systems). While counter-intuitive such a tendency is seen by economists to be completely rational since the insurance makes any loss incurred by the actor feel less than it actually is as the insurance compensates for that loss. Consequently, the costs of preventing and minimizing loss would be deemed to be greater than any loss felt.

While this has been largely overlooked in the knowledge exchange literature some scholars have taken up the notion. The way they have taken the idea of moral hazard up has been to point to a number of self-interested behaviours that individuals adopt when taking part in a knowledge exchange and which could endanger the success of any knowledge exchange relationship. These behaviours include taking advantage of someone else's ideas (Anaton, 2016; Kim *et al*, 2012), protecting their own ideas (Anaton, 2015), taking a free-ride on the work of others (Holmstrom, 1982; Gandal & Stettner, 2016). Taken together, the implied position of these thinkers appears to be

that moral hazard refers to the tendency for collective responsibility for the success of a knowledge exchange relationship to reduce the incentives to prevent or minimize opportunistic self-interested behaviour that might endanger that relationship.

It can be argued that the issue of moral hazard is a serious one for the success of any exchange of knowledge as it amplifies many of the common challenges mentioned in the introduction. First, opportunistic behaviour can magnify the challenge if incentivizing academics to engage in knowledge exchange. The scale of that challenge has been highlighted by Jacobson, Butterill and Goering (2004). They presented a number of barriers that may dissuade academics from engaging with industry. These include the pressure to produce traditional academic outputs such as conference and journal articles as well as seek funding opportunities for academic research. They also include concerns regarding the confidentiality of information which may prevent academics sharing knowledge at an appropriate time. Each of these challenges becomes exacerbated by the moral hazard of opportunistic behaviour. The possibility of industry partners appropriating research ideas may further dissuade academics from engaging in knowledge exchange in favour of pursuing more academic avenues. In addition, the danger of opportunism might intensify concerns regarding confidentiality.

Even if the academic is motivated to enter into a knowledge exchange relationship, the moral hazard of opportunistic behaviour can make the translation of academic knowledge into commercial insight far more challenging. Yang *et al* (2012) pointed to this in their discussion on the relationship between knowledge exchange and knowledge protection. They note that attempts to improve the translation of knowledge by overcoming the different aims and ways of thinking of both partners, "...may enable the opportunistic partner to internalize the proprietary knowledge of the focal firm beyond the cooperation agreement." (p.346). Hence, they call for the simultaneous protection of knowledge. However, engaging in protectionism makes the chances of overcoming different aims and ways of thinking more difficult which, in turn, makes the translation of knowledge more difficult.

Finally, even if the academic enters into the relationship and does not engage in over-protective behaviour, the moral hazard of opportunism makes overcoming the interpersonal challenges of building trust and social capital more difficult. Authors within the knowledge exchange domain have seen both trust and social capital to be inversely proportional where increased trust and social capital leads to decreased chances of there being opportunistic behaviour (Inkpen & Tsang, 2005; Kim *et al*, 2012). It follows then that increased opportunism leads to decreased trust and social capital. Thus, the moral hazard of collective responsibility leading to increased opportunism would make the building of trust and social capital much more difficult.

Taken together, the moral hazard of one of the partners acting opportunistically when the costs to them have been lessened by collective responsibility seriously impacts the incentivization of the appropriate expertise, the translation of that expertise into academic application, and the building of the necessary interpersonal relationships. However, the response of many knowledge exchange academics has been to propose a range of governance structures intended to improve collective responsibility. These include the use of boundary spanners (Chau *et al*, 2016) and gatekeepers (Meissner & Shmatko, 2016). Yet, paradoxically, by trying to improve collective responsibility these mechanisms also increase the chances of one of the partners acting opportunistically. The next

section looks at a promising alternative avenue for addressing this problem by drawing upon the origins of the term 'moral hazard' as well as Aristotle's intellectual virtue of practical wisdom.

### **Moral Hazard, Practical Wisdom and Knowledge Exchange**

The first aspect of this promising avenue derives from the original usage of the term 'moral hazard'. In his genealogy of moral hazard, Baker (1996) highlighted that the aforementioned economics usage of moral field. What was lost was a moral consideration of character and situation. The former referred to the character of the person being insured – those with good habits (carefulness, moderateness) being more likely to be insured than those with bad habits (carelessness, recklessness). The latter referred to those situations that may tempt someone to develop bad habits. Thus, the view of moral hazard as originally used in insurance is less about how insurance reduces the incentives to prevent or minimise loss and more about individuals with poor habits likely to find themselves in tempting situations.

Adopting the original view of moral hazard leads to a different definition of the problem of opportunistic behaviour in knowledge exchange. Instead of being seen as a relational problem it becomes seen as an individual one. The tendency to opportunistically exploit another's knowledge would not be a rational result of cost-benefit analysis but a bad character habit of one of the partners. In addition, engaging in opportunistic behaviour would be seen as a function of being in situations where one is tempted to exploit another's knowledge. Hence, the moral hazard of opportunistic behaviour would be recast as those partners with a tendency to act opportunistically combined with the likelihood of ending up in situations that would tempt them to act opportunistically.

The second aspect of this promising new direction is Aristotle's intellectual virtue of *phronesis*. Alternatively referred to as practical judgement, practical wisdom, or prudence, its promise derives from the fact that Aristotle distinguished *phronesis* from two other virtues that predominate the field of knowledge exchange: *episteme* or procedural knowledge based upon law-like generalisations; and *techne* or practical know-how (Johannisson, 2011; Nonaka and Takeuchi, 2011; Kavanagh, 2012). This distinction was based upon two main characteristics of *phronesis*: (1) its ethical and moral basis; and (2) its situational basis.

The first major difference is that *phronesis*, unlike *episteme* and *techne*, involves a form of ethical or moral judgement. In particular, *phronesis* concerns itself with living the good virtuous life (Nonaka & Takeuchi, 2011). The good itself can be an individual good or a common good that is beneficial to the wider community beyond the individual (Clegg, Jarvis, and Pitsis, 2013; Erden, von Krogh, and Nonaka, 2008). The virtues, meanwhile, are habits of character such as courage, kindness and honesty while character flaws such as cowardice and dishonesty are seen as vices (Aristotle, 2001; Schwartz & Sharpe, 2010). Living the good virtuous life, therefore, involves making moral judgements about how a particular course of action serves the individual or common good in a manner exemplifying the virtues. The second major distinction is that the moral judgements of how to act are situational ones. Unlike *episteme* which refers to the ability to apply universal laws to any situation, *phronesis* refers to the ability to make moral judgements in specific, concrete and unique situations. Particularly, it involves the capacity to draw out the most important features of a given situation and making judgements accordingly while realising that the features of one situation cannot be made universal to all situations given the unique nature of each given situation (Johannisson, 2011; Shotter and Tsoukas, 2014; MacKay, Zundel, and Alkirwi, 2014).

Taking the perspective of phronesis in relation to knowledge helps provide a potential solution to the recast problem of opportunistic behaviour being one of character and situation. For instance, the moral aspect presents a potential solution to opportunistic behaviour as a bad character habit. This it does by promoting knowledge exchange and its benefits as common goods and treating collaborative behaviour as a virtue. In so doing, it would encourage organisations and individuals to look for partners that exemplify that virtue and value knowledge exchange as a common good when seeking appropriate expertise. It would also encourage partners to be mindful of the virtue of collaborative behaviour and the common good of knowledge exchange when trying to develop common goals and ways of thinking. Finally, by continually exemplifying the virtue of collaborative behaviour and supporting the value of knowledge exchange would help build trust and social capital.

In addition, the situational aspect offers a potential solution to handling situations that may tempt partners into opportunistic behaviour. This is because it would involve identifying the salient features of particular knowledge exchange situations that point to the possibility for opportunism. In so doing, it would encourage potential partners to pay attention to features of initial meetings and communications when exploring potential sources of expertise. Moreover, it would lead to extra attention and vigilance being paid to situations that may prove tempting when trying to develop common goals and ways of thinking. Finally, by continually being vigilant to potential tempting situations the partners would reduce the chances of opportunism.

### **Further Development of Paper**

Further conceptual development on the conceptual aspects of how character provides a basis for entering into a knowledge exchange relationship, how practical wisdom provides a basis for operating in that relationship, and how Aristotle's view of friendship provides a foundation for developing trust and social capital.

Specific case studies of knowledge exchange partnerships which can be used to analyse on the basis of character, practical wisdom, and friendship.

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