

# **The changing psychological contract: challenges and implications for HRM, organisations and employees**

by

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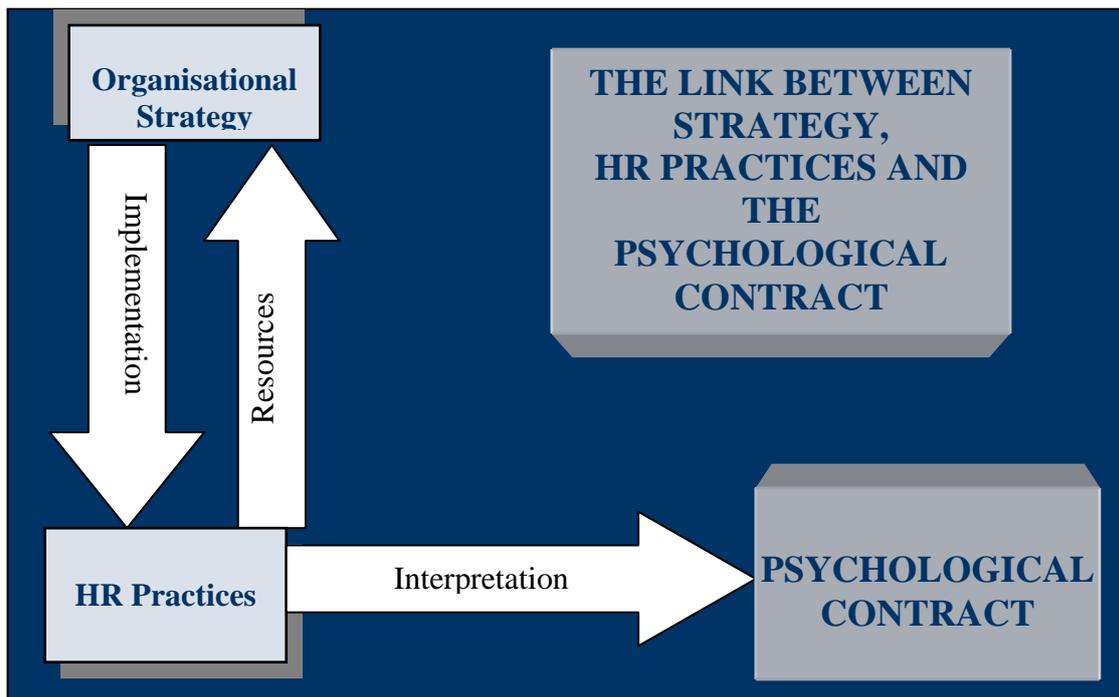
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## **Introduction**

Organisations and their employees face ongoing challenges in the form of new strategic initiatives designed to keep pace in an increasingly complex business environment. In order for these challenges to be successfully met, new behaviours are required on the part of employees (Sims 1994). Defining these new behaviours is initiated through the organisation's human resource (HR) practices (Rousseau & Wade-Benzoni 1994). However, *actual* change in individual employees' behaviour is determined by *interpreting* their employers' HR practices. Such interpretation affects employee behaviour by altering perceptions of the terms of the individually held *psychological contract* (figure 1).

**Figure 1: Relationship between strategy and employee's psychological contract**



Adapted from Rousseau, DM and Wade-Benzoni, KA 1994,  
Linking strategy and human resource practices: how employee and customer contracts are created,  
*Human Resource Management*, Fall, 33 (3), p. 464.

This chapter focuses on the following issues: defining the psychological contract; the function, development and content of the psychological contract; the 'old' versus the 'new' psychological contract; change and the psychological contract; challenging issues associated with the changing psychological contract; implications for the management of human resources; and future directions.

## **Defining the psychological contract**

The exchange relationship between organisation and employee ranges the entire contract spectrum from strictly legal to purely psychological (Spindler 1994). Many aspects of this relationship are shaped by legislation, enterprise agreements and/or an employment contract signed by the employee detailing issues such as hours, salary and benefit plans. However, other aspects of the employment relationship are likely to be confined to the subconscious (Spindler 1994). The term *psychological contract*

(Argyris 1960; Schein 1980; Rousseau 1989) refers to a commonly used exchange concept providing a framework for understanding the 'hidden' aspects of the relationship between organisations and their employees (Shore & Tetrick 1994).

The literature provides a number of definitions for psychological contract. For example:

- 'the set of expectations held by the individual employee that specify what the individual and the organisation expect to give to and receive from each other in the course of their working relationship' (Sims 1994)
- 'an individual's system of belief, shaped by the organisation, regarding terms of an exchange agreement between him/herself and the organisation' (Rousseau 1989; Rousseau & Aquino 1993)
- 'what employees are prepared to give by way of effort and contributions in exchange for something they value from their employer, such as job security, pay and benefits or continuing training' (Newell & Dopson 1996)
- an emotional bond between employer and employee. It is implicit and thus unofficial and includes mutual responsibilities and expectations. Compliance motivation reflects the degree of shared belief and trust (DeMeuse & Tornow 1990).

The common theme underlying these definitions is that the psychological contract refers to an *employee's* unexpressed beliefs, expectations, promises and responsibilities with respect to what constitutes a fair exchange within the boundaries of the employment relationship.

Psychological contracts differ from other types of contracts not only because of the innumerable elements they may contain but also because the employee (the contract taker) and the employer (the contract maker) may have differing expectations with respect to the employment relationship. Few of these elements are likely to have been specifically discussed; most are inferred only, and are subject to change as both individual and organisational expectations change (Goddard 1984; Rousseau 1990; Sims 1990, 1991, 1992).

Psychological contracts differ from legal contracts with respect to procedures followed in the event of breach of contract. Breach of a legal contract allows the aggrieved party to seek enforcement in court. Breach of a psychological contract, however, offers no such recourse, and the aggrieved party may choose only to withhold contributions or to withdraw from the relationship (Spindler 1994).

The psychological contract is a complex phenomenon. Considerable debate has taken place during the past decade over the validity of the concept in the new 'lean and mean' organisation. Assessing its validity requires an understanding of the role played by the psychological contract in the organisational context.

### **The function of the psychological contract**

The primary function of the psychological contract has been described in a number of ways. For example:

- 'Psychological contracts represent an essential feature of organisational life, serving to bind individuals and organisations together and to regulate their behaviour' (Robinson, Kraatz, & Rousseau 1994).

- ‘The psychological contract acts to sustain the employment relationship over time’ (Rousseau & Wade-Benzoni 1994).
- ‘The psychological contract enables the human side of organisations to function smoothly and is particularly important in times of uncertainty and risk such as during corporate restructuring’ (Morrison 1994).
- ‘Psychological contracts act in a similar manner to hygiene factors. Good contracts may not always result in superior performance but poor contracts tend to act as demotivators and can be reflected in lower commitment and heightened absenteeism and turnover’ (Sparrow 1996a).
- Psychological contracts help to accomplish two tasks — i.e. they help to predict the kinds of outputs employers will get from employees, and they help to predict what kind of reward the employee will get from investing time and effort in the organisation (Sparrow & Hiltrop 1997).

Predictability, as suggested by Sparrow and Hiltrop, contributes significantly to the employment relationship created by psychological contracts. Predictability is a critical underpinning to motivation. To be motivated, an employee should be able to predict that performance will result in desired outcomes (Vroom 1964). Predictability, understanding and a sense of control are also key factors in preventing stress (Sutton & Kahn 1986) and in developing trust (Morrison 1994). Morrison argues that predictability, reliability, credibility, loyalty and trust all reinforce one another. These factors are essential for a continued harmonious relationship between the employee and the organisation.

The need for predictability may in fact underlie the development of psychological contracts. It has been suggested (Shore & Tetrick 1994) that psychological contracts

give employees the feeling that they are able to influence their destiny in the organisation, since they are party to the contract and can choose whether to carry out their obligations.

It is commonly proposed that the psychological contract affects employee satisfaction, attitudes and behaviour through constant review of the exchange relationship between employer and employee (Anderson & Schalk 1998). The idea of this exchange relationship is derived from models arising out of social psychology — for example, the inducement-contribution model (March 1958), Homans' Social Exchange Theory (Homans 1974) and Adams Equity Theory (Adams 1965). Without consideration being given to the 'employer perspective', the development of a psychological contract in the minds of employees — that is, a picture of what they owe the organisation and what the organisation owes them in return — can result in perceptions of inequity in the exchange relationship. To retain balance in the psychological contract, any perceived increase in employee obligations to the organisation needs to be matched by a perception of increased rewards. If increases in employee obligations are determined as exceeding increases in employee rewards, it is possible to assume that a negative shift has occurred in the psychological contract. This situation, in turn, is likely to result in a decrease in perceived obligations to the organisation, as witnessed in employee withdrawal of organisational citizenship behaviours (OCBs) or in employees' leaving the organisation. Organ (1988) proposes that the withdrawal of OCBs will negatively affect organisational performance.

The potential cost to organisations of withdrawal of OCBs may explain why much of the literature relating to psychological contracting emphasises the importance of

employee commitment. Commitment, as an employee obligation, can be defined as the relative strength of an individual's identification with and involvement in a particular organisation characterised by:

- strong acceptance or a belief in an organisation's goals and values that is often operationalised in terms of attachment to or pride in the organisation — that is, affective commitment (Meyer & Allen 1984)
- willingness to exert effort on behalf of the organisation
- a strong desire to maintain membership of the organisation, or continuance commitment (Meyer & Allen 1984).

Continuance commitment, which may exist with or without associated affective commitment, may be maintained by a lack of alternatives to the employee's current job (Newell & Dopson 1996). In this case, negative attachment, characterised by an intention to remain accompanied by little intention of meeting organisational demands, may exist (Newell & Dopson 1996). These writers suggest that in times of recession and rationalisation, when a negative shift is perceived in the psychological contract, managers in particular are likely to move from affective to continuance commitment (and possibly negative attachment).

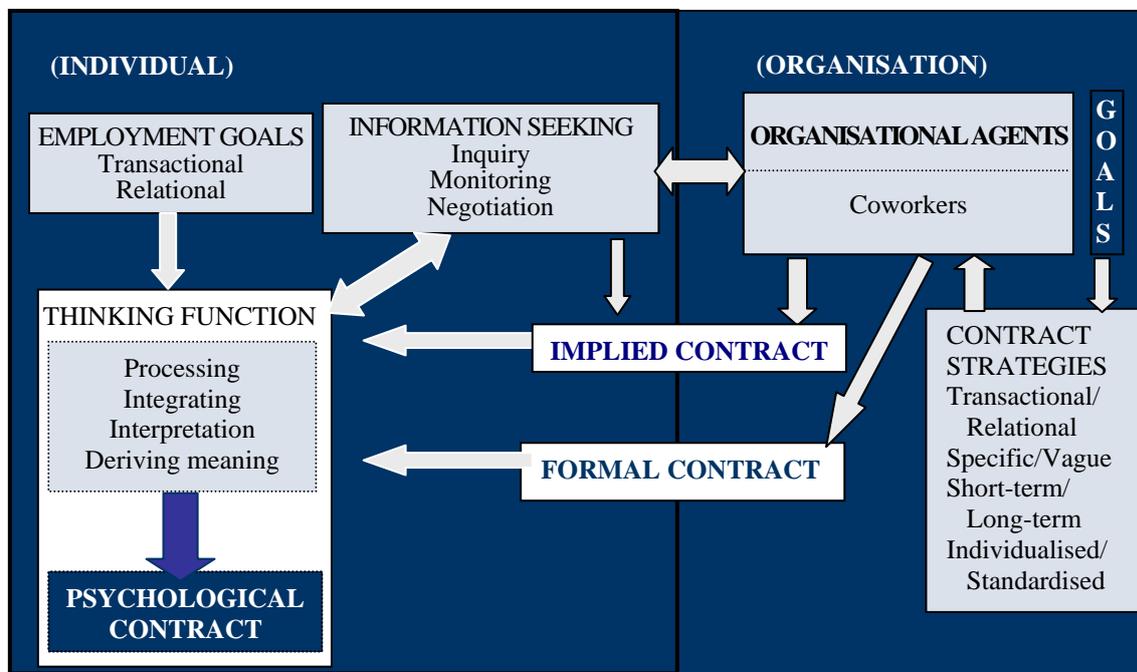
In the next section we will look at the way in which the complex phenomenon of the psychological contract develops before and during an employee's term of employment with an organisation.

### The development of the psychological contract

Psychological contracts first emerge during pre-employment negotiation and are refined during the initial period of employment. The development of the

psychological contract is illustrated in figure 2. Potential employees and organisational agents enter the employment relationship with a set of expectations about the potential relationship. These expectations may be transactional (monetary) and/or relational, and will influence the development of the psychological contract. The dynamic nature of the interaction between the parties to the contract, together with organisational goals and environmental conditions and the goal orientation of the individual, influence the development of the psychological contract (Shore & Tetrick 1994). During their employment with a particular organisation, employees will seek, process, integrate, interpret and derive meaning from information gained from a number of sources, such as co-workers, supervisors and recruiters, as well as the implied and formal employment contract. From this process employees will create their individual interpretations of their obligations and entitlements — that is, their psychological contract with the organisation.

**Figure 2: The Development of the Psychological contract**



Shore, L and Tetrick, L, 1994, The psychological contract as an explanatory framework in the employment relationship, *Trends in Organisational Behaviour*, Vol 1, Cooper, C and Rousseau, D (Eds), John Wiley & Sons Ltd, New York, Figure 7.1, p 97)

Figure 2 illustrates the link between organisational goals and psychological contracts. In times of organisational change, particularly in large, previously stable organisations such as banks and insurance companies, a change in organisation goals can lead to the development of a mismatch in perceptions of obligations between employer and employee. This occurs in part because the development of a psychological contract is a 'deliberate, goal-oriented process' (Shore & Tetrick 1994) through which employees attempt to establish an agreement with their employing organisation to suit their own employment objectives. It might be suggested that this, in turn, influences the type of person who applies for work with an organisation. The concept of particular types of psychological contracts prevailing within a given organisation is supported in the literature (McLean Parks 1993; Mclean Parks, Tsui, Porter, Pearce & Tripoli 1993; Rousseau & Wade-Benzoni 1994).

Employees often hold on to the terms of the psychological contract that operated at time of hire, and subcultures can form around employees according to time served in the organisation, since those with similar tenure can be expected to share similar perceptions of the terms of the psychological contract (Rousseau & Greller 1994b). Tenure, and perhaps age, may therefore influence employee perception of the terms of the psychological contract.

Given the importance to the employee–employer relationship of the psychological contract, attention will now be turned to the content of the psychological contract.

## **The content of the psychological contract**

The literature provides little agreement over the content of the psychological contract. Such contracts are deemed to be voluntary, subjective, informal and dynamic (Hiltrop 1996), with elements being added and deleted over time as employee and employer expectations change (Robinson et al. 1994; Herriot 1995).

Considerable agreement does exist in the literature, however, on the following components of the 'traditional' psychological contract:

- Individual employees are expected to provide hard work, loyalty and commitment, or sacrifice.
- The organisation is expected to provide high pay, advancement, training and development, and job security (Randle 1997; Rousseau 1989; Makin, Cooper & Cox 1996) in Marks, Findlay, Hine, McKinlay & Thompson 1997).

The current relevance of these components of the traditional psychological contract will be discussed in a later section of this paper.

Contracts can be categorised as either transactional or relational (MacNeil 1985).

*Transactional* contracts contain terms of exchange that can be given a monetary value, are specific and exist for a limited duration. The essence of the transactional components of the psychological contract can be expressed as 'a fair day's work for a fair day's pay' (Rousseau & Wade-Benzoni 1994) or as the 'effort exchange/effort bargain' — that is, the reciprocal process of exchanging effort for reward (Marks et al. 1997). By contrast, *relational* contracts contain terms that may not be easily monetisable, and broadly concern the relationship between the individual employee and the organisation (Guzzo & Noonan 1994). This type of contract can be

characterised by a focus on open-ended relationships involving considerable investments by employees and employers (for example, loyalty, commitment and trust in management on behalf of the employee, and job security and training on behalf of the employer (Rousseau & Wade-Benzoni 1994).

The distinction between these two types of contracts can also be drawn with respect to the type of exchange. Transactional contracts are linked with *economic exchange*, while relational contracts are associated with *social exchange* (McLean Parks & Kidder 1994; Rousseau 1989 ; Rousseau & McLean Parks 1993). Economic exchange is based on the assumption that transactions between parties are not long-term or ongoing events (Emerson 1981). Emerson suggests that ‘obligations, trust, interpersonal attachment or commitment to specific exchange partners are not incorporated into economic exchange frameworks’ (p. 35). Economic exchange frameworks are commonly believed to typify the transactional components of the psychological contract. Blau (1964) defines social exchange as occurring when an individual who supplies rewarding services obligates the receiver of these services, and to discharge this obligation, the ‘receiver’ must, in turn, furnish benefits to the supplier. Unlike economic exchange, social exchange focuses on contingent and reciprocal exchange incorporating mutual obligation, trust, attachment and commitment to exchange partners. Social exchange is normally associated with the relational components of the psychological contract.

Rousseau and McLean Parks (1993) have proposed that the relative proportion of transactional versus relational elements within the psychological contract will depend on factors such as:

- employment status
- duration of the employer–employee relationship
- the HR benefits and practices of the organisation.

HR practices that are limited to basic work-related needs, and that may be described as fulfilling the explicit employment contract, concern the transactional component of the psychological contract. Those HR practices that exceed the employee's basic needs and are not contained in the employment agreement comprise the relational component of the contract.

The transactional and relational components of the psychological contract are not independent (Guzzo & Noonan 1994). The transactional terms of the contract can influence the kinds of relational rewards expected by the employee. For example, a manager who is asked to take on additional responsibilities may expect his or her chances of promotion to be increased. Guzzo and Noonan (p. 452) stress that the fulfilment of the psychological contract in both transactional and relational terms influences employee loyalty and commitment. In the context of the impact of restructuring on middle management positions, it could be hypothesised that when a negative shift occurs in the transactional component of an employee's psychological contract, there is little he or she can do to address the imbalance in transactional elements. For example, decreased effort or performance may worsen the situation. Hence, employees facing such a situation may withdraw some or all of their contribution to the relational component of the psychological contract with their employer.

Considerable debate has focused on the content of the transactional and relational components of the psychological contract. Table 1 provides an overview of elements that have been proposed by a selection of authors as transactional or relational components of the psychological contract.

Herriot and Pemberton (1995a) argue that employers are becoming less committed to a relational framework. Empirical evidence of this trend can be found in finance sector organisations where long-term, loyalty-based relationships for middle managers in particular are being abandoned in place of more monetisable and specific transactional agreements that emphasise explicit links between extrinsic rewards and employee performance (Hallier & James 1997; Turnley & Feldman 1998). This type of transition from the 'old' to the 'new' psychological contract will be discussed further in the following section.

**Table 1: Summary of psychological contract content items**

Author	Transactional		Relational	
	Employee contribution	Employee reward	Employee contribution	Employee reward
Robinson, 1996; Robinson, Kraatz and Rousseau, 1997	Giving advance notice of intention to leave Willingness to accept a transfer Refusal to support organisation's competitors Protection of proprietary information	Promotion and advancement High pay Pay based on current level of performance	Spending a minimum of two years with the organisation Working extra hours Loyalty Volunteering to do non-required tasks	Training Long-term job security Career development Sufficient power and responsibility Support with personal problems
Randle, 1997, Rousseau, 1989 Makin, 1996 Marks et al, 1997	Sufficient effort		Loyalty Commitment (affective) Commitment (continuance)	Opportunity for advancement Training and development Job security
Mumford, 1995	Skills and knowledge	Good working conditions Satisfactory relationship with work (job satisfaction)	Loyalty Enthusiasm Motivation	Sense of achievement Responsibility Recognition
McFarlane Shore, 1994		Competent management Opportunity to demonstrate competence		
Maguire, 1998	Reasonable workload Reasonable number of hours worked Moderate level of stress	Appropriate level of autonomy Affiliation with colleagues	Trust in management	Sense of belonging

Note: Items have not been repeated i.e. only those items not already included by previous authors are listed for each author.

## **The ‘old’ versus the ‘new’ psychological contract**

Spindler (1994, p. 328) claims that the ‘old’ psychological contracts based on the exchange of security for compliance have been shattered, with the new contract only now being established. Considerable agreement can be found in the literature for such a proposition. For example:

- ‘The old cradle-to-grave psychological contract...is gone’ (Waxler & Higginson 1993).
- ‘the bond between employer and employee has significantly changed, if not weakened’ (DeMeuse & Tornow 1990).
- ‘the traditional bond between employers and employees rested upon a premise that has been revealed as unworkable’ (Soroohan 1994).
- ‘Loyalty to the company has given way to looking out for oneself’ (Kanter & Mirvis 1989).
- The psychological contract between employer and employee in terms of reasonably permanent employment for work well done is truly being undermined (Cooper 1997).

Sims (1994) describes traditional psychological contracts as having existed in organisations characterised by stability, predictability and growth. The workforces of such organisations were seen as permanent, and employee loyalty was built on guarantees of long-term employment and investment in training. Employee commitment was the norm and employees expected advancement within the organisation. Sims adds that today’s leaner organisations offer limited opportunities for advancement, and employees have learned that job security can no longer be guaranteed even for good performers.

Several authors refer to a dramatic revision in psychological contract provisions (DeMeuse & Tornow 1990; Burack 1993; Burack & Singh 1995). In the past the psychological contract was characterised by employees exchanging cooperation, conformity and performance for tenure and economic security. Such a dependent relationship virtually assured employee loyalty (Singh 1998). The terms of the new contract are not yet settled, but the new responsibility of employers is said to be evolving towards creating opportunities for employees to take care of themselves (Ehrlich 1994). The following summary of this evolving relationship between employer and employee (Kissler 1994) is based on the work of a number of authors (see Table 2).

**Table 2: Kissler’s (1994) distinction between old and new characteristics of psychological contracts**

Old contract	New contract
Organisation is ‘parent’ to employee ‘child’	Organisation and employee enter into ‘adult’ contracts focused on mutually beneficial work
Employee’s identity and worth are defined by the organisation	Employee’s identity and worth are defined by the employee
Those who stay are good and loyal; others are bad and disloyal	The regular flow of people in and out is healthy and should be celebrated
Employees who do what they are told will work until retirement	Long-term employment is unlikely; expect and prepare for multiple relationships
The primary route for growth is through promotion	The primary route for growth is a sense of personal accomplishment

Sparrow (1996) also attempts to differentiate between old and new contracts (see table 3) based on the work of a range of authors (Rousseau 1989; Ehrlich 1994; Kissler 1994; Morrison 1994; Sims 1994; Rousseau & Greller 1994b; Sparrow 1996a).

In a further attempt to differentiate between old and new psychological contracts, Hiltrop (1996) questioned a group of middle managers attending a workshop at the International Institute for Management Development in Lausanne. She found that the keywords used to describe the old contract were stability, permanence, predictability, fairness, tradition and mutual respect, while the new contract was described as a short-term relationship with an emphasis on flexibility, self-reliance and achievement of immediate results (Hiltrop 1996).

**Table 3: Sparrow's (1996) differentiation between old and new psychological contracts**

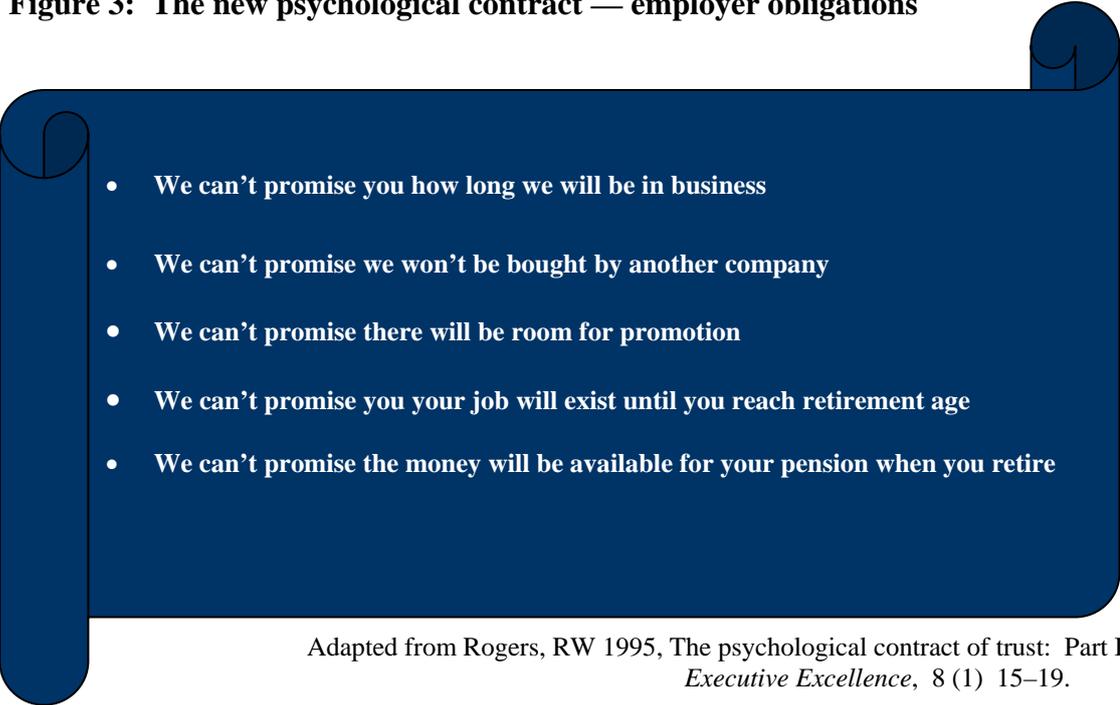
Contract element	Old contract	New contract
Change environment	Stable, short-term focus	Continuous change
Culture	Paternalism, time served, exchange security for commitment	Those who perform get rewarded and have contract developed
Rewards	Paid on level, position and status	Paid on contribution
Motivational currency	Promotion	Job enrichment, competency development
Promotion basis	Expected, time served, technical competence	Less opportunity, new criteria, for those who deserve it
Mobility expectations	Infrequent and on employee's terms	Horizontal, used to rejuvenate organisation, managed process
Redundancy/tenure guarantee	Job for life if perform	Lucky to have a job, no guarantees
Responsibility	Instrumental, employees exchange promotion for more responsibility	To be encouraged, balanced with more accountability, linked to innovation
Status	Very important	To be earned by competence and credibility
Personal development	The organisation's responsibility	Individual's responsibility to improve employability
Trust	High trust possible	Desirable, but expect employees to be more committed to project or profession

Hiltrop describes the new 'self-reliance' orientation as far removed from the 'organisation man' (Whyte 1956) concept of the 1960s according to which employees were expected to invest themselves completely in their company while the company did whatever was necessary to ensure that the employee succeeded in his or her job

and career This increased need for self-reliance among employees permeates most distinctions between the traditional and emerging psychological contracts.

Perry Pascarella (1988), editor-in-chief of *Industry Week*, sums up the terms of the new psychological contract from the perspective of employer obligations (see figure 3).

**Figure 3: The new psychological contract — employer obligations**

- 
- We can't promise you how long we will be in business
  - We can't promise we won't be bought by another company
  - We can't promise there will be room for promotion
  - We can't promise you your job will exist until you reach retirement age
  - We can't promise the money will be available for your pension when you retire

Adapted from Rogers, RW 1995, The psychological contract of trust: Part I, *Executive Excellence*, 8 (1) 15–19.

The way in which the psychological contract changes in response to organisational employment practices and other factors will be discussed in the next section.

## **Change and the psychological contract**

While the content of the psychological contract may be difficult, if not impossible, to define in periods of stability, the perceived terms often become painfully obvious when a breach of the contract is believed to have occurred. In such a case, the contract may be portrayed as a 'highly emotionally charged construct' (Sparrow 1996a).

In times of organisational change, psychological contracts assume an increasingly important role in employment relationships (Robinson 1996). The terms of the employment agreement are being repeatedly managed, renegotiated and altered to fit changing circumstances (Tichy 1983; Altman & Post 1996). Within such a dynamic environment, organisations may become less willing and/or less able to fulfil all of their promises to employees. Non-fulfilment of promises is referred to as 'breach of contract', and evidence has been found that the majority of employees currently believe that their employer has breached some aspect of their employment agreement (Robinson & Rousseau 1994).

Much of the concern that has been focused on the changing nature of the employment relationship over the past decade has concentrated on decreased job security and the associated lower levels of employee commitment that are claimed to be caused by organisational restructuring. There is widespread acknowledgement in the literature that changes in the *psychological contract* between workers and their organisations have not benefited employees (Turnley & Feldman 1998). Employees appear to be disadvantaged by a situation in which employers want employee involvement and loyalty but without offering in return a guarantee of job tenure and advancement (Hiltrop 1996). While employee entitlements appear to be decreasing, competitive

pressures are leading organisations to demand greater commitment, initiative and flexibility from their employees (Schor 1992).

As described in the previous section, psychological contracts are not static (Guzzo; Noonan & Elron 1994). As the HR practices of an organisation respond to changing environmental conditions and as employees gain experience, employees will closely scan their existing psychological contracts in order to re-evaluate and renegotiate both their own and their employer's obligations (Rousseau & McLean Parks 1993). This process is supported in the literature by social information processing theory (Salancik & Pfeffer 1978), which suggests that information obtained by employees through observing their own behaviour and that of their employer will alter employees' perceptions of what they owe the employer and what they are owed in return (Robinson et al. 1994).

As HR practices and societal changes bring about alterations to employees' expectations of what they owe and are owed by the organisation, a sense of employee outrage commonly emerges (Rousseau & Greller 1994b). Rousseau and Greller explain that such a reaction results from the fact that employees are being asked to bear risks that were previously carried by the organisation. At the same time, reward systems do not appear to have compensated for this situation. Even if, in future, greater employee risk is offset by the opportunity for greater rewards, some employees may be 'so risk averse that no amount of reward sharing would offset the discomfort' (Rousseau & Greller 1994b).

The impact of HR or societal change on the psychological contract is complicated by the diversity of such contracts that may exist within the organisation. Since employment conditions change over time, different generations of employees may have varying expectations of obligations and entitlements (Rousseau & Greller 1994a). However, Rousseau and Greller suggest that even where varying expectations exist, organisations will normally support a number of core contract terms, such as job security, that create a status quo that becomes extremely difficult to change without contract violation.

The terms of the contract may also be affected by growing resentment among employees facing constant, often mismanaged change. Turnley and Feldman's study revealed that bank managers had developed high levels of resentment because they felt that the organisation was continually revising its performance criteria (Turnley & Feldman, 1998). Resentful employees are likely, subconsciously at least, to downgrade their perceived obligations and to increase perceptions of their entitlements.

Employee cynicism about organisational change has been defined as 'an attitude of pessimism and hopelessness towards future organisational change induced by repeated exposure to mismanaged change attempts' (Wanous, Reichers & Austin 1994).

Cynicism has been described as both a generalised and specific attitude involving frustration, disillusionment and negative feelings towards, and distrust of, a person, group or objects (Andersson & Bateman 1997). Andersson and Bateman (1997) point out that job dissatisfaction and cynicism share an element of frustration. However, cynicism is anticipatory and directed outward while job dissatisfaction is retrospective

and self-focused (Wanous et al. 1994). Results of a study by Reichers et al. (table 4) show that cynicism about organisational change has negative consequences for commitment, satisfaction and motivation among employees.

**Table 4: Reichers, Wanous and Austin's 1997 study of cynicism in the workplace**

	High cynicism N = 209	Low cynicism N = 226
High job satisfaction	42.8%	85.3%
Organisational commitment	38.9%	84.9%
Participation in decision-making	28.5%	53.2%

When one considers the two concepts of psychological contracting and cynicism, a somewhat negative prediction can be made about the success of organisational change. Previous sections have addressed the trend from relational to transactional contracts brought about by organisational change. This trend is reinforced by the likelihood that cynicism will also decrease commitment and credibility for organisational leaders. However, the literature would also suggest that more transactional contracts focusing on the exchange relationship might enjoy limited success given, for example, the decreased effectiveness of compensation systems as a motivator. The essential difference between the two concepts may lie in the fact that cynicism is created through a response to a 'history of change attempts', whereas a single change initiative may bring about changes in the psychological contract. Does it then follow that change to the psychological contract results from initial change but if employees see such change as mismanaged, then subsequent change efforts may result in both changed psychological contracts and organisational cynicism?

Sims (1994) summarises the effects of change on the psychological contract as follows:

*The unilateral cancellation of the implied contract profoundly affects the surviving employees. Some of their most basic tenets — beliefs in fairness, equity and justice — have been violated. Their sense of security has been destroyed; their identity and self-esteem are threatened; and they mistrust their organisations' managements. For some, the contract has become null and void.*

There is general agreement within the literature that psychological contracts are changing as a result of organisational change initiatives and societal factors. In the next section, the challenges posed by the changing psychological contract are discussed.

## Challenging issues associated with the changing psychological contract

### *The role of middle management*

Middle managers play a critical role in redefining and regulating change in the employee–employer relationship (Hallier & James 1997). Therefore, in times of organisational change the attitudes and behaviours of middle managers assume great importance.

For middle managers, the traditional psychological contract has been based on loyalty and commitment to the organisation in return for strong expectations of job security and career progression linked to increased status and increased rewards (Newell & Dopson 1996). Such strong expectations do not sit well with a workforce experiencing layoffs at record rates (McLean Parks & Schmedemann 1994). Recent economic conditions have resulted in the demise of jobs that once offered real, long-term security (Fetterman & Lawlor 1991). Consequently, the preferential treatment

once afforded managers has diminished and become less easy to distinguish from the conditions of subordinate workers (Hallier & James 1997). The removal of middle management positions from organisations has been referred to as the 'massacre of the mid-ranks' (Toffler 1990) and as 'organisational liposuction' (Kissler 1991).

Middle managers appear not only to have become more vulnerable to job loss but also to have become the group whose psychological contract has been most severely violated. Research has shown that changes to the psychological contract between managers and their organisations have left managers feeling that they work harder and under tighter controls but without receiving compensation for the increased job pressure. A 1998 study by Turnley and Feldman found that managers in restructured organisations felt that their psychological contract had been violated in a number of areas, including:

- responsibility and power
- input into decision making
- job security
- opportunities for advancement.

The strong sense among middle managers of violation of the psychological contract may be the result of a number of factors. First, middle managers, as stated above, have been disproportionately affected by changes such as restructuring, downsizing, redundancy and outsourcing. Second, middle managers are a group of employees who had previously been 'immune' from the effects of organisational restructuring. Third, middle managers, particularly in the finance sector, are likely to have had lengthy tenure within their organisations. These employees may therefore have become

'bound to specific jobs through such standard personnel policies as seniority policies' (McLean Parks & Schmedemann 1994). Human capital theory explains that the longer an employee stays with a specific employer, the fewer are his or her options in the job market. Long-serving employees are therefore likely to both expect and depend on job security (Gordon & Lee 1990; Glendon & Lev 1990; Shapiro & Tune 1974). Part of the difficulty experienced by managers in downsized and/or restructured organisations may also stem from the fact that these employees may hold dual allegiances — that is, allegiance to their employing organisation and loyalty to the employees they manage (Rousseau & Wade-Benzoni 1994). It could be argued that managers in service organisations may also hold a third allegiance — to their customers. With two or three layers of allegiance, adjustments to the psychological contract are likely to become more complex.

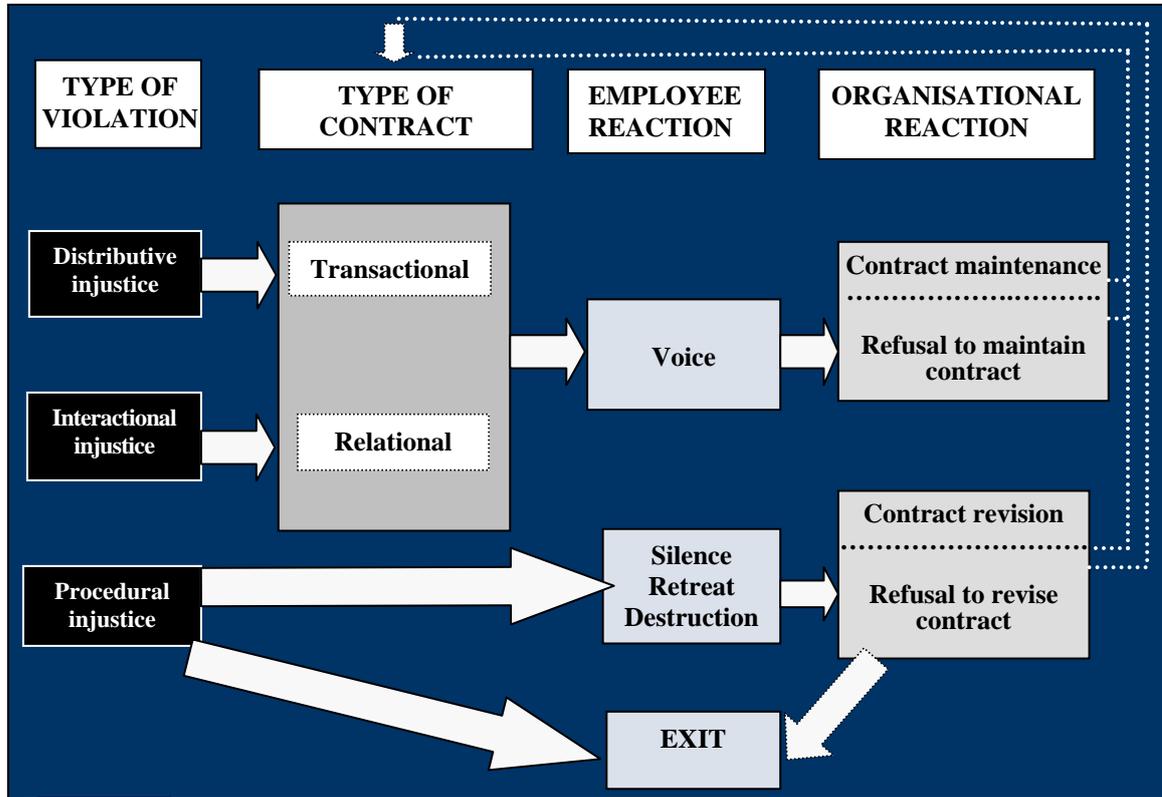
### ***Managing employee response to change and alterations to their psychological contract***

Two approaches can be taken to determining how employees will respond to changes in the psychological contract. The *situational* approach suggests that situational variables play a crucial role in determining employee responses by modifying the relationships between violations of the psychological contract and employee reactions. The *content* approach posits that the type of violation will determine how employees will respond (Turnley 1996).

The literature suggests that there are five potential employee responses (figure 4) to contract violation (Robinson & Morrison 1993) — voice, silence, retreat, destruction and exit. *Voice* is described as an action orientation in which an attempt is made to maintain and reinstate the psychological contract. *Silence, retreat, destruction and exit*

are referred to as state orientations in which employees attempt to survive the violation by lowering their, or their employer's, perceived obligations or by withdrawing from the employment relationship (Shore & Tetrick 1994).

**Figure 4: Shore and Tetrick's schematic representation of the response to violation of the psychological contract**



Shore, L and Tetrick, L, 1994, The psychological contract as an explanatory framework in the employment relationship, *Trends in Organisational Behaviour*, Vol 1, Figure 7.2: Schematic representation of the response to violation of the psychological contract, p 103

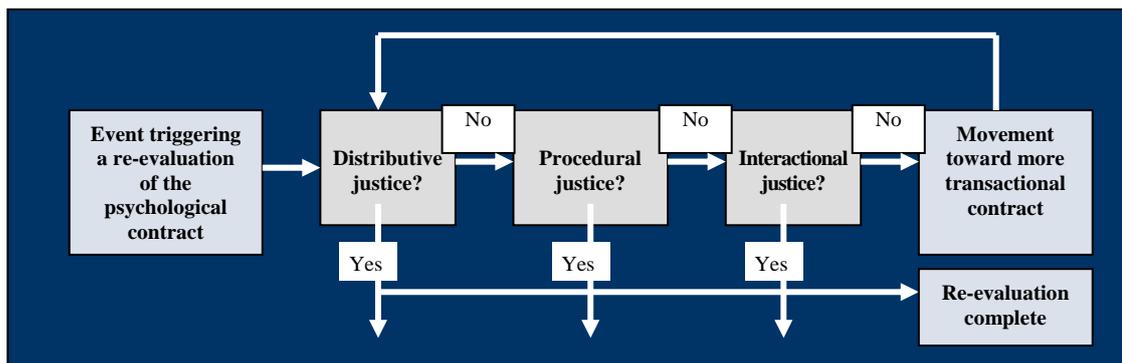
Shore and Tetrick's first proposition in the model illustrated in figure 4 is that employee response will in part be affected by the type of violation. Based on the organisational justice literature (Bies 1987; Greenberg 1990; Sweeney & McFarlin 1993), McFarlane Shore and Tetrick (1994, pp. 103–4) argue that there are three types of violation. These are:

- distributive injustice, comprising unfulfilled transaction obligations that usually have specific monetisable outcomes

- procedural justice, comprising an assessment of the fairness of procedures through which outcomes have been allocated
- interactional justice, which assesses the interpersonal treatment received during implementation (Bies 1987).

A fourth type of justice needs to be considered with respect to violation of the psychological contract. The effort by one party to the contract to inhibit contract violation by imposing significant and potentially painful consequences is referred to as retributive justice (Leatherwood & Spector 1991; Trevino 1992). The existence of retributive justice may explain why employees who believe their psychological contracts have been violated, and who as a consequence demonstrate a lack of loyalty and commitment to their organisations, continue to contribute considerable effort. The consequences of reduced effort (which is far more observable than commitment or loyalty) could well be the loss of their jobs or demotion. McLean Parks and Kidder (1994) illustrate the relationship between the various types of justice/injustice in figure 5.

**Figure 5: Re-evaluation of relational psychological contracts in asymmetric power situations**



Adapted from McLean Parks, J and Kidder, D 1994, 'Till death us do part...' — Changing work relationships in the 1990s. In Cooper, CL and Rousseau, DM (Eds). *Trends in Organisational Behaviour*, vol. 1. New York, John Wiley and Sons.

Parks and Kidder argue that in transactional contracts procedural justice and interactional justice may not be considered, irrespective of symmetric or asymmetric power, because of the short-term nature of the contract. They also suggest that, in the

case of relational contracts with symmetric power, an assessment of procedural justice may not occur. Symmetric power produces a state comparable to bilateral deterrence (Lawler 1986). The fact that one's contracting partner holds equal power discourages contract violations, so that if a perceived breach does occur the violated party will attempt to restore balance in accordance with equity theory (Adams 1965) or to renegotiate the terms of the contract. However, situations of symmetric power are rare under current labour market conditions.

Following an event trigger, such as organisational restructuring or downsizing, it is hypothesised that employees assess the event outcomes. If principles of distributive justice appear to have been upheld, the re-evaluation may be completed at this point. If, however, an employee perceives distributive injustice (a discrepancy between employee and employer contributions), procedural justice will then be assessed. If the procedures used to allocate outcomes are understood as fair, the re-evaluation process may terminate. If, however procedural justice is perceived as not being upheld, the employee will assess interactional justice. If this assessment reveals that the interpersonal treatment received during implementation was beyond reproach, the re-evaluation process will be complete. In the event of perceived interactional injustice, however, there is likely to be a marked shift towards a more transactional contract, with employees withdrawing from the relational aspects of their psychological contract. This will create a much more critical assessment of distributive justice.

The McFarlane Shore and Tetrick model (figure 5) suggests that, after the type of violation, the next most significant influence on employee response to violation may be the type of contract — specifically, whether the contract is largely transactional or

relational in nature. McFarlane Shore and Tetrick draw here on the work of Robinson, Kraatz and Rousseau (1994), which suggested that reactions to violation of short-term transactional contracts may be less intense and more 'amenable to revision' than violation of long-standing relational contracts based on mutual trust. McFarlane Shore and Tetrick's work also suggests that distributive injustice is of greater importance to employees whose psychological contracts are principally transactional, whereas interactional and procedural injustices will assume greater importance for those with relational contracts who may be prepared to discount small incidents of distributive injustice.

McFarlane Shore and Tetrick's model (figure 5) suggests that employee voice response may be met by the organisation's agreeing to maintain or reinstate the contract, or by its refusal to maintain the contract, in which case the employee response may change to a state orientation — that is, silence, retreat or destruction. Organisational reaction to a state orientation could mean a revision of the terms of the psychological contract (which is likely to occur where employees have considerable power — perhaps in the form of rare skills or expertise). Alternatively, the organisation may refuse to revise the contract. Theoretically, this would lead to employee exit; however, such a reaction is largely determined by labour market conditions and how long the employee has worked in the organisation.

There is general agreement in the literature that violations of the psychological contract are negatively related to trust, organisational citizenship behaviour, employee relational obligations and employee withdrawal behaviour, as well as to intentions to

quit and other disaffections (Robinson & Morrison 1993; Robinson & Rousseau 1994; Robinson et al. 1994; Guzzo et al. 1994).

There is also general agreement that employee response to perceived violation will be influenced by:

- the type of violation
  - the size of discrepancy
  - the degree of assessed organisational responsibility for the unmet obligations (McFarlane Shore & Tetrick 1994)
  - the likelihood of future violations (Floodgate 1994)
  - positive working relationships with colleagues (Floodgate 1994).
- Content approach
- Situational approach

### ***Norm of reciprocity***

Robinson et al.'s study found greater support for the fact that employees' perceptions of their obligations decreased over time while their employers' obligations increased (instrumental perspective), than for the norm or reciprocity perspective, which suggests that both employee and employer obligations would increase over time (p. 145). This finding confirms employees' perception of tenure, or time spent with the organisation, as itself an important contribution in that it should be reciprocated with increasing entitlements over time.

From an instrumental perspective, it could be argued that employees would be likely to increase their expectations of their employer in proportion to their time spent with a particular organisation. Robinson, Kraatz and Rousseau (1994) suggest that this occurs because of employees' desire to maintain equity between contributions and rewards. Continued employment (continuance commitment — a component of the psychological contract) is an increasingly valuable contribution that the employee

perceives as enhancing their entitlement. A change in a relational component of the psychological contract (in this case, continuance commitment) therefore influences employees' perception of equity, which may in turn lead to a change in perception of entitlement under the transactional (increased pay) and relational (increased opportunity for advancement) components of the psychological contract.

### ***Identifying the terms of the new contract***

Uncertainty over the terms of the psychological contract is not new. However, it is increasingly unclear what employees and organisations owe one another 'because the traditional assumption of job security and steady rewards in return for hard work and loyalty no longer exist in most cases' (Sims 1994).

The common perception among employees that their psychological contracts have been breached may result from the fact that while the expectations that organisations have of their employees for hard work, loyalty and commitment are basically unchanged, the benefits exchanged for such contributions have changed. In the case of middle managers, for example, increased hours and stress levels have commonly been met with reduced opportunities for advancement, minimal job security, and reduced training and development.

It could be assumed that if the types of inducements offered by the organisation change, a change in employee contributions could be expected in order to maintain perceived equity in the relationship.

### *Employee commitment*

In times of recession and rationalisation, managers may suffer 'unilateral variations of their psychological contracts' that result in a move away from affective commitment towards continuance commitment (Newell & Dopson 1996). Given their perception that hard work is no protection from layoff, employees are no longer prepared to attach themselves to the organisation (Waxler & Higginson 1993). Such negative impacts of restructuring could have serious consequences, since the very factors that are causing the change in role and psychological contract of middle managers mean that organisational survival is increasingly dependent on the innovation, creativity and commitment of this group of workers (Newell & Dopson 1996).

Organisations have been accused of treating employees as 'emotionally anorexic' (Kidd 1998). Such accusations result from the fact that HR departments have tended to ignore the implications of HR practices on the creation of psychological contracts (Fineman 1995). Failure to consider the implications for the psychological contract could prove costly for organisations in the current changing organisational environment, and this makes it difficult for organisations to specify all conditions of employment at time of hire. Lack of definition of conditions may lead employees to 'psychologically' fill in more of the blanks in the employment contract, creating a strong possibility of divergence between the organisation's and the employee's understanding of the contract (Rousseau & Greller 1994b).

## **Implications for HR management**

Often in managing organisational change, HR practices focus clearly on changes to employees' jobs and career prospects. Situational factors such as commitment of employees to the change process and satisfaction with the change process make important contributions to withdrawal of employee commitment, loyalty, trust, pessimism and powerlessness. HR managers need to pay increased attention to the development of employee trust and the management of situational factors to avoid many of the negative consequences of organisational change.

### ***Developing employee trust***

Considerable research has been conducted into the impact on organisations of psychological contract breach (Robinson & Rousseau 1994; Robinson 1996; Sparrow 1996a). It has been argued that the intensity of the reaction to these violations results not only from unmet expectations of entitlements but also from 'more general beliefs about respect of persons, codes of conduct and other patterns of behaviour associated with relationships, involving trust' (Rousseau 1989).

Robinson (1996, p. 2) integrated various definitions of trust (e.g. Frost, Stimpson & Maughan 1978; Barber 1983; Gambetta 1988) to coin her own definition of trust:

*One's expectations, assumptions or beliefs about the likelihood that another's future actions will be beneficial, favourable, or at least not detrimental to one's interests.*

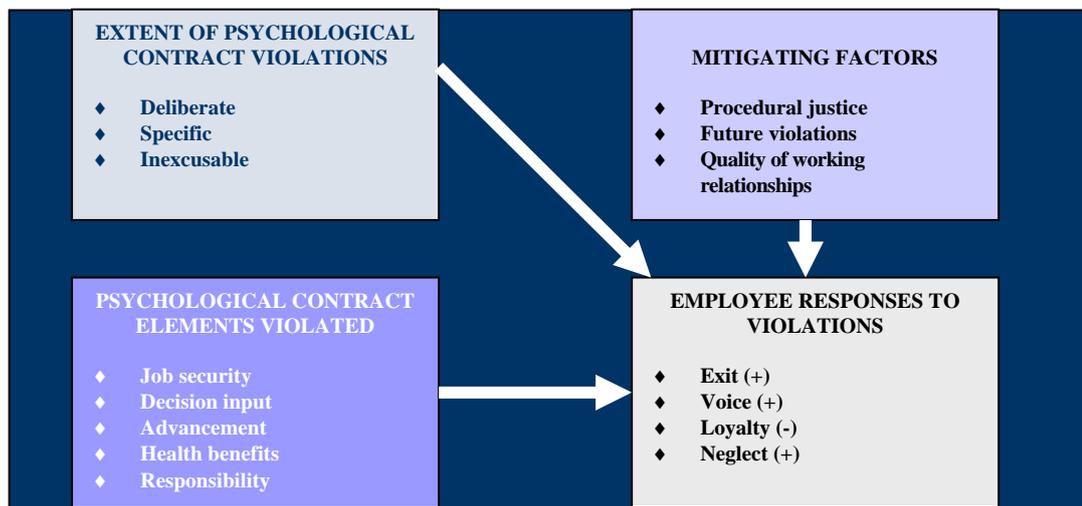
Robinson (1996) suggests that trust plays a significant role in the subjective experience of psychological contract breach by one's employer. Robinson claims that employees with low levels of trust are likely to be more vigilant in identifying breaches and more likely to perceive a breach even when there is none because such a

finding would be consistent with low levels of trust. Lack of trust results in employees losing confidence that their contributions will be reciprocated as promised by the employer (Robinson 1996). Trust is based on the implicit assumption that others in one's social relationships have respect and concern for one's welfare (Barber 1983; Gambetta 1988). Such an assumption is taken for granted and usually unacknowledged until violated (Garfinkel 1963; Luhmann 1979; Zucher 1986).

***Monitoring the situational factors***

Turnley and Feldman (1998) draw on previous research in the area of layoffs (Leana & Feldman 1992; Brockner, Grover, O'Malley, Reed & Glynn 1993) to support the findings of their own study, which suggested that 'employees react less negatively to changes in psychological contracts when they attribute the violations to legitimate, external events outside the organisation's control' (p. 81). Turnley and Feldman's model is illustrated in figure 6.

**Figure 6: Turnley and Feldman's model summarising results of their 1998 study**



Source: Turnley, W and Feldman, D 1998, Psychological contract violations during corporate restructuring, *Human Resource Management*, 37 (1) 82.

If the Turnley and Feldman model is placed within the context of the *type* of psychological contract (i.e. largely relational or transactional) and if interactional

justice is added to the list of mitigating factors, a succinct summary of much of the literature on psychological contract violation is created. It should be noted, however, that the 'psychological contract elements violated' would depend not only on the type of contract involved but also on the organisational context in which the violation occurred. The model, which adopts the situational approach, also has much to offer management of those organisations involved in change events that are likely to trigger breach and/or violation of the psychological contract. If management can convince employees that:

- obligations cannot be met because of compelling external environmental factors, and the organisation was compelled to introduce such change in order to survive
- procedures allocating the outcomes of such change were fair and open
- people involved in the change process were managed in a manner consistent with the notions of trust
- future violations were unlikely,

then negative consequences of violation of the psychological contract could be minimised. This is important at a time when employees are being told there is no job security and no chance of promotion and that no job is safe from being reorganised, re-engineered, recombined, flattened or simply eliminated (Navran 1994). Reactions in such circumstances may include distrust resulting from the breach of implied promises, vulnerability or powerlessness, pessimism and loss of morale and motivation. Such reactions can result in dire consequences for restructured or downsized organisations that need the efforts and commitment of remaining employees in order to survive in a highly competitive environment. Turnley's work suggests that employee perceptions of the way in which the restructuring process is managed may be an important determinant of employee reaction.

## **Future directions**

The human resource objectives of the organisation of the future are likely to emphasise guiding employees towards an attitude of 'self-employment' (Kets de Vries & Balazs 1997). Employees are encouraged to keep their work experience as up-to-date as possible so that they are better equipped to secure a new job if laid off. Kets de Vries suggests that shorter term employment contracts may be initiated, offering limited job security for a defined period of time. The ramifications of such contracts are yet to be fully understood, but concern has been expressed about the following aspects of the 'new' psychological contract:

- Increasing demands for a flexible workforce create a need for additional skills training. However, skills are expensive to develop and, in the absence of job security, newly trained employees may not remain long enough for the organisation to recoup the training costs (Cappelli 1997).
- The new contract may not prove suitable for those who have a strong need for connectedness and affiliation (Kets de Vries & Balazs 1997).

The new contract may prove unworkable. Employers, under increasing pressure in dynamic environments of increasing competition, will want an agreement under which they will pay salaries for only as long as necessary and will opt out of the burden of providing more than minimal employee benefits, while employees will have little incentive to do more than the minimum and will be unlikely to develop loyalty or to be highly productive (Tornow & DeMeuse 1994).

The role of the organisation in the new psychological contract is subject to debate. If the new 'protean' career contract is with the self rather than with the organisation (Hall & Moss 1998), what role will the organisation play? Hall and Moss define the

protean career as being independent and directed by the needs and values of the individual, with success described as internal (psychological). Given this definition, the organisation may be seen as having an obligation to provide the opportunity for continuous learning to assist in employability. However, as argued earlier, organisations may question the financial incentive for developing their employees' careers; what little research has been done suggests that organisations do not see career development as an important part of their business strategy (Smith 1997).

In most discussions of the new psychological contract, the term 'employability' has replaced the concept of job tenure. William J. Morin, Chair and CEO of Drake Beam Morin, describes this new concept as 'non dependent trust', whereby employees take responsibility for their own careers and organisations give them the tools to do so.

Employee perceptions of obligations and entitlements may also be affected by changes that transcend the workplace (Cappelli 1997). Cappelli claims that the Protestant work ethic may have been replaced by a view of work as a source of personal satisfaction. Empirical data appear to support this claim; in a US survey of workers 49 per cent of respondents regarded having a job that they enjoyed as a measure of personal success, yet a decade earlier the percentage of respondents in this category barely registered (Yankelovich 1993). If work is becoming an increasingly important source of personal satisfaction, it is likely that intrinsic rewards such as recognition, sense of achievement, relationship with colleagues, autonomy and opportunities for personal growth will become important employee expectations along with job satisfaction. These rewards are rarely mentioned in the literature with respect to the content of the psychological contract, yet one could expect that they are of considerable importance

to employees, and particularly to middle managers. In addition, as the ability of organisations to promise traditional employee rewards such as job security and extensive training diminishes, new rewards are likely to be sought, and these traditional intrinsic employee rewards are more likely to find their way into the psychological contract through information gained by employees through organisational agents at the recruitment and induction stages of their working life.

As a result of the negative shift in the terms of their employment relationship, many workers are now staying with their organisations only because alternative opportunities are so poor that they have nowhere else to go (Morrison 1994). The sense of dependency and fear experienced by these employees reflects a perceived employer breach of the employment contract that workers feel powerless to redress (Kissler 1994). In order to secure and retain a committed workforce, organisations need employees who are working for the organisation because they want to, not because they have no other option (Spindler 1994). Morrison (1994) poses the question of whether, when the economy improves, there is likely to be an exodus of leadership from downsized organisations in which the terms of the psychological contract have deteriorated.

## **Conclusion**

The relationship between organisations and their employees has undoubtedly undergone dramatic change in recent decades, particularly in white-collar industries. The co-dependency between employee and organisation that provided the major underpinning of the psychological contract has weakened considerably.

If employees move towards the new protean career, organisations may be loath to invest in training and development programs for employees because of a perceived lack of continuance commitment among employees. Taken to the extreme, this could produce a highly transient workforce in which employees are simply attracted to the organisation offering the highest rewards. In this situation, the psychological contract may take on far less importance than traditionally. An increasingly transient workforce, however, has considerable dollar costs for organisations. Careful research may be needed by organisations into the types of rewards that will attract employee loyalty and both affective and continuance commitment, and into the content, operation and organisational advantages offered by the psychological contract.

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