

Insideview

The Hidden Costs of Offshore Outsourcing

Interview with Dr. Jens Dibbern and Jessica Winkler,
School of Business at the University of Mannheim

Together with Prof. Armin Heinzl you conducted a number of case studies on offshore outsourcing of software development and maintenance in the financial services industry. What are your key findings?

Dr. Jens Dibbern: We studied multiple software development and maintenance projects that were offshored by German banks and insurance companies to service providers located in India. The major reason for offshore outsourcing in each of those cases was the desire to save costs. However, we found that only in a few cases cost savings were actually realized. In fact, in some cases the costs were perceived to be substantially higher than without offshoring. The main reason for the failure to realize costs savings was that the client companies underestimated extra costs that arose for their own effort in requirements specification and design, knowledge transfer, control, and coordination. While such extra costs apply to offshoring of software work in general, we found those extra costs to vary substantially between projects.

How do you explain these variations in extra costs?

Jessica Winkler: Extra costs were especially

high in cases where a high level of client-specific knowledge about idiosyncratic business processes and software systems had to be adopted by the offshore vendor to perform the software development and maintenance activities. In those cases, knowledge transfer was very hard to achieve, and the client companies had to support the vendor by providing additional specifications and increased control to ensure quality. In other words, it is the type of software service that matters. The more customized the software is to reflect very unique business processes and technological infrastructures of the client, the less offshoring makes sense economically.

What is the role of cultural differences in this context?

Jessica Winkler: The Indian culture is often characterized by a high level of power distance and conformism. In our research, we observed certain behaviors that are associated with those attributes, such as the Indian professionals' tendency to oblige or to keep to given specifications. Management needs to address these behaviors to ensure a successful cooperation, which frequently



Dr. Jens Dibbern,
Assistant Professor in Information Systems,
School of Business at the University
of Mannheim

leads to extra costs. For example, feedback mechanisms need to be established to recognize misunderstandings at an early stage, and very detailed and accurate specifications have to be provided by the client companies.

Most of the service providers in India are certified CMM level 5, while German companies are not. What are the implications with respect to offshoring to India?

Dr. Jens Dibbern: When talking about CMM certifications, you need to distinguish between process quality on the one hand and product quality on the other. CMM level 5 essentially means high process quality in an engineering kind of way. However, high process quality does not automatically ensure high product quality. We found the quality of the resulting software product to be perceived quite low



Jessica Winkler,
Ph.D. student,
School of Business at the University
of Mannheim

in many of our cases. And the main reason for this was lack of understanding of the client-specific business processes underlying an application, which is not captured by the CMM certification. This is essentially the same distinction as efficiency versus effectiveness. Focus on efficiency and standardized processes may be suitable for very general, easily understandable software applications. In those cases, the offshore vendor can draw on prior experiences and realize economies of scale, while still meeting the client's requirements. If the client has very idiosyncratic requirements, however, then many of the standardized processes and engineering tools are not that useful any more.

Thank you for this interesting conversation.