

WORKING PAPER

> **Determinants of Price in Custom Software: A Hedonic Analysis of Offshore Development Projects¹**

The starting point for this paper is the general paucity of research on the demand-side of custom software development. As an initial step, we derive and estimate a Hedonic Pricing model using a sample of 160 projects executed by a large software solutions vendor based in India. Our results indicate that there are powerful economic incentives spurring the increasing trend toward offshoring of custom software projects. We estimate the average annual decline in quality adjusted price amounted to about 14 percent. Second, we also estimate the contribution of quality and human capital to price premia in software projects which helps us pinpoint the targets of vendor effort allocation that will help boost client value functions. This leads us to speculate that the efficiency of custom software development can perhaps be improved by the allocation (or re-allocation) of vendor resources designed to increase quality and delivery performance. We discuss the implications of our results for the research and practice of software development.

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