

Putting Diversification at the Center of Your Firm's Technology Strategy—Using a Simple Grid Approach

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Diversification is an approach that is often recommended in the world of technology. Security experts often warn about vulnerabilities raised by a monocultural approach to hardware and software. Good backup procedures require a variety of layers and approaches. Technology training often is presented in several formats so that users can take advantage of the education that best matches their learning styles. The Open Source software movement emphasizes a bottom-up, community-based development method that welcomes and includes all types of participants.

The idea of diversification can also be applied to technology strategy. In fact, in this time of economic challenge combined with rapidly changing technological innovation, diversification might well be the best approach to technology strategy.

You have no doubt gotten much advice on the need to diversify investments, especially in your retirement plans. The sickening drop in U. S. stock values in late 2008 and early 2009 certainly drove home the dangers of, as they used to say when I was growing up, "keeping all your eggs in one basket." We got a lesson in the importance of spreading risk across asset classes and of considering other factors like timeframes, need to use assets presently and the like.

A Portfolio Perspective

In the investment world, the approach advocated for most of us is to develop and maintain a "portfolio" of investments that reflects a balanced approach to risk and reward and our own appetite for risk based on our timeframes for actual need for the money (retirement, college costs, home purchase, etc.). Our task then becomes one of "portfolio management" as we evaluate our investments as a whole and try to maintain an appropriate mix based on our circumstances.

This approach is based on a Nobel Prize winning economic theory called "Modern Portfolio Theory." http://en.wikipedia.org/wiki/Modern_portfolio_theory Modern Portfolio Theory is an implementation of the concept of diversification of investments and reflects the core idea that, over time, a bundle of mixed assets will outperform any given individual asset. The approach reflects the interplay of risk and reward, and maintains that the careful choice of investment vehicles makes it possible to reduce risk and increase return.

The important part of the theory is the mix. While you might believe that choosing only the "lowest-risk" investments, such as U.S. Treasury notes or long-term certificates of deposit, is the safest and wisest investment, the fact is that in a period of high inflation, they will be bad investments. The

"safety" you expected will result in the value of your principal disappearing due to inflation while you receive interest payments at a rate that seemed adequate in pre-inflationary times, but might be laughable (or cryable) in inflationary times.

The paradox then becomes that the "safe" approach turned out to be a very risky one and that, instead, the better (and safer) approach would have been to use an investment portfolio that included investments that would be seen as risky in isolation—small cap stocks or stocks in emerging international markets—to help the whole portfolio outperform the "safe" investments without the same risks.

Your "best" approach would be a portfolio that included a diversified mix of low-, medium- and high-risk assets, with low, medium and high rates of historical return, balanced in accordance with your risk appetite and investment timeframe. As I said, the mix is the key. Diversification becomes a core part of a "prudent" investment approach.

I advocate applying the same principles to your technology strategies to create a consistent, prudent approach, give you a workable framework for making decisions and evaluating projects, and, most importantly, reduce risk and increase returns on technology investments.

Introducing the Grid

Consider the following grid:

RETURN	High (VII)	High (VIII)	High (IX)
	Medium (IV)	Medium (V)	Medium (VI)
	Low (I)	Low (II)	Low (III)
	RISK		

Benefits of Using the Grid

This simple grid can be a big help in setting your technology strategy and improving your discussions and decisions about both specific technology projects and overall technology directions. Note that I

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focus on "return" rather than "cost." Cost is obviously a very important factor, but I want you to think in terms of net return for this exercise.

First, the grid can help you inventory and categorize your current technology projects and approaches. In most firms, the vast majority of, if not all, technology projects will fall in the low-risk column, probably in boxes I and IV, or maybe only in box I. Don't worry about that initially. The first step is to get an accurate overall assessment. I suggest drawing the grid on a white board or large sheet of paper and physically writing each of your projects and strategies into the appropriate box. This approach will give you a good snapshot of where you are. This exercise alone should be very helpful to you, your technology committee and your decision makers.

Second, the grid can help you assess where you are. The picture really will be worth a thousand words (or, in the case of lawyers, ten thousand words). Seeing a cluster of projects only in I and IV and a vast deserted territory in the rest of the grid will speak volumes about your approach and your diversification. The patterns will also help you assess diversification in general. It might also highlight high-risk and low-return efforts that need current attention.

Third, the grid can help you align projects and directions with your firm's risk tolerance and diversification goals. Conceptually, this is a simple matter—you want to see projects in more boxes rather than in fewer boxes. You also want to see more projects in boxes VII, VIII and IX—the high return row. Realistically, however, the grid's main use will be to start the necessary and difficult discussions about what to put in those empty boxes. It will also help you picture what your risk tolerance and risk philosophy really are.

Here are a few observations on alignment, based on my own perspectives and biases. I consider a disproportionate focus on low-risk, low-return technology investments in this time of constant and game-changing technological innovation is the equivalent of investing in low-interest bonds in a time of high inflation. "Safe" investments may have surprising risk as you stand still while everything else moves rapidly. Perhaps more than ever, it has become prudent to push more toward higher-risk, higher-return projects for a *portion* of your technology strategy portfolio. I have written in the past about "client-driven" or "client-focused" technologies. These technologies are ones that improve client service, help tie the client to you or your firm, make it easier for the client to do more business with you, provide extra client value and the like. Sometimes, these technology projects even come at a client's suggestion. I consider everything that falls into the client-focused category as arguably "high return." For example, today, I see simple client extranets as a "low risk, high return."

Fourth, after you determining how where you are aligns with where you want to be, you can use the grid to help you set direction. Put the grid on a whiteboard and start evaluating current and future projects and where they fit. Look for ways to create diversification and balance. Remember that I'm advocating a very simple approach to setting technology strategy and that other factors and philosophies can enter into the picture. However, the grid framework is a very useful framework for focusing discussions, making quick decisions and keeping the big picture in view. Since most firms have no consistent approach to technology strategy, you'll be surprised how far ahead of the game this simple grid approach will put you when compared to your competitors.

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Fifth, the grid will help you manage your technology strategy and technology portfolios on an ongoing basis, which, as in your retirement investments, is an essential part of a prudent process. Whether you do this exercise annually or quarterly, the simple focus on risk and, most important, return will be a big help in making good decisions about technology. If you tag a project as high return and there is no return after a year, you might need to move it (you certainly need to reassess it) and rebalance accordingly. Proposed new projects should also be discussed and evaluated within the grid framework and considered in the context of diversification.

Moving Forward

Lawyers and law firms are, by their nature, cautious and risk-adverse when it comes to technology. Paradoxically, especially in times of great economic and technological change, a cautious approach can actually have the unintended consequences of creating substantial risks in an undiversified, unmanaged technology portfolio. The stock market lessons of 2008-2009 and Modern Portfolio Theory can both open our eyes to these risks and help us create prudent approaches to technology strategy that will serve us well over the long term. The two keys are diversification and taking a portfolio management approach to technologies, technology projects and technology strategies. The simple grid technique suggested in this article can move you well down the path to a prudent, successful and thoughtful approach to your technology future.

About the Author

Dennis Kennedy writes the technology column for the *ABA Journal*, is a well-known author, speaker and blogger (<http://www.denniskennedy.com/blog>) on legal technology topics, and is an information technology lawyer. He is the co-author, with Tom Mighell, of the book *The Lawyer's Guide to Collaboration Tools and Technologies: Smart Ways to Work Together* and the co-host of The Kennedy-Mighell Report podcast on the Legal Talk Network.
