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Thema: Exploring the offshoring approach of German Companies compared to to the U. S. American approach

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1. Introduction

2. Offshoring in Literature

Offshoring has been widely studied in the past decades. There are two major branches of research: the first describes reality through statistics or case studies (e.g. Rottman and Lacity, 2008 and Pedersen et al., 2013) while the second branch designs trade models to explain the discovered correlations (e.g. Antràs and Helpman, 2004, Grossman and Rossi-Hansberg, 2008 and Helpman, 1999).

This wealth of existing knowledge has been used for the following section, where the relevant terms of the subject are defined first. Furthermore, a brief history of offshoring is given before describing offshoring in the USA first, then offshoring in Germany.

2.1. Definition and Terms

In existing literature, there is no single definition of the term offshoring nor one precise delimitation to the term outsourcing. Both terms refer to sourcing decisions in companies.

For example, according to Knolmayer, 2007, pp. 1f, outsourcing is buying services from other companies. Offshoring is defined as a special form of outsourcing, in which the service is bought from a foreign company. On the other hand, Alebrand, 2013, p. 2 defines outsourcing and offshoring as mutually exclusive: outsourcing is the provision of services by external companies, offshoring is the internal execution of tasks in a foreign country.

These contrasting definitions may serve as an example for the lack of distinct terms in this field of research. Nevertheless all the definitions agree that outsourcing pertains to external service provision and offshoring refers to service provision in a foreign country. This Bachelor's thesis will use the following definition of the term offshoring by Andersson, Karpaty, and Savsin, 2016, p. 321:

> "Offshoring [is the] disintegration of the firms' production processes across national borders[...]"

This means, offshoring is not only a description for the state of an organization, but also the process to relocate business processes.

The term outsourcing is derived from "Outside Resource Using"(Specht and Lutz, 2007, p. 46). It is acquiring intermediate inputs from external businesses (Specht and Lutz, 2007, p. 46).

Therefore, the terms offshoring and outsourcing do not have a direct relation; both terms are independent and describe different possibilities of entrepreneurial organization. In figure 1, the delimitation between outsourcing and offshoring is clearly shown. A company can choose to offshore, outsource or both; every single possibility has its own term.

Offshoring, in the context of this thesis, means foreign outsourcing and Foreign Direct Investment (FDI), unless otherwise specified.

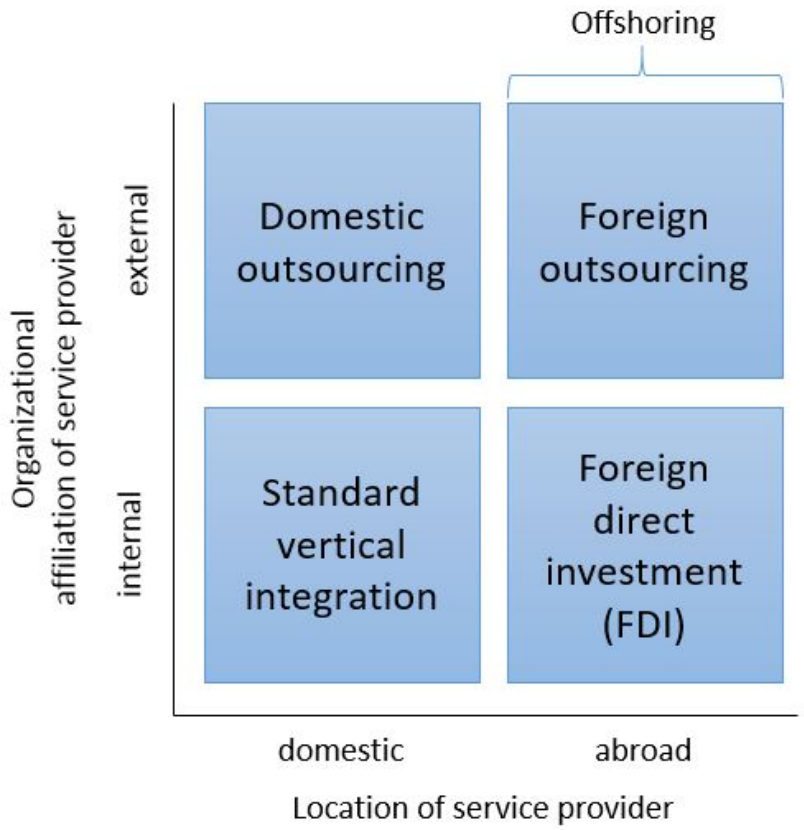

Figure 1: Definition of terms, based on Antràs and Helpman, 2004, pp. 552f

Some publications add a geographical dimension to their definition of offshoring. Jahns, Hartmann, and Bals, 2007 state that there must be shores between the customer and the supplier in order to call the transaction offshoring, otherwise the correct term would be Nearshoring. Cappallo and Da-Cruz, 2006 postulate a need for a relatively high distance ("relativ hohe räumliche Distanz", p. 487) between the partners. Dressler, 2007 defines offshoring only as transaction between partners on different continents. Given the ambiguous and arbitrary nature of the distinction between offshoring and nearshoring, this thesis refrains from using the term nearshoring. All provision of services outside the captive country of a company are called offshoring.

2.2. Factors for the Development of Offshoring

Globalization, and offshoring as part of the development, had its early beginnings in the 1970s and gained traction once the Iron Curtain had fallen in 1989 (Sachs and Warner, 1995, p. 1). This section describes the various factors that enabled the development of offshoring to the point it is today.

Political and Historical Developments After the end of Second World War (WWII), countries belonged to one of three distinct sectors of the world: the capitalist western countries, communist eastern companies or developing countries that sought a way to not get crushed between the two super powers and proclaimed state-led industrialization, a third way between capitalism and communism. (Sachs and Warner, 1995, pp. 12f)

With the majority of world population in countries without market-based economic mechanisms in place and most of the currencies not freely convertible, international trade was basically nonexistent in the post-war world. While western countries systematically restored their trade relations, developing countries were much slower to open their economic systems to international trade. By 1994, most countries had opened their trade policies through removing trade barriers, ensuring the free convertibility of their currencies and disestablishing state monopolies. (Sachs and Warner, 1995, pp. 12-25)

In the last twenty years, global trade relations have only increased. Trade agreements and organizations such as the World Trade Organization (WTO)[1], the North American Free Trade Agreement (NAFTA)[2] or the European Economic Community (EEC)[3] (a predecessor of the European Union) further facilitated global trade and created a stable environment for long-term business agreements across borders.

Information and Communication Technology Innovations in Information and Communication Technology (ICT) have been paramount in enabling offshoring. Beginning with the invention of the first computer in 1941, the rapid development of computing power, data storage and particularly data transmission removed the need for local completion of tasks. The Internet necessitated a quick standardization and modernization of communication systems on a global scale – the prerequisite for offshoring. (Hutzschenreuter, Dresel, and Ressler, 2007, pp. 9f and Jahns, Hartmann, and Bals, 2007, p. 93)

Organizational Factors In order to efficiently offshore tasks or processes, the work has to be well-defined and standardized. In this way, economies of scale can fully be utilized and completion of work can be managed across multiple involved companies or subsidiaries. (Hutzschenreuter, Dresel, and Ressler, 2007, p. 11)

The aforementioned developments in ICT remove the need for local presence of the service provider (Uno-Actu-Principle) for most services. Digitalization enables organizations to detach tasks from specific locations. In a first step, those tasks are centralized and standardized. The second step is often offshoring the tasks. (Hutzschenreuter, Dresel, and Ressler, 2007, pp. 12f)

[1]For further information please see the website of the WTO, `https://www.wto.org/`, visited on 05. August 2016

[2]Further information: `https://ustr.gov/trade-agreements/free-trade-agreements/north-american-free-trade-agreement-nafta`, visited on 05. August 2016

[3]Established 1957 with the Treaty of Rome `http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=URISERV:xy0023`, visited on 05. August 2016

Macroeconomic and Socio-Demographic Factors ICT developments, organizational and political factors are enablers for offshoring, but the main driver for offshoring decisions in companies are the differences in salaries, taxes, and interest rates between industrialized and developing countries that result in cost arbitrage. In Jahns, Hartmann, and Bals, 2007, p. 89, the example of engineering wages in 2000 is given: while German and American engineers earned \$31 and \$36 per hour, an Indian engineer made only \$6.5[4] per hour[5]. It is obvious that companies want to use this disparity to their advantage.

In addition to the wage differences, socio-demographic factors such as education, motivation and age distribution in developing countries influence offshoring supply. High social prestige connected to working for large western companies contributes to a higher ratio of academics that apply for offshoring related jobs and motivates employees. Thus, the quality of work is often very good and may be better than in the original country. (Jahns, Hartmann, and Bals, 2007, p. 93)

In the following sections, those factors for both the USA and Germany will be examined. Furthermore, a quantification of offshoring will be attempted in order to provide a basis for the direct comparison of both countries in section 2.5.

2.3. Offshoring in the USA

Political and Historical Developments

Offshoring Quantified

> "The United States is the world's largest direct investor[...]" (Kozlow, 2006, p. 3)

Offshoring originated in the USA in the early 1990s (Pisani and Ricart, 2016, p. 389). Even earlier, U.S. companies pioneered in foreign investment, e.g. by establishing production sites abroad (Kozlow, 2006, p. 5). Looking at the past 25 years, imports of services and especially imports of ICT have grown exponentially. In figure 2], import volume for ICT services is shown. Short of a small decline in 2002, which can be explained with the burst of the Dotcom Bubble in the same year, volumes have consistently grown and tripled from \$12 bn in 1999 to \$36 bn in 2015. Since 2010, the growth has slowed down considerably. It remains to be seen if this trend persists or if it is just a small break in further growth.

It is difficult to accurately measure how many jobs have been shifted to countries outside of the U.S.. Often, one company may outsource to a different company in the U.S., which in turn could use a subcontractor in a different country. In this scenario, no company has actively shifted jobs abroad, but there is still an impact on the employment market. An

[4]Figures are given with a decimal point.

[5]The authors refer to United Nations Secretary and Industry Labor Office (2002) as source of these wages, which could not be verified at the time of writing this thesis.

estimation by Bureau of Economoc Analysis (BEA) of job losses due to offshoring was 195 000 jobs per year from 1999 to 2001, which is only 1.5% of the 13 million jobs that were lost overall per year. (Kozlow, 2006, pp. 14ff)

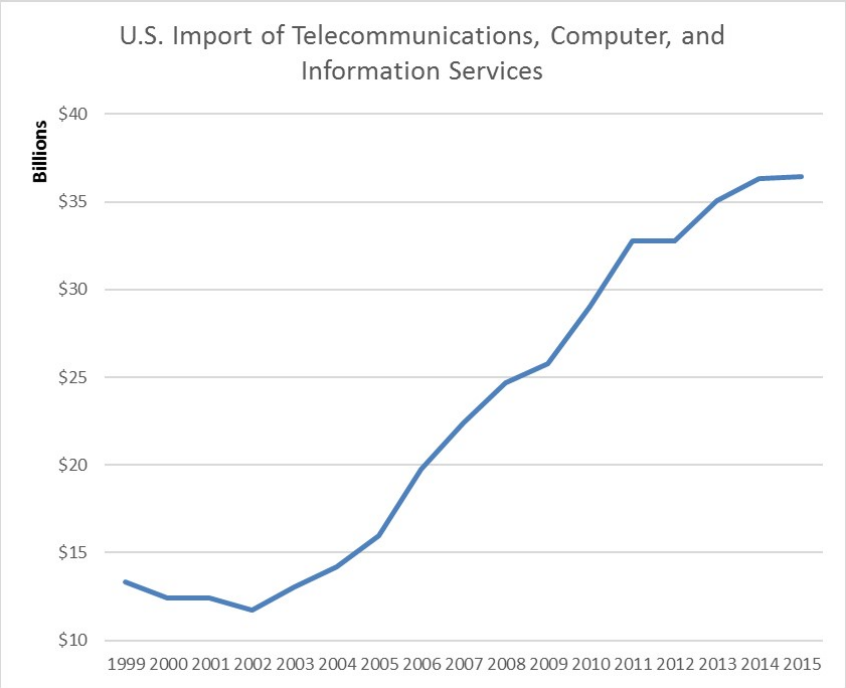

Figure 2: U.S. import of ICT services[6]

2.4. Offshoring in Germany

Political and Historical Developments In the aftermath of WWII, German economy was devastated. Vast areas of the country were destroyed by allied bombs, including cities and production plants. The country was devided into four military occupation zones, one of which would become the soviet-influenced German Democratic Republic (GDR) in 1949.

In GDR, the Soviet Union undertook an extensive industrial dismantling, while similar plans had not been executed in the allied occupation zones. Still, reconstruction of German economy progressed very slowly. Facing the threat of communist ideology spreading in Europe, Secretary of State Marshall established the "Marshall Plan", which allowed participating countries to receive U.S. goods and raw materials while paying in their local currency. This was the foundation for a rapid growth of West German economy between 1950 and 1960, the so-called 'Wirtschaftswunder'. (Kimmel, 2005)

On an international level, Federal Republic of Germany (FRG) had quickly become a valued trading partner and important exporter of industrial machines, automobiles and

[6]Data source: `www.bea.gov/newsreleases/international/trade/trad_time_series.xls`, visited on 10. August 2016

Offshoring Quantified According to Eickelpasch, 2015, p. 70, only 9.3 % of business services have been imported in 2010[7]. This may seem like a very low number, even though it is expected that fewer German companies offshore, compared to the USA. However, Eickelpasch only accounts for Foreign Outsourcing as his definition of offshoring does not include FDIs(Eickelpasch, 2015, p. 56). This information is therefore not sufficient to draw any conclusions concerning offshoring in Germany.

Further insights into the prevalence of offshoring in Germany can be found in a survey that has been conducted by German Statistisches Bundesamt in 2008. For this survey, 9361 manufacturing and service companies answered a questionnaire focusing on drivers, scope and results of offshoring on firm-level (Statistisches Bundesamt, 2008, p. 7). Of the polled service companies[8], 15.4% had offshored one or multiple corporate functions until 2006, and 10.7% planned to do so in the time span 2007 - 2009. The percentage of companies that offshore grows with the number of employees. (Statistisches Bundesamt, 2008, p. 11)

Regarding cooperation partners, the survey found that 81.4% of service companies practiced or planned FDI and only 24.7% chose Foreign Outsourcing, transferring tasks to external partners. Most often, a new subsidiary had been established (47.5%). (Statistisches Bundesamt, 2008, p. 18)

2.5. Significant Differences between Germany and the USA

As shown in the previous sections, there are vast differences between Germany and the USA when it comes to offshoring. However, accurately quantifying those differences is no small effort. Government institutions for measuring trade activities exist in both countries, but there are no international standards regarding the indicators. Furthermore, both economies vary largely in size. The U.S. are the worlds largest economy with a Gross Domestic Product (GDP) of $17.947 trillion in 2015, while Germany had a GDP of $3.356 trillion[9]. Therefore one can not simply compare unadjusted offshoring volume. Additionally, currency conversion is to be considered.

2.5.1. Maturity of Offshoring

2.5.2. Offshoring Locations and Distances

94% of American Offshoring Destinations: “Farshore”, Germany: 52 Near, 48 Farshore Hutzschenreuter, Dresel, and Ressler, 2007, pp. 175f

[7]The author cites input-output tables of Statistisches Bundesamt and calculations of DIW Berlin.

[8]The survey is on shifting business activities abroad, so it includes production abroad. This thesis focuses on offshoring services, so only results of service companies are included.

[9]Data source: World Bank, `http://data.worldbank.org/indicator/NY.GDP.MKTP.CD?locations=US-DE&start=1990`, visited on 14. August 2016

3. Case Studies

3.1. Interview Technique

In order to complement theoretical findings from literature research, expert interviews have been conducted. A structure for the interviews has been defined (see appendix). In this way, statements from different experts can be compared and evaluated, which allows for a comprehensive review. Even though interviewees may share their native language (German) with the interviewer, interviews have always been conducted in English. Thus, any inaccuracies that may occur during translating the statements were prevented and comparability of interviews has been improved.

The interviews were held remotely, either via an Internet VoIP-Service such as Skype, or via using WebEx, the standard communication platform used at T-Systems when interviewing employees of this company. Considering the often tight schedules of experts in their fields, the duration of interviews was limited to 45 minutes.

To further document the interviews and the steps leading up to them as well as the steps of refinement that follow, a process (see figure 3) has been defined and adhered to.

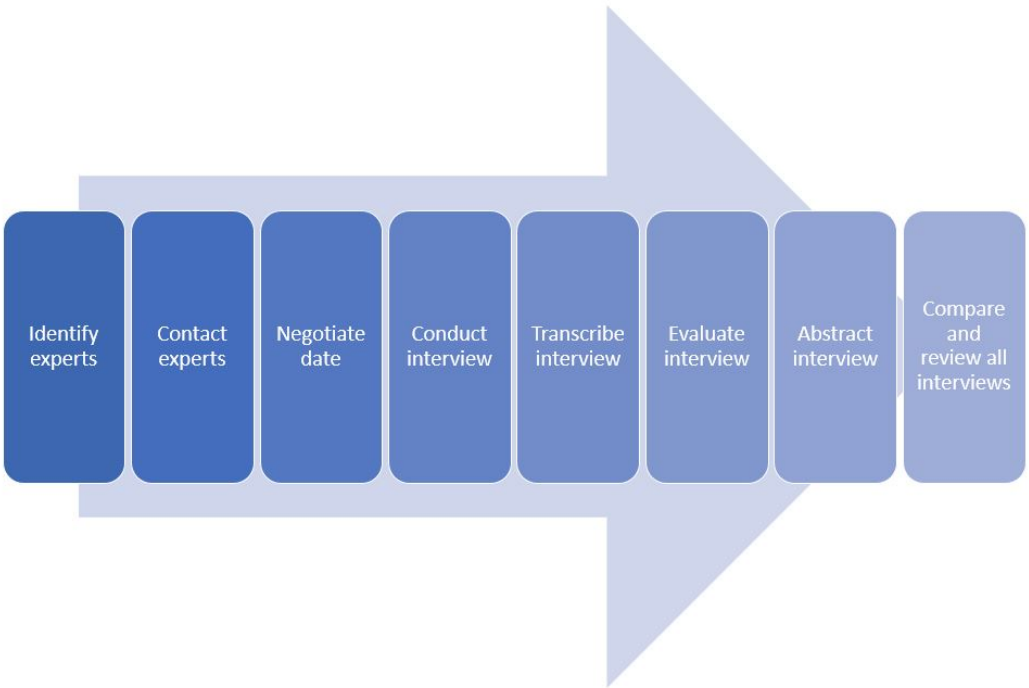

Figure 3: Interview process

Identify experts The experts are identified by conducting a network-based search. Initial contacts are asked to identify persons they consider an expert on the topic, who are in turn asked to provide further contacts.

Contact experts Initial contact to the expert is established via an email sent by the expert's contact. Included is a standard email explaining the topic, duration and process of the interview and providing the researchers' contact details.

Negotiate date Once the expert has agreed to participate in the interview, the researcher contacts them directly in order to set up date, time and method of communication for the interview. Note that all interviews are conducted using at least voice-based communication. Video can be added to further facilitate the communication between the expert and the researcher.

Conduct interview The interviews are conducted in five phases with defined leading questions. This means, the leading questions will be asked, but the researcher will also ask further questions as appropriate to the course of the interview. These phases are:

- Introduction
- Offshoring Experiences in the USA
- Offshoring Experiences in Germany
- Comparison of Experiences in Germany and the USA
- Finalization

During the interview, audio has been recorded. The audio files form the primary source of knowledge gained from the experts.

Evaluate interview The recordings are evaluated and any important passages are noted. These evaluations are added to the appendix.

Abstract interview For each interview, an abstract is developed. The abstracts are included in the thesis.

Compare and evaluate all interviews Finally, an overview and comparison of all interviews is generated to derive common statements and areas of disagreement.

3.2. Case Study Title 1

3.2.1. Background

3.2.2. Results of Interview

3.2.3. Conclusions

3.3. Case study Title 2

3.3.1. Background

3.3.2. Results of Interview

3.3.3. Conclusions

3.4. Summary and Evaluation

4. Conclusions and Limitations

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Appendix

A. Interview Structure

Introduction [10 Minutes]

Hello, thank you for participating in this expert interview! I'd like to preface with a short introduction to what my thesis is all about. However, before we start I need your consent to me recording this conversation. Do you agree with recording the interview?

– Wait for answer –

Thank you.

First, let me introduce myself. My name is Veronika; I'm currently in the last leg of studying Information Systems and working on my Bachelors' Thesis. This thesis is about comparing offshoring approaches in the US and Germany. The following questions are all about learning as much as possible from your experience, so please take the freedom to answer as detailed as you deem appropriate.

First of all, I'd like to learn something about you. Please introduce yourself and tell me about your international working experiences.

Offshoring Experiences in the US / with the US [10 Minutes]

- In what way did you experience offshoring in U.S. companies? (Internal / Provider)
- In your experience, how do U.S. American companies approach offshoring?
- How is the working relationship between the US and the offshoring destination?
- If you think about offshoring in U.S. companies, is there any significant anecdote you'd like to share? Why is this a typical situation in this context?

Offshoring Experiences in Germany [10 Minutes]

- In what way did you experience offshoring in German companies? (Internal / Provider)
- In your experience, how do German companies approach offshoring?
- How is the working relationship between Germany and the offshoring destination?
- If you think about offshoring in German companies, is there any significant anecdote you'd like to share? Why is this a typical situation in this context?

Comparison [10 Minutes]

- In your opinion, what are the most significant differences between US American and German companies when it comes to offshoring?

- Further questions to clarify points as needed

Finalization [5 Minutes] Thank you again for taking the time to answer my questions today. It was a great help! Is there anything you would like to add, or any feedback you might have regarding this interview?

It was great to learn from your experience today. I'll be in touch should there be any points that need further clarification, is that all right for you?

Thank you again, have a great day/evening/weekend!

B. Interview Summaries

The expert interviews are summarized based on the recorded .mp3-files. There may be gaps in the summaries, when there is no relevant discussion or breaks caused by external influences. All interview recordings have been added to the appendix on a CD and are considered the primary source.

B.1. Michael Scheitza

Time	Summary
01:00 – 01:55	Introduction and consent to recording
01:55 – 02:49	Michael Scheitza has worked for eight years with different offshore approaches. He has experience with Russia, Poland, Romania, India, Malaysia, Mexico and Brazil. The longest projects he had with Russia, Romania and India.
03:45 – 03:54	He has worked for a few weeks in Malaysia and India. In Poland, he worked for half a year, but that was not for an offshoring experience.
03:54 – 04:24	He has no experience with offshoring from an U.S. American point of view, so this part of the interview is skipped.
05:22 – 08:05	At T-Systems, application management contracts work well with offshoring, provided there's no legal obligation to deliver locally. Most customers leave the choice of location of delivery to T-Systems. The delivery model is usually decided by needed skills, requested language and required service levels (pertaining to time zones).
08:05 – 09:35	Knowledge is not the only factor in deciding on a delivery model, but scalability is also very important. For a project, there need to be enough people with the required knowledge. When this can't be ensured, a different point of production must be chosen.

09:47– 10:45 Working relationship between T-Systems and the offshoring partner depends on the type of contract. There is an example given of an application management deal with Brazil, which contained many small applications. This meant that the team size was about 20 people, all of which were requested to speak enough German to directly interact with the customer.

10:45 – 11:43 In the transition phase of the project, the Brazilian team came to Germany in order to get the needed knowledge directly from the customer. In this time, one-on-one relationships between the Brazilian team, the customer and project management in Germany were established. This facilitated collaboration later on because people knew each other in person and not only via email and telephone.

11:43 – 12:45 In larger deals that involve a larger team, such deep collaboration is usually not established. Instead, the working relationship is managed via Service Level Agreements (SLAs) and Key Performance Indicators (KPIs), where quality and quantity of deliverables are defined.

12:46 – 13:57 Neither approach is clearly superior to the other (personal collaboration vs. management via SLA)

13:57 – 15:38 He had an experience once with an Indian Team, where money was spent on bringing people to Germany to improve collaboration and quality. Few months later, these people ended up leaving the project to further their careers, because having worked abroad is an achievement that enables people to earn more in India. So the money spent on improving collaboration was essentially burned.

15:38 – 17:09 In the first three months, it is good to build personal relationships with team members. In the long run, there are two options. One option is the really deep personal exchange outlined in the example of the Brazilian team , which has the downside of increasing volatility in the team and is not a standard approach. The other option is to draw motivation out of the contract and out of being successful in fulfilling the contract.

17:12 – 19:01 Personal relationships are very important for employee satisfaction, but there are two possible identifications for people working offshore for a project: one is the identification with the project itself and being motivated by the local team lead. The other possibility is getting into the personal relationship with the customer (can be both T-Systems and the end customer) and identifying as part of a team.

19:01 – 19:25 Such identification with a global delivery team is not possible in large teams (50+ persons), in his experiences.

19:25 – 20:15 If the onsite and the offshore team share the same tasks ("Verlängerte Werkbank"), the team size is usually less than 30 people. The project manager is then distributing tasks directly to offshore team members.

20:15 – 20:36 If the team is large enough to be organized into different organizational layers, e.g. local project managers or team leads, these personal relationships get lost.

21:05 – 22:22	There is the cliché that in the US, there is a certain motivation culture that involves a lot of enthusiasm, whereas in Germany, there is a lot of focus on the organization and the end result. Both have a certain truth to them but do not cover reality. Similarly, in general people are happier when working in an integrated way in an offshore team. The prerequisite is that the tasks enable this working mode.
25:00 – 26:47	In smaller scale collaborations, it is important to know the people you are working with on a personal level, not only by a name and picture. Especially in Munich, he has hosted so many offshoring partners that he is now one of the best tourist guides. He shows them the sights in order to let his guests learn about our cultural background and to start a discussion. This is helpful in building personal relationships.
27:55 – 28:50	Thanking the interview partner and finalization

B.2. Viswanathan ??

Time	Summary

B.3. Ingo Kümmritz

Time	Summary

B.4. Subir Pu???

Time	Summary