



## The Control System and External Control of Organization

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### *Abstract*

*This paper aims to discuss control - a function in an organization – by relooking some works in control system and external control of the organization. A classical work of Pfeffer and Salancik (1978) becomes an important basic source in this review paper which discussing the external control of the organization from a resource dependence perspective. Luckily, Dill (1981) reviewed this ten chapters book giving a basic understanding of the control function of the organization. Another important source comes from Eilon's (1996) work which provides a theoretical framework on the basic concept of identifying and classifying of the administration control system. The more recent works in the control system strengthen this review paper such as Chenhall (2003) that provides a critical review of findings from contingency-based studies relating to the management control system (MCS), and Gillan (2006) describing corporate governance as another aspect in control function of management. This paper concludes that there is a logical consequence in discussing the control system and external control of an organization should relate to the organization itself, organizing function of management, and the environment of the organization.*

**Keywords:** *control system, external control, environment, organization, corporate governance*

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## **INTRODUCTION**

In a management theory seminar course, it is occasionally discussed about management and organization. One time, after discussions with introduction, management theory, managerial work, and executive function – that we can assume as common theoretical framework in learning management and a planning function of management – we are now entering the next function, namely organizing. But, our specific topic begins with organization and its macro level. Not surprisingly, the function of organizing indeed has strong relationship with the organization. Frankly, that is the first curiosity why we discuss the organization, not the organizing as management function.

Second curiosity is the only one reference using in this discussion, the book of Pfeffer and Salancik (1978) under the title *The External Control of Organization: Resource Dependence Perspective*. The word “control” is rather disturbing the mind. Since we have known that “control” is another management function. So, that, how could it be discussed in organizing function or in organization topic.

Carried away the curiosity, it is started looking for answer. That the reason why, we need another view of this book, to help me answering the concerns. Fortunately, it is found William Dill’ reviewed work on *American Journal of Sociology*.

After reading some materials regarding this concern, it is realized that the book is about how organizational environment affect and constraint organizations and how organizations respond to external constrains, and organizational behavior is constrained and shaped by the demands and pressures of organizations and groups in its environment. Another new curiosity then appears the mind, the environment. What is the importance of the environment for an organization?

Before go further discussing in external control of organization and the environment, the function of control should stay steadily in our mind. This paper describes the control system which choose classical work of Eilon (1966) in *Journal of Management Studies*.

This paper is believed to enrich the understanding of the control system of an organization. Specifically, when the control system of organization be associated with the external control of the organization, corporate governance and its recent developments and management control system. The integration of those concepts within this paper might yield a more comprehensive conclusions and could be documented in the relevant body of knowledge literatures. Since, this discussion took place in a forum of organizing management function. Come with that, the purpose of this paper is revealing one aspect in management function namely the control which be deepen with re-examination of control system and the external control of the organization.

## **THEORETICAL FRAMEWORK**

Eilon in his article published in 1996, wrote the basic concept of administration control system classification. He described the system’s response to instruction, those were form of output, response amplitude, and response time. Most important he classified the element of a control system: standards, measurement, controllers, and control of control.

Actually, this paper aimed to define, identify and classify administrative control system. There were two obvious pre-requisites to a control system: a standard and procedure for measurement. The sequence of control system processes that defined as the control procedure and describe the way in which a controller fits into the work of the

system, has elements: standard of performance, a measurement process, the controllers' role in the system and evaluation of control effectiveness (control of control).

These elements themselves has made me realize that this topic has strong relationship to the function of management. Even in control system, there are management function applied, such as simply plan-do-check. Standard of performance can be identified as planning function, while a measurement process and the role of controllers as doing function, and evaluation of control as check function. Interestingly, there is a control function in the control function. We do deduce, that control is the important of management function.

The author proposed characteristics of administrative control system as follows:

1. Standards  
Including: Language (numerical values, rankings on a utility scale without numerical value, description); Set (single characteristics, multiple characteristic); Objective: short term only, short and long term objective specified; Control limits (single control limit, double control limits), Rigidity (rigid standards, adaptive standard, operation serves as a standard)
2. Measurement  
Including: Frequency (continuous, periodic, random); Delay (instantaneous measurement, delay in measurement or transmission); Duplication (single measurement process, number or parallel measurements in action)
3. Controllers  
Including Number and linkage: a single controller, several first order controllers on series, several first order controllers on parallel, several controllers in series-at least one is of the second order, several controllers in parallel-at least one is of the second order, as above and there is at least one hybrid controller, mixed control of second order, hierarchical control, controllers also play a prominent part in other systems; Time span such as an hour, a day, a week, a month, a quarter, half a year, a year, two years, etc.
4. Control of Control  
Including: continuous, periodic, random, absent altogether, acts only in cases of failure or breakdowns.

This classification can be used as basic concept to control system.

### **The Management Control System**

After looking backward from the 1966 Eilon's classification of control system, we move on the more recent management control system almost after 50 years. First, we look at 2003 Chenhall's research findings in this area.

Through his article, Chenhall attempted to provide a critical review of finding from contingency- based studies over the past 20 years from until 2003, derived a series of propositions relating management control system (MCS) to organizational context. The paper also examined issues related to the purpose of MCS, the elements of MCS, the meaning and measurement of contextual variables, and issues concerning theory development. In the end of this paper the author considered the possibility that contingency-based ideas could encompass insight from a variety of theories to help

understand MCS within its organizational context. A contingency-based research as we knew has a long history in MCS.

The concept of MCS including organizational framework for contingency-based MCS research, the meaning of MCS, and outcome of MCS and their critical evaluations can be read more detail from page 128 to 136. We prefer to summarize the contextual variables in MCS as follows:

1. The external environment, a powerful contextual variable that is at the foundation of contingency-based research.
2. Generic concepts of technology, how organization's work processes operate and include hardware, materials, people, software and knowledge.
3. Contemporary technologies, the role of advance technologies such as just in time (JIT), total quality management (TQM), and flexible manufacturing (FM)
4. Organizational structure, the formal specification of different roles for organizational members, or task for groups, to ensure that the activities of the organization are carried out.
5. Size, that enable firms to improve efficiency, providing opportunities for specialization and the division of labor
6. Strategy, whereby managers can influence the nature of the external environment, the technologies of the organization, the structural arrangement and the control culture and the MCS
7. Culture, represent an extension of contingency-based research from its organizational foundations into more sociological concerns.

### **Corporate Governance.**

There is another aspect in control function of management that during the last two decades the research in this area increased dramatically, that is corporate governance. Gillan (2006), with his article aim to present a corporate governance framework, provide a broad overview of the issues and recent work in the area, and place each of the special issue papers within this context. His paper proceeded with definitions of corporate governance, elements of internal governance, external governance mechanism, broad view of governance emphasizing the study of multiple governance mechanism, and some thought on future research.

Zingales (1998) defined governance system as the complex set of constraints that shape the ex post bargaining over the quasi-rents generated by the firm. (Shleifer & Vishny, 1997) Shleifer & Vishny (1997) defined corporate governance as the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. While (Gillan & Starks, 1998) Gillan & Starks (1998) broadly defined as the system of laws, rules, and factors that control operation at a company. From these definitions, we can see the strong relationship between corporate governance and the control function in management, even it is more stress in financial matters.

From those definitions, the author then developed corporate governance framework. The framework generally divided into two aspects: internal and external governance. Internal governance consists of 5 basic categories: (1) the board of directors and their role structure, and incentive, (2) managerial incentive, (3) capital structure, (4) Bylaw and Charter Provision or antitakeover measure, (5) internal control system. Similarly, the external governance also have 5 groups: (1) law and regulation, specifically federal law,

self-regulatory organization, and state law, (2) markets 1 including capital market, the market for corporate control, labor market, product market, (3) market 2 emphasizing providers of capital market information such as that provided by credit, equity, and governance analysts, (4) market 3 focusing on accounting, financial and legal services from parties external to the firm including auditing, directors' and officers' liability insurance, and investment banking advice, (5) private sources of external oversight particularly the media and external lawsuits.

The author gave some notes to his papers regarding corporate governance, that each adds to our understanding of one or more specific governance issues, in a manner consistent with contemporaneous governance research the paper in the issue increasingly focus on multiple aspect of corporate governance, and more generally the research fall into one of three broad classification: performance as a function of governance, governance as a function of governance and the impact of governance on performance. Finally, however, the future research is still needed to add the understanding of governance system.

The research in this relatively new area in control function of management is encouraged to scholars who interested in. we think with the basic concept of control from Eilon, management control system from Chenhall and corporate governance from Gillan give us rather enough materials to start the research.

## **METHODOLOGIES**

This paper is one of basic research to describe the control system of organization by reviewing some academic works related to the topic. Therefore, the library research is used in this review paper. The library research itself is a study which collect secondary data from previous literatures that compare, contrast, criticize, synthesize and summarize the phenomena in a certain area.

As a primary data source of this paper, the classical work of Pfeffer and Salancik (1978) and the latest of 2003 edition with appropriate new perspective which strengthen with Dill (1981), Nakajima (2010) and Mahadeen et.al, (2016) reviewed papers are used to discuss about the control function of organization. The book consists ten chapters, which provide an understanding the behavior of organization, organization and social context defined, social control of organization, managing environment demands, altering organization interdependence, environment, executive succession, and the design and management of externally controlled organizations. The more recent studies regarding the control system and the external control also compare with the internal perspective of organizational control.

Those concepts of organization and its environment are based by more recent theoretical review of Eilon (1996), Chenhall (2003), and Gillan (2006) paper reviews. The theoretical references are believed to enhance the point of review to the specific theme. Eilon provided the basic concept of administration system classification, the definition and the identification the control system, and proposed the characteristic of the control system. While Chenhall provided a critical review of finding from contingency based studies and management control system (MCS) in terms of the purposes, the elements, the meaning and measurement of contextual variables, and the theory development. Chenhall's works obviously offered the theoretical frameworks, approaches, methodologies, and proposition to initialize the opportunity in MCS research. Finally, Gillan with his article provided a corporate governance framework and a broad overview of this topic including definitions,

elements of internal governance, mechanism of external governance, and ideas for next studies.

## DISCUSSION

Before finding out all the curiosities, the following paragraphs are to summarize the content of this book. The book consists of ten chapters. An external perspective on organization is the first chapter that introduce to us how to understand the behavior of an organization, one must understand the context of that behavior – that is the ecology of the organization (p.1). Organization survive to the extent that they are effective that derives from the management of demand. Every organization requires some transaction with its environment, and this calls for maintaining social legitimacy and political acceptance.

In chapter 2, organization are mostly defined in terms of goal-orientation or an instrumental view, but the authors define organization as coalitions. Organizations are markets for influence and control. In conclusion, organizations are coalitions, maintained by providing inducements (satisfaction) to participants who support the organization (p.29). This chapter is titled organization and social context defined.

Next chapter tells deeply about social control of organizations. Social control involves a process in which both the influences and the focal organization act to affect the conditions governing the influence process. An organization's dependence on another could be determined by (1) importance of resources, (2) discretion over resources allocation and use of an interest group, and (3) concentration of resource control or substitutability of resources (p.45-46).

Environment of an organization can affect organization's outcomes without affecting its behavior. Environment can be thought of as having three levels, the entire system, the set of individuals and organization, and the level of organization's perception and representation of the environment. Planning is based on a theory of the past, and when plans go wrong, it is the theory and not the environment that is wrong (p.73). We can find this in fourth chapter about the organizational environment and how it is known.

Chapter 5: Managing environment demands: adaptation and avoidance. The density and interconnectedness of inter-organizational field today derives from adaptations to past problems. Organization must be prepared to avoid influence. The organization must either choose which of the various competing demands to address or to somehow avoid the conflict or demands. On the other hand, avoidance for resources dependence could be achieved through buffering against instability, or by controlling the rules of trade through formal or informal means, or taking control of the organization providing needed resources, or altering the organization itself to hedge its risk through building substitutable exchanges or diversification (The External Control of Organization, 2014).

Altering organizational interdependence in chapter 6 tell us that organizations engage in merger to control interdependence. Authors empirically demonstrate that there is a relative importance of sales or purchase interdependence for explaining merger activities by an industry. Authors argue that growth is consequence of interdependence, such as uncertainty. Organizational control over critical activities and reduces problematic dependence. Monopolistic power by large business enterprise is taken in form or risk avoidance or uncertainty reduction rather than in the form of increase profits (p.138).

Most direct method of controlling dependence is to control the source of that dependence. There are several informal mechanism and semiformal inter-organizational

linkages, including: cooptation, trade association, cartels, reciprocal trade agreement, coordinated councils, advisory boards, and boards of directors, joint ventures, and social norms (p.144). Environmental munificence appears mainly responsible for firm shifting between cooperation and conflict. Evidently, environment can be negotiated in chapter 7.

Moreover, environment can be also created. In next chapter, faced with otherwise unmanageable interdependencies, organization through political mechanism, attempt to create for itself an environment that is better for its interest. Environment is not only a given, to be absorbed, avoided or accepted, it is itself the dynamic outcome of the action of many formal organizations seeking their own interest (p.190).

The length of an administrator's tenure in office is likely to be less when there is visible evidence of his inability to cope with critical contingency and he is unable to institutional control (p.242). Executive succession (the title of Chapter 9), hiring and movement is a strategic response to environmental contingencies, as they often lead to inter-organizational linkages and enhances communication between organizations.

In the last chapter under the title of the design and management of externally controlled organizations, stated that organization are other-directed, involved in a constant struggle for autonomy and discretion, confronted with constrains and external control (p.257). Power in an organization organizes around critical and scarce resources. In essentially, the book emphasizes on the need for an organization to remain as autonomous as possible and suggest mechanism thought which its dependence on others' can be reduced.

### **An External Perspective on Organization**

Since this book centralize in understanding the behavior of an organization that is the ecology of the organization, it is important not only to manage the organization but also to control it. It is generally accepted that context organizational environment, are important for understanding action and structures. Therefore, this book discusses how organizations manage to survive. How managers go about ensuring their organizations survival is what this book is about (p.2). The key to organizational survival is the ability to acquire and maintain resources. In spite of the importance of organizational environment, not much attention on this matter, that rather than acquiring, most scholars dealt with using the resources.

Some key concepts developed a contextual perspective of organization. Organizational effectiveness is the ability to create acceptable outcomes and actions. Organizational effectiveness is an external standard of how well an organization is meeting the demands of the various groups and organizations that are concerned with its activities. While the organizational efficiency is an internal standard of performance. Efficiency measured by ratio of resources utilized to output produced. Organizational environment is made from the external basis for judging organizational effectiveness. Organizational environments are not given realities, they are created through a process of attention and interpretation. Organizational constrained actions occur when ever one response to a given situation is more probable than any other response to the situation, regardless of the actor responding (p.14). Finally, there are some perspective of the role of management in organizations: the symbolic role of management and the possibilities of managerial action that can adjust and alter the social context surrounding the organization.

### **Organization and Social Context Defined**

In the social context, the authors preferred to view organizations as coalitions altering their purposes and domains to accommodate new interests, sloughing off parts of themselves to avoid some interest when necessary, becoming involved in activities far afield from their stated central purposes (p.24). An organization, according to organization as market for influence and control perspective, is viable as long as its available inducements are sufficient to elicit the necessary contributions, or to maintain a viable coalition of support. In regard of organizations are coalitions, management faces the necessity of coping with competing and conflicting demands.

An organization as a structured body has boundary that is its influence over activities compared to the influence of other social actors over the same activities of the same participants. Once, organizational effectiveness is the assessment of the organization's output and activities by each of various groups or participants. The task of organizational effectiveness is the management of coalition to ensure continued support and survival of the organization.

### **The Organizational Environment and How It Is Known**

In understanding the organizational environment, there are three level of the environment: the environment consists of the entire system of interconnected individuals and organizations who are related to one another and to focal organization through the organization's transaction; the set of individuals and organizations with whom this organization directly interacts; and the level of organization's perception and presentation of the environment – its enacted environment.

According to Emery & Trist (1965) there are four types of environment: (1) placid-randomized, a situation in which the resources desired were randomly distributed throughout the environment, (2) placid-clustered, refers to an environment in which the pattern of resources is sequentially predictable, (3) distributed-reactive, that the distributions and probabilities of resources are created by the actions of organizations themselves, (4) turbulent, that involves the connection of sets of actors to other sets of actors interdependently.

In knowing the environment, the enactment process can be used to describe. The human creates the environment to which the system then adapts. The human actor does not react to an environment, he enacts it (Weick, 1969). This concept of enactment provides important implications for understanding organizational actions in environments. The determinants for this process are organizational structures, organizational information system structure, and organizational activities. The problems in environmental enactment may misread interdependence, misinterpret demands, remain committed to past practices or fail to see the various conflict in demands.

Reading along this book, the curiosity become clearer. Dill (1981) also realized that he has taken a long time for the ides to take hold that we must understand an organization's environment before we can understand the organization. Chester Barnard's central idea of an organization and its relevant environment as a managed network of participant, bartering contribution that each can make for material or physics inducements in return, has attracted new prominence (Dill, 1981).

It is realized that the environment is important for an organization as Peter Drucker suggested that the importance of environment can be useful in behavioral research. In fact,



this importance of environment, then Pfeffer and Salancik's book become an interesting and broad-ranging contribution in studying organization. This book is based on their own research on the performance of organizations. They were mainly interested in assessing an organization's level of dependence on outside groups for resources and how an organization and its leader assess the nature and significance of that dependence and find ways to reduce resultant uncertainties or detrimental consequences (Dill, 1981). The authors' argument reinforces our belief that the environment is important.

## **CONCLUSION**

To sum up, let's restate what has been drawn throughout this paper. Discussing organizing function of management begins with organization and its macro level, because the organizing indeed has strong relationship with the organization. The discussion then be helped by other reviewing work and enriched by discussing the environment. To relieve the curiosity, Eilon's work (1996) provided theoretically background in terms of administration control system classification: standards, measurement, controllers, and control of control. Along with Chenhall (2003)'s research findings in terms of contingency-based studies over the pass twenty years derived a management control system and Gillan (2006)'s paper discussing the corporate governance. The discussion starts with summarizing Eilon's book, then observes an external perspective on organization, the organization and social context defined, and the environment of organization. So far, the discussions can relieve the curiosity that there is a logical consequence in discussing the control system and external control of organization should relate to the organization itself, organizing function of management, and the environment of the organization.

## **RECOMMENDATION**

Finally, there are some concluded recommendation that we may consider: correct knowledge about important environmental dependencies call for organizations to devote more resources to environmental scanning and to have operating people who must make decisions; organizations which have grown too dependent in uncontrollable ways on outside groups should consider escaping those dependencies by diversifying in other fields; to cope with the conflicting demands that they acknowledge diversification creates, they argue the importance of having organizational slack and a loosely coupled, constituency-oriented organizational structure; they urge that there should be protections in organizations against institutionalization of power for executive and improvements in ways to change leaders in response to environmental demands (Dill, 1981). These recommendations is believed to have successfully answer all the curiosity regarding the organization, the environment, the control to the organization externally, thus the importance of environment to the organization.

## **LIMITATION**

There are some limitations of this review paper. First, substantially, the topic discussing the control system and external control of organization seems like to be too narrow to understand the organizing function of management. However, it discussed the organization itself and the organizations' environment. Second, the use of few related papers could generate provisional conclusions. The main source of this paper is a single book of Pfeffer & Salancik supported by Dill's reviewed work.

## **FUTURE RESEARCH**

The author ended the article with consideration of literature that while not without imperfections in method, it has provided a basis for generalized proposition between elements of MCS and context. Maintaining the relevance of MCS contingency-based research, scholars need to focus in attention on contemporary dimension of MCS, context, and organizational and social outcomes. Other approaches based in economics and psychology can readily be included within contingency-based frameworks. Moreover, the contingency-based research can provide an ordered way to integrate thinking about the sociological processes affecting MCS in action. Now, it our turn to catch these opportunities. Theoretical frameworks, approaches, methodologies, even proposition are available to arrange the next step in management control system research.

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