

# PSYCHOLOGICAL CONTRACTING: Is it still an important organisational phenomenon?

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## ABSTRACT

*Current business environments are testing the relevance of the traditional psychological contract between employees and organisations. Commitment, previously the cornerstones of many psychological contracts, is diminishing in importance as organisations pursue increasingly transactional relationships with employees and as employees move towards 'protean' careers. The question of whether these more self-serving organisational and personal strategies diminish the importance of the 'psychological contract' is addressed. The paper concludes, firstly, that such contracts continue to make an important contribution to organisational relationships but that organisations must seek ways of adjusting the terms of such contracts to meet the needs of an increasingly mobile and protean workforce. A second conclusion is that the psychological contract can play an important part in creating the 'agile' enterprise.*

## WHAT IS THE PSYCHOLOGICAL CONTRACT?

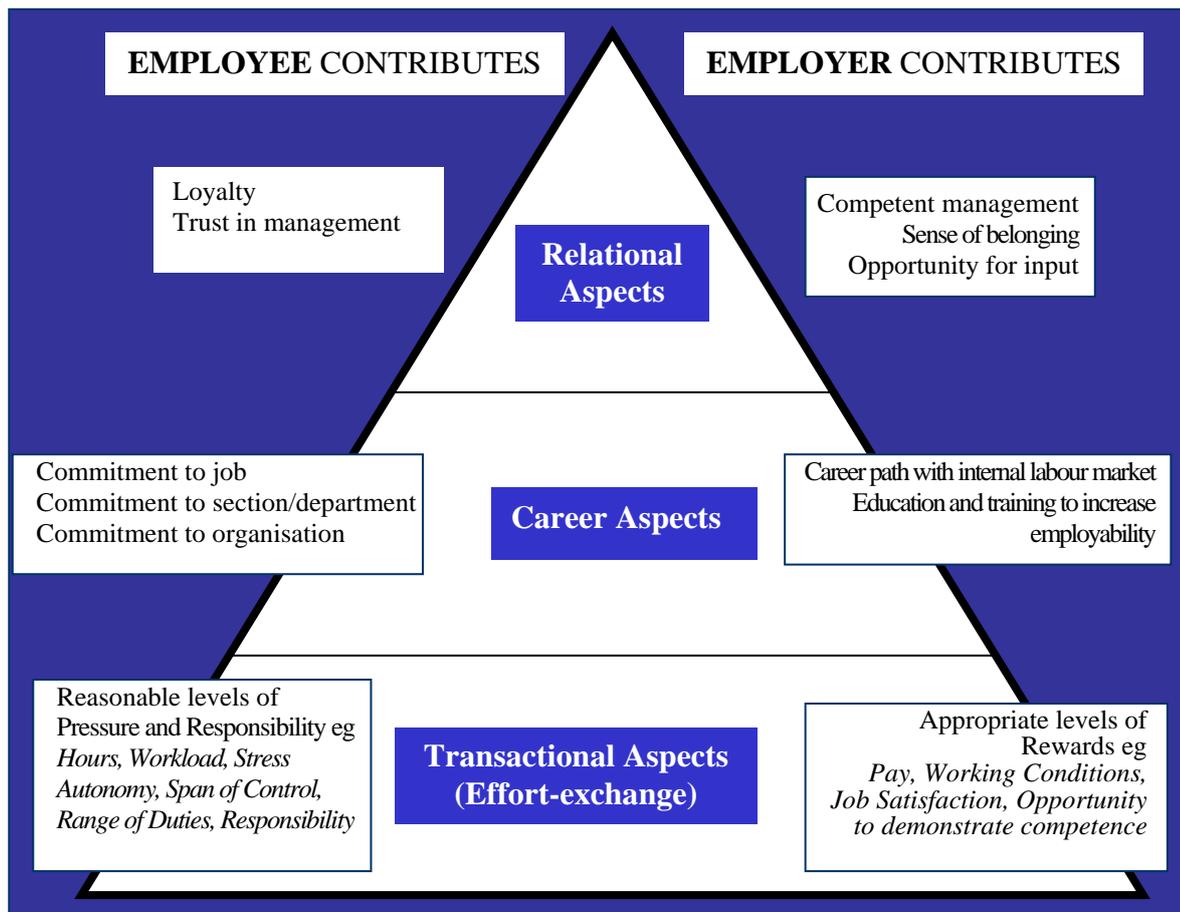
The employment relationship can be described as an exchange relationship (Mowday, Porter, and Steers, 1982), which runs the entire contract spectrum from strictly legal to purely psychological (Spindler, 1994). Many aspects of the relationship between an organisation and its employees are covered by legislation, enterprise agreements or an employment contract signed by the employee detailing aspects such as hours, salary and benefit plans. However, there are always likely to be aspects of the employment relationship which are confined to the subconscious (Spindler, 1994). This 'hidden' aspect of the employment exchange (Eisenberger, Huntington, Hutchison, and Sowa, 1986; Greenberg, 1990) has come to be known as the psychological contract (Argyris, 1960; Schein, 1980; Rousseau, 1989).

The psychological contract can be described as the set of expectations *held by the individual employee* which specifies what the individual and the organisation expect to give to and receive from each other in the course of their working relationship (Sims, 1994). As such, psychological contracts form an important component of the relationship between employees and their organisations.

Psychological contracts differ from other types of contracts not only because of the innumerable number of items they may contain but also because the employee and the employer may have differing expectations in respect to the employment relationship. Few items which make up the psychological contract are likely to have been specifically discussed so most items are only inferred and are subject to change as both individual and organisational expectations change (Goddard 1984; Rousseau 1990; Sims 1990; 1991; 1992). Whilst the individual employee believes in a specific type of psychological contract or reciprocal exchange agreement, members of the organisation may not share the employee's understanding of the contract (Rousseau and McLean Parks 1993)

Based on a wide range of relevant literature Maguire (2001) developed a three-tier model of the psychological contract (Figure 1). The model proposes that, at the most basic level, employees were assumed to contribute reasonable levels of pressure and responsibility, incorporating reasonable hours, manageable workload, moderate levels of stress, appropriate autonomy, reasonable span of control, manageable range of duties and appropriate responsibility in return for appropriate levels of rewards eg appropriate level of pay, suitable working conditions, job satisfaction and the opportunity to demonstrate competence. This aspect of the psychological contract is referred to as the transactional component (Rousseau and Wade-Benzoni, 1994).

**Figure 1: 3-tier model of the psychological contract**



The second tier of the psychological contract – career aspects – refers to the exchange of commitment (to the job, their branch/department, and to the organisation and its goals) on behalf of the employee in return for a career path within an internal labour market (if applicable) and/or education and training to increase employability.

The third tier of the psychological contract model incorporates the relational aspects of the contract. The model proposes that employees would, at the relational level, contribute loyalty and trust in management in return for competent management, the opportunity for input into decision-making and a work culture that provided a sense of belonging.

The relevant importance of the various tiers of the psychological contract will depend to some extent on the type of work the employee carries out and the position held by the employee in the organisational hierarchy.

The transactional, career and relational components of the psychological contract interact (Guzzo and Noonan, 1994). Changes in the transactional terms of the contract can influence the kinds of relational rewards expected or obligations perceived by the employee. For example, when an employee is given extra tasks or more stressful work without additional compensation or increased prospects of promotion this is likely to be regarded as a negative shift in the transactional component of the employee's psychological contract. There may be little he/she can do to address the imbalance in respect to transactional items. For example, should employees be tempted to decrease effort or performance level to reduce the imbalance, this may act to worsen the situation. It is likely, in such a situation, that employees will withdraw some or all of their contribution to the relational component of the psychological contract by reducing commitment, loyalty or trust in management. It is this interactivity between transactional and relational components of the psychological contract which has the potential to create problems for organisations in times of organisational change.

### WHAT FUNCTIONS DOES THE PSYCHOLOGICAL CONTRACT FULFIL?

Much has been written about the function of the psychological contract. Relevant works include those by Robinson, Kraatz and Rousseau (1994), Rousseau and Wade-Benzoni (1994), Morrison (1994), Sparrow (1996a), Sparrow and Hiltrop (1997). Sparrow (1996a) claims that psychological contracts underpin the work relationship and provide a basis for capturing complex organisational phenomena by acting 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 and Hiltrop (1997) suggest that psychological contracts help employees to predict the kind of rewards they will receive for investing time and effort in the organisation. Having created perceptions of expected rewards, 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 because they can choose whether to carry out their obligations. These last two points are closely related. Predictability is important to motivation i.e. an employee needs to be able to predict that performance will result in desired outcomes (Vroom 1964). Predictability has also been suggested as a key factor in preventing stress (Sutton and Kahn 1986) and as an important factor in the development of trust (Morrison 1994).

One problem with the ability of the psychological contract to project predictability into employee's perceptions of perceived rewards is that this need for predictability creates a pull towards past expectations and a resultant resistance to change (Morrison, 1994). This resistance to change impacts upon the ability of the psychological contract to accurately capture organisational phenomena in times of organisational change.

### CHANGE AND THE PSYCHOLOGICAL CONTRACT

Organisational change may impact heavily upon employees' psychological contracts. When change occurs, social information processing theory suggests that employees will alter their perceptions of what they owe the employer and what they are owed in return (Salancik and Pfeffer, 1978; Robinson, Kraatz and Rousseau, 1994). As the human resource practices of an organisation respond to changing environmental conditions and as employees gain experience, they will reappraise their existing psychological contracts in order to reevaluate and renegotiate both their own and their employer's obligations (Rousseau and McLean Parks, 1993). This scanning process commonly results in a sense of employee outrage (Rousseau and Greller, 1994b) as a reaction to the

fact that employees are being asked to bear risks which were previously carried by the organisation or to increase effort without reward systems compensating for such a situation. Employees' ability to predict the rewards likely to be received in return for time, effort, loyalty and commitment is decimated.

To retain balance in the effort exchange, in organisations experiencing employment market slack, employees are unlikely to decrease effort in the post restructuring work environment because of the lack of alternative employment opportunities. Hence it is likely that relational aspects of employee input are likely to be affected. Commitment is likely to feature amongst these relational aspects. Commitment 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; willingness to exert effort on behalf of the organisation; and a strong desire to maintain membership of the organisation (Mowday, Porter, and Steers 1982). The first characteristic of commitment i.e. 'belief in an organisation's goals and values' is often operationalised in terms of attachment or pride in the organisation (Cook and Wall, 1980) and is commonly referred to as affective commitment. The desire to maintain membership of the organisation can be operationalised in terms of past and future tenure intentions and is referred to as continuance commitment (Meyer and Allen 1984). Continuance commitment can often be maintained by a lack of alternatives to the employees' current jobs (Newell and Dopson 1996). Newell and Dopson refer to this situation as negative attachment. They suggest that in times of rationalisation, managers in particular are likely to move from affective to continuance commitment and possibly negative attachment.

Research has shown that organisations can reduce any negative impact on the psychological contract of organisational change. An empirical study of organisational change and the impact on the psychological contract conducted by Maguire (1999) found that it is not so much the change in employees' jobs or career prospects which destroy commitment, loyalty and trust in management but rather the opportunity employees have had for input into the process, their perceptions of management competence and their sense of belonging to the organisation together with their commitment to and satisfaction with the change process itself.

### THE 'OLD' V THE 'NEW?' PSYCHOLOGICAL CONTRACT

The key differences between the 'traditional' and the 'new' concepts of the psychological contract relate to the decreased expectation of paternalistic human resource practices, the replacement of the concept of organisational worth with 'self worth', the substitution of personal accomplishment for promotion as the route to growth and the decreased importance of tenure.

How important will relational aspects be to the new psychological contract? If employees are anticipated to become more loyal to themselves within the new protean career and organisations withdraw from long term commitment to employees, how important is the psychological relationship between employee and organisation? It could be suggested that, as relationships between organisation and employees become more transactional, organisations will need to develop relationships at the relational level to prevent employees becoming free agents in constant search of the highest bidder for their services.

**Table 1: Sparrow's (1996) differentiation between old and new psychological contracts**

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

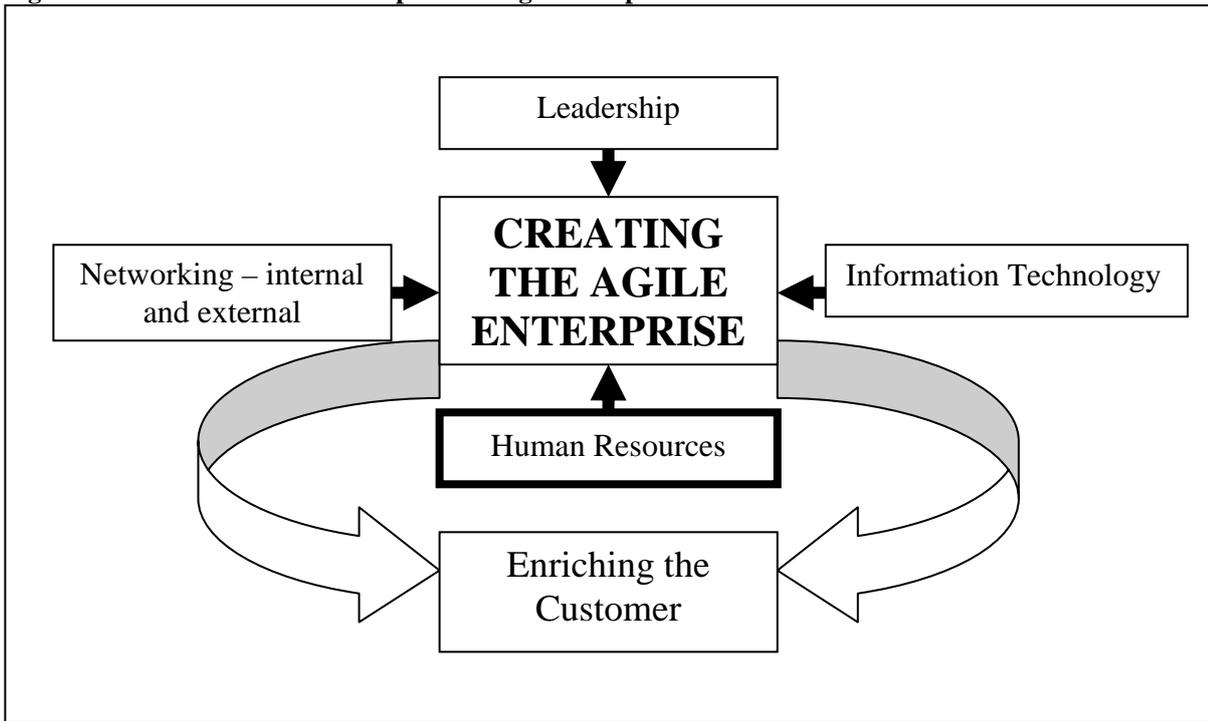
## PSYCHOLOGICAL CONTRACTING AS A MEANS OF ACHIEVING AGILITY

Over the last decade firms have placed greater emphasis on flexibility in order to meet undergoing changes to customer requirements. Those firms which can acquire the capability to respond quickly to unanticipated change have become known as 'agile' organisations. The importance of agility to organisations is emphasized by the work of Fliedner and Vokurka (1997) who noted that, because of the increasing dynamism of the global market, agility may emerge as the most competitive priority of the early twenty-first century. Goldman, Nagel and Preiss (1995) and Meade and Sarkis (1999) provided a model for the creation of agile business process. An adaptation of the Goldman et al model is provided in Figure 2.

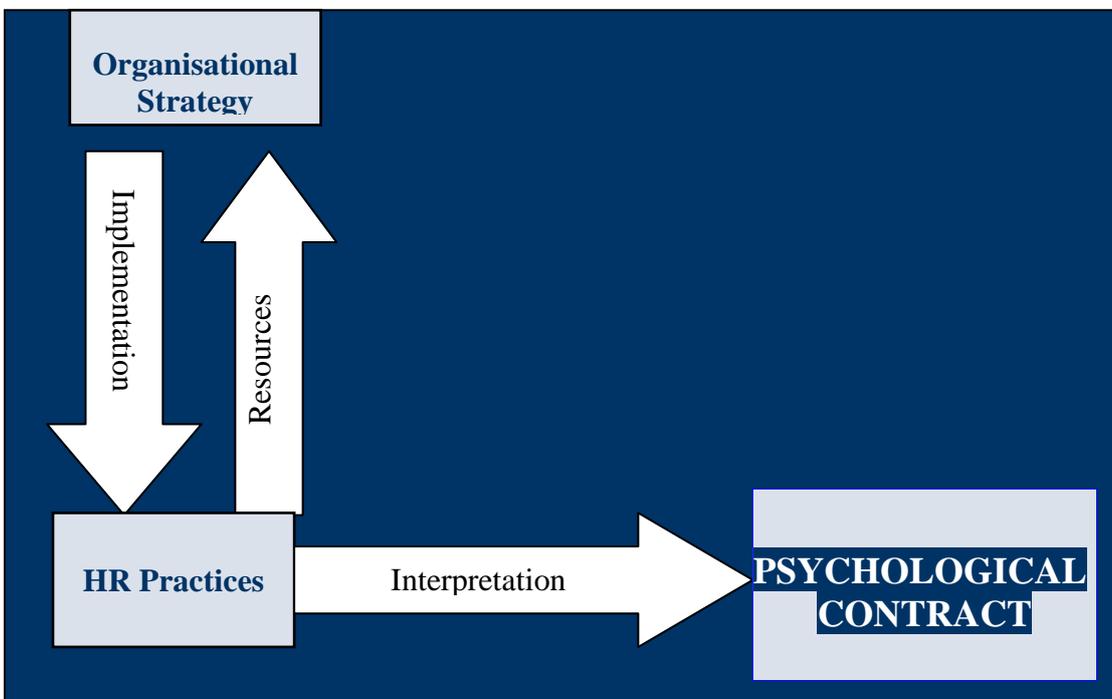
The ultimate aim of the agile business process is to enrich the customer ie to understand the unique requirements of each individual customer and to rapidly provide them (Fliedner and Vokurka, 1997). This may be seen as a transition towards the company ceasing to sell products, as such, and focusing on selling its ability to fulfil customer's needs (Maskell, 2001). The human resources dimension of the Goldman model recognizes the importance of employees in creating an agile enterprise.

In order for change initiatives to succeed (including the transition to agility), new behaviours are required on the part of employees (Sims 1994). The creation of these new employee behaviours is initiated through the organisation's human resource (HR) practices (Rousseau and Wade-Benzoni 1994). However, actual change in individual employees' behaviour will be determined by interpretation of the employer's human resource practices. Such interpretation affects employee behaviour by altering perception of the terms of the individually held psychological contract (Figure 3).

**Figure 2: The dimensions and output of an agile enterprise**



**Figure 3: Relationship between strategy and employee’s psychological contract**



(Adapted from Rousseau, D M and Wade-Benzoni, K A, 1994, Linking strategy and human resource practices: How employee and customer contracts are created, *Human Resource Management*, Fall, Vol 33, No 3, Figure 1: Framework, p 464

Organisations have, however, been accused of treating employees as ‘emotionally anorexic’ (Kidd 1998) during periods of organisational change. Such accusations result from the fact that human resource departments have tended to ignore the implications of HR practices on employees’ psychological contracts (Fineman 1995).

In change environments, the commitment of top management as well as the engagement of all the company’s employees is an absolute necessity. Therefore it can be expected that in creating the agile organisation, significant problems could be encountered in ensuring the commitment and engagement of employees in the face of constant and unpredictable change. Hormozi (2001) suggests that employees resist change but that agile manufacturing requires employees to be creative and prepared to constantly challenge the way they (and others) perform their jobs. Such circumstances require close monitoring of employees’ psychological contracts to ensure alignment of organizational and individual employee goals. Since the psychological contract represents an employee’s perceptions of what he needs to contribute to the organisation and what he will receive in return (Maguire, 2001) any negative shift in the perceived terms of the psychological contract will result in reduced commitment and engagement. This situation in turn will reduce the potential for agility.

Using the HR component of an organisation to assist in attaining agility can be accomplished by paying careful attention to the concept of the psychological contract. The following suggestions can help in leveraging the impact of the human factor.

Firstly, it is important both in recruitment campaigns and in training sessions for existing employees that the transition to agility is referred to, explained and built into employee expectations of what their jobs are likely to become;

Secondly, employees should be involved, at every possible opportunity, in the decision-making process during the transition period. This will help retain trust in management and increase employee morale through increased opportunity for input. Trust in management as defined as confidence that others’ actions are consistent with their words, that those people with whom you work are concerned about your welfare and interests apart from what you can do for them (Rogers 1995) is critical in times of organisational change.

Thirdly, where agility is likely to demand employee flexibility, suitable training/retraining programmes should be implemented so that employees have ample opportunity to demonstrate competence.

## CONCLUSION

The terms of the psychological contract have no doubt altered. In order to buy commitment to the current job, employers will face the challenge of generating new terms for the psychological contract that put less emphasis on security and more on other sources of fulfilment (Bower, 1996). In order to meet increasing demands for flexibility, organisations may shy away from establishing relationships with employees based on job security and steadily rising income streams. However they still need the commitment of employees to ensure satisfactory levels of productivity.

The question is what can organisations offer in order to ‘purchase’ commitment. Consideration of such purchase options may not be of such importance when employees perceive that no better contract could be established elsewhere. However, in a slack labour market, such

decisions will become imperative. Training and continuous development is a high cost option in times of low continuance commitment and a highly mobile workforce. A lower cost alternative may be to ensure, particularly at the recruitment stage, that employees have realistic expectations of what their job will entail. This will need to be supplemented with considerable opportunity for employee input, the development of employee trust in management and organisational commitment to provide employees with the opportunity to demonstrate competence. New HR strategies, particularly in those organisations aiming for agility need to focus on these three new employee rewards in place of the traditional job security and a steadily rising income stream.

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