Revisiting the Controlling Function in Multinational Corporations: A Critical Review of Literature

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ABSTRACT

The complexities of managing multinational corporations (MNCs) have been increasing over a period of time. Developing a new controlling model for MNCs is critical and is required for their effective management. This paper analyses the ‘evolutionary theory of multinational corporation’ as well as the ‘business network theory’. Exploring the ‘Evolutional model of controlling’ based on multi-factor analysis, the paper examines the assumptions of the controlling concept, and wherever possible, redefines them. It extends the approach by incorporating additional functions and features including reverse knowledge transfer and measuring controlling effectiveness. Additional indirect parameters for the effective measurement of controlling are analysed. The drawbacks of controlling are mentioned and gaps are identified to develop a new model of controlling. The newer model is based on management approaches, decision making theory and an analogy of the human nervous system.

Keywords: Management; Controlling; Effectiveness; Multinational corporations.

1.0 Introduction

Control is the process of setting standards, monitoring performance and, identifying and correcting deviations from standards so that the organizational objectives are met. In the case of MNCs, which have diverse businesses across countries, the parent company (principal) needs to control the operations of the subsidiary companies (agent) to ensure that overall organizational objectives are met. Some management thinkers believe that the pattern of ownership has an influence on the level of control. Control does not necessarily mean retention of decision-making power with the parent company.

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Control of the subsidiaries can be at three levels: strategic, organizational and operational. Corporate strategy, organizational structure and control systems work in an integrated framework. An MNC’s approach to globalization - ethnocentric, polycentric or geocentric - will determine the need for coordination among subsidiaries and consequently, the amount of standardization or customization required in the product and operations.

The SBU structure and the product division structure facilitate decentralized decision-making. On the other hand, international division and functional structures facilitate centralized decision making and the consequent standardization of products and processes. The decision to centralize or decentralize decision-making depends on the amount of standardization or customization required in products. The ability to respond faster to changes in market demand can be a source of competitive advantage to the firm. It is easier for firms to achieve this in a decentralized environment. A Strategic Business Unit (SBU) and worldwide product structure are some forms of a subsidiary with lesser control from the parent company. Parent companies can exercise control over SBUs by influencing their financial and strategic decisions. Companies that establish international subsidiaries need to adapt to economic, political and other conditions in the respective host countries and have to overcome geographical and cultural divides to manage their operations. Management control (MC) helps to align employee decisions and actions with corporate objectives. With increasing internationalization, companies face the challenge of transferring MC across national borders to distant subsidiaries. Multinational companies (MNCs) combine diverse mechanisms like planning, standardized procedures and training to control their foreign subsidiaries. Various factors, either within or outside the company, influence the application and electiveness of control mechanisms in MNCs.

2.0 Review of Literature

An MNC’s approach to globalization - ethnocentric, polycentric or geocentric - will determine the need for coordination among subsidiaries and consequently, the amount of standardization or customization required in the product and operations. MNCs operate in various countries with widely differing characteristics and hence, need to consider a broad set of influencing factors within and outside the company when designing their MCS. An overview of control mechanisms applied by MNCs and influencing factors, as well as their effects, has not yet been provided. This systematic literature review presents a comprehensive overview of control mechanisms in MNCs.
and discusses interactions between control mechanisms and a broad set of factors that impact MNC’s in a multinational environment.

An MNC is characterized by geographically dispersed units whereby headquarters and subsidiaries are located in different countries. Each unit operates in the specific context of its host country and interacts with local business networks like suppliers or buyers within the legal and economic framework of the country, which influences the characteristics of the MNCs (Ghoshal & Bartlett, 1990). MNCs are characterized by high complexity, which is also common with diversified and decentralized domestic companies.

In addition to coordinating different business divisions, MNCs have to overcome geographical and cultural distances and need to adapt to the environment of the host country (Merchant & Stede, 2017). Foreign markets are entered either by establishing a wholly-owned subsidiary, acquiring an existing company or by forming a joint venture with a partner in the local market (Yiu & Makino, 2002). Coordinating with a foreign partner adds complexity to managing and controlling non-domestic activities and therefore joint ventures represent a specific organizational context (Ding, 1997). Studies on management control in joint ventures deal predominantly with the relationship between partners and the protection of their resource contributions, which this literature review does not focus on. Accordingly, findings that solely reference joint ventures are excluded.

A broad variety of definitions exist for MC and MCS which are partly inconsistent (Chenhall, 2003; Malmi & Brown, 2008; Merchant & Otley, 2007) and complicate the interpretation of the research findings (Malmi & Brown, 2008). Some concepts cover as wide a spectrum that almost all organizational practices are included in MCSs (Merchant & Otley, 2007). For this literature review, MC is defined according to Malmi & Brown (2008, p. 290) as “systems, rules, practices, values and other activities management put in place in order to direct employee behavior”. MCSs consist of a range of such MCs and are “means of gathering and using information to aid and coordinate the planning and control decisions throughout an organization” (Horngren et al., 2012, p. 775). While strategic control focuses on the external environment and potentials compared to the competitors, MC predominantly concentrates on internal activities that influence employee behavior according to predefined targets (Merchant & Stede, 2017).

MNCs employ various control mechanisms to coordinate units worldwide in order to meet the global organizational objectives (Harzing & Sorge, 2003). Despite the considerable number of definitions (Chow et al., 1999; Malmi & Brown 2008; Martinez & Jarillo 1991), a broad consensus exists on the meaning of output control in terms of achieving goals and results and comprising planning and reporting (Harzing, 1999;
Martinez & Jarillo, 1991). Process controls specify desirable employee behavior and include centralization and standardization, as well as written manuals, to ensure that employees adhere to specified processes (Brenner & Ambos, 2013). The last category encompasses a broad spectrum of mechanisms such as socialization, communication and training (Harzing, 1999). According to Brenner & Ambos (2013) these formal and informal mechanisms are labeled as social control and serve to spread corporate culture and values in order to build acceptance for other control mechanisms. The extent of control indicates the tightness of control an organization exerts to achieve its objectives, e.g., in terms of frequency, accuracy and combination of various MCs (Merchant & Stede, 2017).

In accordance of Pavlovskä & Kuzmina-Merlino, 2013; breaks down into simpler parts of controlling systems turning into complexity in every step during this evolution. For the first time in 1994, the thought to consider externalities was explored by Byrne & Kavanagh (1994). They investigated expansion activities to western market and began to assess and classified Environmental Performance Indicators (EPI). EPI measures and bifurcates in two ways: (a) first relating to Financial Measures (Contingent Environmental Obligations, Environmental Operating Costs, Preventive Costs and Investments); (b) the second is relating to Non-financial Measures (physical indicators and compliance). Globalization and internalization requires a broader perspective rather than a local perspective on controlling. Faster growth of companies at the international level (MNC’s) requires a new management paradigm as the key success or critical factor. Dynamic systems would have to find out the future impact of strategic initiatives (Kunc & Morecroft, 2006). A New compatible model of controlling should be explored to address the new challenges.

3.0 Research Questions

This research paper explores the following questions. The first question describes and explores the two models of controlling of MNCs. The second question explains and tests the relationship between the two models. The third question evaluates and acts to find out the gaps between these two models

- What are the characteristics of the German and USA Model of Controlling?
- What is the relationship between the German Model and USA Model of Controlling?
- What are the Gaps of the German Model and USA Model of Controlling?
4.0 Research Methodology

Controlling consists of verifying whether everything occurs in conformity with the plans adopted, instructions issued and principles established. The main objective is to detect the weaknesses and errors in order to rectify them and to prevent recurrence. It operates on everything, i.e., people and action (Fayol, 1949). This is called the presence of force in business which guides it to a pre-determined objective by means of pre-determined policies and decisions (McFarland, 1974). Control relates to check the current Performance against pre-determined standards devised in the plans ensuring adequate progress and satisfactory performance. Management control seeks to compel events to conform to plans (Goetz, 1949). Control is that function of the system which provides direction in conformance to the plans. Control maintains equilibrium between the ends and means, output and efforts (Drucker, 1954). This research paper presents and analyzes the “Evolutionary Theory of Multinational Corporation” and the “Business Network Theory” as the contextual part of the study. The “Grounded Theory” has been used as the basis of the methodological approach (Corbin & Strauss, 2015), and for context specific inductive theory building. TRIZ and the System Evolution Theory are used as main inductive tools for the analytical research of controlling. Controlling has been defined in various manners and a scientific study brings out the various issues of the Controlling definition. The study firstly understands controlling from the international perspective. The Evolutional model is investigated by Pavlovska & kuzmina-Merlino (2014). This model compares the required time for hypothesis with tested system changes affecting the testing variables; and this method of investigation could not be judged as relevant for proofing. The evolutional model can be a better option, as this represents system and possible future states of the system. The main purpose of this research paper is to design an evidence-based theoretical model and study controlling scope; major factors including sources of information and functions, and develop a newer model of controlling for MNCs. This research focuses on developing a new concept of controlling framework in MNCs. Testing of processes should be conducted for a new theoretical framework in Grounded Theory (Imenda, 2014).

5.0 Research Objectives

The research work carries the following key objectives:

- To study the Evolutonal Model of Controlling based on multi-factor analysis
- To study the controlling concept assumptions, validity measurement and wherever possible, redefine them.
• Find out a new framework of a controlling model in MNCs

This also facilitates future research hypothesis and establishes grounds for quantitative testing and expertise reviews. Latest published or secondary research data are analyzed to conduct this research.

6.0 Research Design

The Research Design consists of GAP Analysis relating to the existing scope and definition lacking the common understanding of the term controlling. For this purpose, in the first step, classical theoretical research approaches are used, and the German and USA model are compared. In the second step, MNC’s approach is discussed. At the third stage, a new development model of controlling is devised. In this analysis, controlling analysis is presented from the viewpoints of MNCs. This study compares the models of the USA and Germany, and later emphasises only on the German Controlling model. All concepts and assumptions are relating to MNCs.

7.0 Controlling Concept and Models

Controlling is the process of ensuring that actual activities conform to plan activities. Controlling is determining what is being accomplished that is, the performance, evaluating the performance and if necessary, applying corrective measures, so that performance takes place according to plans (Terry, 1972). Control verifies conformity of plans with actions, issues orders and established principles. The main objective is to detect out the weakness and errors in order to rectify them and to prevent recurrence. It operates on everything, i.e., people and action (Fayol, 1949). This is called the presence of force in business which guides it to a pre-determined objective by means of pre-determined policies and decisions (McFarland, 1974). Control relates to check the Current Performance against Pre-determined Standards devised in the plans ensuring adequate progress and satisfactory performance (Breach, 2010). Management control seeks to compel events to conform to plans (Goetz, 1979). Control is that function of the system which provides direction in conformance to the plans. Control maintains equilibrium between the ends and means, output and efforts (Drucker, 1954). Control, like planning, is ideally forward looking and the best kind of managerial control corrects deviations from plans before they occur (Koontz & O’Donnell, 1982). The above definition concludes that control is the last step of management and equally important for efficient, smooth, speedy and proper attainment of organisational goals. Even if all effort
like, formulating policies, procedures and other factors are put in by the management, next important and crucial part of the road to attainment of goals is their implementation.

The history of controlling concepts is not so much longer, they have been evolved as a process and mechanism. The Traditional model of controlling is simpler in comparison to the contemporary controlling model. Contemporary model of controlling is more complex and broader. This study compares the two popular models and finds out their similarities and differences. It is important for the study to have a look at both of them and find out their orientation in the controlling system. The Anglo-Saxon and German model of controlling are having similarities. Controlling originates from German and it’s a pseudo-English word popular in Germany. Most of the German corporation is applied as “Management Control System”. Both of these terms “Controlling” and “Management Control System” are different and have different connotations. Behavioural, cultural and applications differences have a larger impact to carry out the meaning of these terms. Generally, Management control system consists of organizational structure or relationship of parts/components, or various responsibility structures within the organisation. Schultz (2012) defined in German language, but this draws from English “to Control”; it’s referred to checking and managing. Control concerns the control of the planning, coordination and control of the company’s tasks and is necessary to provide the necessary tools and information for real-time understanding and correction based on management. Albrecht Deyhle proposed three components of controlling: first target-oriented control, second controllers and managers acting as a team, and third interplay between analytics and soft factors (Deyhle, 1993). The use of control is very important for an organization and is the beginning of a chaotic development of control theories. New trends are within the scope of activities: strategic risk and sustainability, future orientation, and the role of the supervisor. Core theories and practices of controlling have been started to develop. This research paper analyzes thoughts of different theories and their dimensions. The research paper firstly analyzes the scope of controlling. The second component analyzes by the study of future orientation and third is the role of controller and last and fourth is the centre of controlling in the organisation.

This research study gets a second look to investigate historical scale and geographical location. The understanding of controlling concept should be divided into two groups: First group relating “USA and Countries following this principle and second group relating to “German and Countries following this principle”. The major differences have been shown in the scope between the two models (USA and German Model) in Table 1.
Table 1: Comparison between USA and German Model of Controlling

<table>
<thead>
<tr>
<th>Scope</th>
<th>USA Model</th>
<th>German Model</th>
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<tbody>
<tr>
<td>Future Orientation</td>
<td>View and present information well to stakeholders</td>
<td>Accelerate the planning, monitoring, and repair of operations and strategic business levels</td>
</tr>
<tr>
<td>Orientation to the future</td>
<td>Examine the current situation and find out the causes of what happened</td>
<td>In addition to tracking history, try to predict the future</td>
</tr>
<tr>
<td>The role of the controller</td>
<td>Auditor watch, report, examine stakeholders Interest</td>
<td>Assistance with business planning, management and development</td>
</tr>
<tr>
<td>Organizational Part</td>
<td>As an external part. Only for large organizations</td>
<td>Inner part. Additional activities. According to the size of activities</td>
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Sources: Jackson (1949), Falko (2008), Vollmuth (2007), and The Dictionary for Controllers (2010)

Table 2: Controlling: Scope, Additional Functions, Prototype and Authors

<table>
<thead>
<tr>
<th>Time Period</th>
<th>Scope of Controlling</th>
<th>Prototype</th>
<th>Main Authors</th>
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<tbody>
<tr>
<td>1930-1970s</td>
<td>Finance controlling, mostly focused on cost</td>
<td>Simple Sensor</td>
<td>Deyhle, A., Mann, R., Mayer, E., Vollmuth, H. J., Scown, T</td>
</tr>
<tr>
<td>1970-1980s</td>
<td>Support information system, reporting, single point of trust for management</td>
<td>Simple automat</td>
<td>Reichmann, Th., Preishler, P., Schaffer U.</td>
</tr>
<tr>
<td>1990s</td>
<td>Planning and controlling of budget</td>
<td>Simple toolbox</td>
<td>Hann, D., Horvath, P., Schneider, D.</td>
</tr>
<tr>
<td>1990’s</td>
<td>Coordination function to achieve goals and pre-defined targets</td>
<td>Communication centre</td>
<td>Küpper, H.-U., Bendak, J., Schmidt, A., Weber J.</td>
</tr>
<tr>
<td>1990’s</td>
<td>Company management system – from planning and budgeting to correcting action implementation after deviation analysis. KPIs and business processes</td>
<td>Negative feedback, Homeostasis</td>
<td>Steinmann, H., Kustermann, B., Schreyogg, G., Newman, WH., Russell, K.A., Siegel, GH., Kulesza, CS.</td>
</tr>
<tr>
<td>2000s-2014</td>
<td>Decision making system, knowledge management system</td>
<td>Immune system (react only on problems)</td>
<td>Steinmann, H., Scherer, AG., Ortmann, G., Sydow, J., Windeler, A., Becker, A.</td>
</tr>
<tr>
<td>On Demand</td>
<td>Management system which provides flexible planning for dynamic targets, and provide pro-actions for unpredictable events</td>
<td>Nervous System</td>
<td>Defined by Authors</td>
</tr>
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</table>

Sources: Complied by author

This research study concentrates on the German Model of Controlling, because this model has larger applications and responsibilities and potential outcome. This German model precisely defines sustainability and future development in MNCs. This model further developed, adjusted and localized in several countries and modified
accordingly like Chinese, Japanese, Bulgarian, Russian and others models (Falko, 2008). Real life experiences are incorporated in the development of the controlling model and its prototype. This study contributes to increase the scope of controlling and easily applies and define and does not propose any change in it completely. To some extent, this increases complexity by extending scope and more resources are required. The new challenges add additional function with previous functions, and this has been shown in the table below. Table 2 shows time periods, changing scope of controlling in terms of additional functions, prototype and name of contributory authors.

8.0 Multinational Corporations and Basic Postulates for the Controlling Model

The Head Quarter operated models of controlling have been adopted by the Multinational Corporation, where HQ deploys the resources, ensuring the conformity. MNC’s faces lots of challenges in this crisis period and management crisis needs to be operated to get the real time conditions. Foss et al., (2012) explained that headquarters may not be properly informed due to overloading of information, uncertainty, faster movement, ignorance and bounded reliability. Traditional forms of MNC move towards Network MNC’s emphasize on dynamic environment and this allows more intervention by Head Quarters. The first assumption is that MNC’s operate, control and manage in global markets as the same way in the home country. Managers started to ignore due to asymmetry information, differences in geographical and cultural dimensions, shifts in time zone, etc. The second postulate is relating to the prediction of future conditions and simplifies conditions by considering a limited number of variables. The International Group suggested using four dimensions; Balance Scorecard as a controlling technique to assess and predict the causes and impact of uncertainty. This BSC Model of controlling, unable to show acceleration or deceleration on the most significant trends of second derivation. This approach reacts heavily with the time factor and leads to work with consequences instead of adopting pro-active behaviour.

Considering the above discussion, the first new assumption is to be “Markets are heterogeneous”. Le Cottier & Santalo (2014) found that subsidiaries perform better when the distance in market munificence between their home and host markets is small. This analysis is based on unique panel database, gathering ownership ties and financial performance for 3,828 listed multinational corporations (MNCs) and 18,234 of their European subsidiaries over a three-year period demonstrate this result.

This research paper put forward previous assumptions: “(a) Others’ Markets should be operated differently in comparison to the home market. (b)This difference
between the home market and other markets make a major impact on the final result. (c) Historical or past information can give only a part of picture of future vision.

9.0 Development of a New Model of Controlling

A Multi-national Corporation is a complex system having sub-systems and different degrees of freedom, and consisting of different controlling centers which is represented by a multi factor model, where all factors are equally important and joint composition of all these factors gives a precise and realistic picture of business. The main drawback of the existing system of controlling MNC’s model is the lacking of adjusting or adopting to the dynamic environment. This representation is based on a new type of prototype: Nervous system consists of reactions on both threats and opportunities; learning and self-changing and accommodating process.

The table depicts a descriptive analysis of sources of information and main functions in the development of controlling model. The core concepts of controlling have been drawn from the original definition of controlling and Controlling ideas are being presented or tabulated in historical sequential order. The third column of the table indicates additional Scope added in the process of development of controlling. The last column of the table indicates the suitability of the controlling model, company profile and focus points. The first two traditional models given in the table are lacking functionality and not consisting of all corporation activities. The next four models given in the table show precise analysis and depict additional values. The New Model given in the table shows the new controlling model with functions and sources advocated by experts.

**Table 3: Evolution of Controlling Model**

<table>
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<tr>
<th>Controlling Definition</th>
<th>Detailed Scope of Controlling and Information Sources</th>
<th>Main Focus and Company Profile</th>
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<tr>
<td>System of Cost Accounting and Reporting</td>
<td>Main functions:Creating methods and tools of cost and later managerial accounting. Organize Internal Cost (Managerial) accounting in company. Main sources:Accounting data (including managerial accounting approach on the later stage)</td>
<td>Focused on production, small companies, in the small market</td>
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<tr>
<td>Split between strategic and operational controlling. Different level of planning. Main functions: Target definition. Main sources: Planned with actual date from functional areas.</td>
<td>Focused on future development or/and R&amp;D. Middle size companies in the middle size market.</td>
<td></td>
</tr>
<tr>
<td>Coordination function to achieve goals and pre-defined targets. Main functions: Coordination and balancing of company processes to achieve pre-defined targets. Main sources: Structured hierarchical reporting.</td>
<td>Focused on client’s marketing with various processes inside or outside of the company, mostly middle – large size local companies in the big local markets.</td>
<td></td>
</tr>
<tr>
<td>Decision making support system, knowledge transfer. Main functions: Complete information for decision-making. Knowledge transfers from headquarters to subsidiaries. Reflection of processes and its formalization. Forecasts. Main source: Knowledge management system</td>
<td>MNCs with traditional hierarchical leadership style which are focused into existing in the long run.</td>
<td></td>
</tr>
<tr>
<td>Management of company management. Main functions: Corporate performance – multi process model. Effectiveness and efficiency of decision-making. Decision making unit. Methods and tools for flexible planning and company development. Main sources: Informational management system (includes but not limited) corporate performance management, ERP, CRM, MMP and others Globalization dimension Environment factors</td>
<td>Network MNCs with focus on sustainability, effective and efficient management on all levels of the company.</td>
<td></td>
</tr>
<tr>
<td>System of management with several sub-systems of planning, budgeting, funding, as well control target fulfilment and correction action if required. Main functions: KPI control for every functional area of the company. Deviation analysis. Main sources: KPI and deviation of targets.</td>
<td>Focused on the wide network organization, middle and large companies with subsidiaries, mostly with traditional hierarchical forms of leadership.</td>
<td></td>
</tr>
</tbody>
</table>

Source: Collected and compiled by author
10.0 Results and Conclusions

10.1 Results

Controlling in today’s perspective is relating to the firm’s future, by aligning an entire development system along with its development of sub-system oriented towards the future target of a company. Formulation of strategy and achievement of mission/objectives are the future targets of the company (Drury, 2007). Controlling has been seen as a part of systems of the company performing different functions and roles and working in a cohesive manner and growing together. Development controlling or self-development can be attained with the focus on both internal as well as external factors. Strategic targets should be devised and accommodated in the light of the dynamic environment. Environment keeps on changing, so accordingly controlling tactics should be changed in accordance with the priority of targets.

Controlling becomes more sensitive in case of Multinational corporations, as MNCs faces various challenges at global level. As per TRIZ (Altshuller, 1984), system development is not synchronization and symmetrical, as different systems have a variety of speeds of development and deal with various issues and contradictions. Spasmodic or inconsistent growth of parts in a system depicts a system consists of different parts, and these different parts evolve differently leading to newer paradigm and issues. System turns to be ineffective and inefficient without coordination, integration and balancing, which further leads to distort strategic targets. Several analogies in biology and engineering sciences visualize and give a proper understanding of controlling. Out of them, one is the nervous system which automatically coordinates different parts, processes and systems of the body like organs, muscles, hearing, watching, senses, etc.

The dysfunction of the nervous system originates various problems in human beings, and similar situations arise in organization when controlling is not properly installed and working. There is a principle in biological science, which defines that nervous system complexity corresponds with bio-system complexity. This principle might be applicable in management science as well. The research paper suggested model/prototype integration and coordination of all activities and functions at all organisational levels of the Multi-national corporation and send indications and information to different parts of the corporation. The study found controlling as integrated morphological and functional sets of structures consisting of activities and responsive to dynamic environmental factors. The main focus point of the system is Signals, and these have different levels; starting from highest to lowest priorities. Indicators for transmission of Singles may be strong or weak; depending on the nature of
singles, the systems start to react and operate immediately and start to correct and resurrect the system.

10.2. Conclusions

Developing a new controlling model of MNC’s is critical in today’s dynamic environment and required for effective management and for sustainability. Globalization changes the nature of controlling and the entire paradigm of controlling forces change in the global environment. Historical data based controlling model and financial model are unable to solve and address all practical issues of today’s corporation. Controlling has been applied as statistical tools for management decision making. The German model of controlling takes into consideration the timeframe, maturity level, and nature of market, Size, and prototypes. The USA Controlling model views and presents information to stakeholders and examines the current situation, finds out the causes of what happens, auditor’s reports and examine stakeholders’ interest and understands externalities.

The study finds controlling models based on two basic approaches: first is based on historical information and data, and second is based on Unified system and procedures applied in an integrated manner. This integrated system is applied to organization as a whole including headquarters and subsidiaries and ignores cultural differences and others. The new postulates of controlling model are as follows: (a) “Markets are heterogeneous” (b) Foreign Markets operate differently from home Markets. (c) Historical data/information can cover only a part of the future vision. This newer model proposed by the study evolves new assumptions of the controlling model, which is based on the Approaches of management and the Theory of Decision Making. The newer assumptions proposed in the new controlling model devise new features. This model can be represented by an analogy of the human nervous system. These findings are important in today’s complex business environment and relevant for the MNC’s to survive and stabilize itself in the challenging environment.

References


