

15.10: What Does Control Mean in the Business Setting?

Learning Outcomes

- Explain what control means in a business setting.
- Describe the benefits and costs of organizational control.



Control in general is a device or mechanism used to regulate or guide the operation of a machine, apparatus, or system. Control in a business setting, or **organizational control**, involves the processes and procedures that regulate, guide, and protect an organization. It is one of the four primary managerial functions, along with planning, organizing, and leading.

One common type of control companies use is a set of financial policies. These policies may not be communicated to all employees, but they exist for all but the smallest firms. Controls start with managing cash. For example, controls limit check-writing authority and the use of company credit cards. For example, a firm may require two signatures on checks more than \$10,000 or have one person to log journal entries and another person to review the entries. These policies help prevent fraud and errors as well as monitor whether company goals are being met. In larger companies, each department manager submits an annual budget and profit-and-loss statements.

The most common style, or approach, of organizational control is **top-down** control. With top-down control, decisions are made by high-level executives, and information flows down to the lower-level employees of the organization.

The three types of organizational control include the familiar feedback, proactive, and concurrent controls. We'll talk about these more later, but first, let's explore some of the benefits and disadvantages of organizational control.

Practice Question

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Implementing Organizational Control

Organizational control involves developing rules, procedures, or other protocols for directing the work of employees and processes as well as monitoring the work. Organizational control is an important function because it helps identify errors and deviation from standards so that corrective actions can be taken to achieve goals. The purpose of organizational control is to ensure that a specific function is performed according to established standards.

Benefits

Organizational control has many varied benefits, including improved communication, financial stability, increased productivity and efficiency, help in meeting annual goals, improved morale, legal compliance, improved quality control, and fraud and error prevention.

Controls help to better define an organization's objectives so that employees and resources are focused on them. They safeguard against misuse of resources and facilitate corrective measures. Having good records means management will better understand what happened in the past and where change can be effective.

All businesses need controls. Even sole proprietor businesses must keep records for tax reporting. Public companies are legally required to have extensive controls to protect stockholders, and good controls help a company to raise funds through stock and debt

issuance.

Employee morale may be higher when workers see that management is paying attention and knows what it is doing. As an earlier module discussed, better morale means better productivity. Better controls can mean more freedom and responsibility for employees. Management is able to step back a little, knowing that the controls will flag any exceptions.

Toyota has made control a competitive advantage. As an article in the Harvard Business Review says, “Toyota’s way is to measure everything—even the noise that car doors make when they open and close as workers perform their final inspections on newly manufactured automobiles.”^[1] After bad publicity over unusual brake issues, Toyota was again at the top of Consumer Reports’ 2016 reliability report.^[2]

Disadvantages

Even the simplest control is an added expense. Some systems can be very expensive, so management must weigh the cost versus the benefit for each control. Banks spend billions on controls, but it is worthwhile for the large banks, because they handle trillions and their profits are still in the billions.

A control mentality can lead to overstaffing and unsustainable costs for some businesses. Community banks, for example, feel the burden of new regulations on the banking industry more heavily than the largest nationwide banks. Research from the Federal Reserve Bank of Minneapolis, Minnesota, and quoted in the New York Times “suggests that adding just two members to the compliance department would make a third of the smallest banks unprofitable.”^[3]

A less obvious expense is maintaining the controls. Systems need continuous updating as the organization changes. If they are not maintained, the controls may become ineffective.

Controls can become a blind spot for management. Overreliance on controls may lead to relaxation in supervision and allow manipulation of accounts and assets. Employees tend to follow the letter of rules, not the intent, so management needs to check in regularly on how controls are actually operating.

A rigid implementation may lead to a slowdown in the operation of the business. At Freddie Mac, a financial services company, the new product approval process required 25 signatures and took more than a year. The new opportunities in the market disappeared before products could be approved.

The wrong controls may expose the firm to more errors and fraud. And employees will be frustrated if the controls are cumbersome.

? Practice Question

<https://assessments.lumenlearning.co...essments/12318>

1. Thomas A. Stewart and Anand P. Raman, “Lessons from Toyota's Long Drive,” Harvard Business Review, July–August 2007, <https://hbr.org/2007/07/lessons-from-toyotas-long-drive>. ↵
2. Michelle Naranjo, “CR's Car Reliability Survey Reveals Shuffles in Brand and Model Rankings,” Consumer Reports, October 24, 2016, <https://www.consumerreports.org/car-reliability/car-reliability-survey-2016/>. ↵
3. Marshall Lux and Robert Greene, “Dodd-Frank Is Hurting Community Banks,” New York Times, last updated April 14, 2016, <https://www.nytimes.com/roomfordebate/2016/04/14/has-dodd-frank-eliminated-the-dangers-in-the-banking-system/dodd-frank-is-hurting-community-banks>. ↵

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