

# The psychological contract

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The employment relationship, as described in Chapter 15, is a fundamental feature of all aspects of people management. At its most basic level, the employment relationship consists of a unique combination of beliefs held by an individual and his or her employer about what they expect of one another. This is the psychological contract, and to manage the employment relationship effectively it is necessary to understand what the psychological contract is, how it is formed and its significance.

## THE PSYCHOLOGICAL CONTRACT DEFINED

Fundamentally, the psychological contract expresses the combination of beliefs held by an individual and his or her employer about what they expect of one another. It can be described as the set of reciprocal but unarticulated expectations that exist between individual employees and their employers. As defined by Schein (1965): 'The notion of a psychological contract implies that there is an unwritten set of expectations operating at all times between every member of an organization and the various managers and others in that organization.'

This definition was amplified by Rousseau and Wade-Benzoni (1994) who stated that:

Psychological contracts refer to beliefs that individuals hold regarding promises made, accepted and relied upon between themselves and another. (In the case of organizations, these parties include an employee, client, manager, and/or organization as a whole.) Because psychological contracts represent how people *interpret* promises and commitments, both parties in the same employment relationship (employer and employee) can have different views regarding specific terms.

Sparrow (1999b) defined the psychological contract as:

an open-ended agreement about what the individual and the organization expect to give and receive in return from the employment relationship... psychological contracts represent a dynamic and reciprocal deal... New expectations are added over time as perceptions about the employer's commitment evolve. These unwritten individual contracts are therefore concerned with the social and emotional aspects of the exchange between employer and employee.

Within organizations, as Katz and Kahn (1966) pointed out, every role is basically a set of behavioural expectations. These expectations are often implicit – they are not defined in the employment contract. Basic models of motivation such as expectancy theory (Vroom, 1964) and operant conditioning (Skinner, 1974) maintain that employees behave in ways they expect will produce positive outcomes. But they do not necessarily know what to expect. As Rousseau and Greller (1994) comment:

The ideal contract in employment would detail expectations of both employee and employer. Typical contracts, however, are incomplete due to bounded rationality, which limits individual information seeking, and to a changing organizational environment that makes it impossible to specify all conditions up front. Both employee and employer are left to fill up the blanks.

The notion of bounded rationality expresses the belief that while people often try to act rationally, the extent to which they do so is limited by their emotional reactions to the situation they are in.

Employees may expect to be treated fairly as human beings, to be provided with work that uses their abilities, to be rewarded equitably in accordance with their contribution, to be able to display competence, to have opportunities for further growth, to know what is expected of them and to be given feedback (preferably positive) on how they are doing. Employers may expect employees to do their best on behalf of the organization – ‘to put themselves out for the company’ – to be fully committed to its values, to be compliant and loyal, and to enhance the image of the

organization with its customers and suppliers. Sometimes these assumptions are justified – often they are not. Mutual misunderstandings can cause friction and stress and lead to recriminations and poor performance, or to a termination of the employment relationship.

To summarize, in the words of Guest and Conway (1998), the psychological contract lacks many of the characteristics of the formal contract: 'It is not generally written down, it is somewhat blurred at the edges, and it cannot be enforced in a court or tribunal.' They believe that: 'The psychological contract is best seen as a metaphor; a word or phrase borrowed from another context which helps us make sense of our experience. The psychological contract is a way of interpreting the state of the employment relationship and helping to plot significant changes.'

## THE SIGNIFICANCE OF THE PSYCHOLOGICAL CONTRACT

As suggested by Spindler (1994): 'A psychological contract creates emotions and attitudes which form and control behaviour.' The significance of the psychological contract was further explained by Sims (1994) as follows: 'A balanced psychological contract is necessary for a continuing, harmonious relationship between the employee and the organization. However, the violation of the psychological contract can signal to the participants that the parties no longer share (or never shared) a common set of values or goals.'

The concept highlights the fact that employee/employer expectations take the form of unarticulated assumptions. Disappointments on the part of management as well as employees may therefore be inevitable. These disappointments can, however, be alleviated if managements appreciate that one of their key roles is to manage expectations, which means clarifying what they believe employees should achieve, the competencies they should possess and the values they should uphold. And this is a matter not just of articulating and stipulating these requirements but of discussing and agreeing them with individuals and teams.

The psychological contract governs the continuing development of the employment relationship, which is constantly evolving over time. But how the contract is developing and the impact it makes may not be fully understood by any of the parties involved. Spindler (1994) comments that: 'In a psychological contract the rights and obligations of the parties have not been articulated, much less agreed to. The parties do not express their expectations and, in fact, may be quite incapable of doing so.'

People who have no clear idea about what they expect may, if such unexpressed expectations have not been fulfilled, have no clear idea why they have been disappointed. But they will be aware that something does not feel right. And a company staffed by 'cheated' individuals who expect more than they get is heading for trouble.

The importance of the psychological contract was emphasized by Schein (1965) who suggested that the extent to which people work effectively and are committed to the organization depends on:

- the degree to which their own expectations of what the organization will provide to them and what they owe the organization in return match that organization's expectations of what it will give and get in return;
- the nature of *what is actually to be exchanged* (assuming there is some agreement) – money in exchange for time at work; social need satisfaction and security in exchange for hard work and loyalty; opportunities for self-actualization and challenging work in exchange for high productivity, high-quality work, and creative effort in the service of organizational goals; or various combinations of these and other things.

The research conducted by Guest and Conway (2002) led to the conclusion that 'The management of the psychological contract as Schalk and Rousseau (2001) suggest, is a core task of management and acknowledged as such by many senior HR and employment relations managers, and shows that it has a positive association with a range of outcomes within the employment relationship and is a useful way of conceptualising that relationship.'

## THE NATURE OF THE PSYCHOLOGICAL CONTRACT

A psychological contract is a system of beliefs that may not have been articulated. It encompasses the actions employees believe are expected of them and what response they expect in return from their employer. As described by Guest *et al* (1996): 'It is concerned with assumptions, expectations, promises and mutual obligations.' It creates attitudes and emotions that form and govern behaviour. A psychological contract is implicit. It is also dynamic – it develops over time as experience accumulates, employment conditions change and employees re-evaluate their expectations.

The psychological contract may provide some indication of the answers to the two fundamental employment relationship questions that individuals pose: 'What can I reasonably expect from the organization?' and 'What should I reasonably be expected to contribute in return?' But it is unlikely that the psychological contract

and therefore the employment relationship will ever be fully understood by either party.

The aspects of the employment relationship covered by the psychological contract will include, from the employee's point of view:

- how they are treated in terms of fairness, equity and consistency;
- security of employment;
- scope to demonstrate competence;
- career expectations and the opportunity to develop skills;
- involvement and influence;
- trust in the management of the organization to keep their promises;
- safe working environment.

From the employer's point of view, the psychological contract covers such aspects of the employment relationship as:

- competence;
- effort;
- compliance;
- commitment;
- loyalty.

As Guest *et al* (1996) point out:

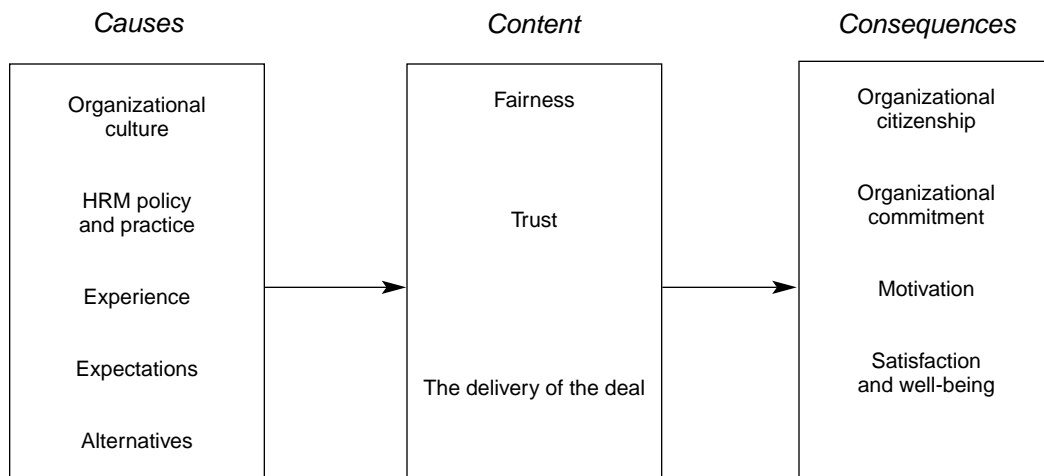
While employees may want what they have always wanted – security, a career, fair rewards, interesting work and so on – employers no longer feel able or obliged to provide these. Instead, they have been demanding more of their employees in terms of greater input and tolerance of uncertainty and change, while providing less in return, in particular less security and more limited career prospects.

### *An operational model of the psychological contract*

An operational model of the psychological contract as formulated by Guest *et al* (1996) suggests that the core of the contract can be measured in terms of fairness of treatment, trust, and the extent to which the explicit deal or contract is perceived to be delivered. The full model is illustrated in Figure 16.1.

## HOW PSYCHOLOGICAL CONTRACTS DEVELOP

Psychological contracts are not developed by means of a single transaction. There are many contract makers who exert influence over the whole duration of an employee's involvement with an organization. As Spindler (1994) comments:



**Figure 16.1** A model of the psychological contract

(Source: D Guest, N Conway, R Briner and M Dickman, *The State of the Psychological Contract in Employment: Issues in people management*, Institute of Personnel and Development, London, 1996)

Every day we create relationships by means other than formal contracts... As individuals form relationships they necessarily bring their accumulated experience and developed personalities with them. In ways unknown to them, what they expect from the relationship reflects the sum total of their conscious and unconscious learning to date.

The problem with psychological contracts is that employees are often unclear about what they want from the organization or what they can contribute to it. Some employees are equally unclear about what they expect from their employees.

Because of these factors, and because a psychological contract is essentially implicit, it is likely to develop in an unplanned way with unforeseen consequences. Anything that management does or is perceived as doing that affects the interests of employees will modify the psychological contract. Similarly the actual or perceived behaviour of employees, individually or collectively, will affect an employer's concept of the contract.

## THE CHANGING NATURE OF THE PSYCHOLOGICAL CONTRACT

Many commentators have delivered warnings about changes to the psychological contract that are not all advantageous to employees. And the nature of the psychological contract is changing in many organizations in response to changes in their external and internal environments. This is largely because of the impact of global competition and the effect this has had on how businesses operate, including moves into 'lean' forms of operation.

The psychological contract has not been an issue in the past because usually it did not change much. This is no longer the case because:

- business organizations are neither stable nor long-lived – uncertainty prevails, job security is no longer on offer by employers who are less anxious to maintain a stable workforce – as Mirvis and Hall (1994) point out, organizations are making continued employment explicitly contingent on the fit between people's competences and business needs;
- flexibility, adaptability and speed of response are all-important and individual roles may be subject to constant change – continuity and predictability are no longer available for employees;
- leaner organizations mean that careers may mainly develop laterally – expectations that progress will be made by promotion through the hierarchy are no longer so valid;
- leaner organizations may make greater demands on employees and are less likely to tolerate people who no longer precisely fit their requirements.

But, more positively, some organizations are realizing that steps have to be taken to increase mutuality and to provide scope for lateral career development and improvement in knowledge and skills through opportunities for learning. They recognize that because they can no longer guarantee long-term employment they have the responsibility to help people to continue to develop their careers if they have to move on. In other words they take steps to improve employability. Even those that have fully embraced the 'core-periphery' concept may recognize that they still need to obtain the commitment of their core employees and pay attention to their continuous development, although in most organizations the emphasis is likely to be on self-development.

Kissler (1994) summed up the differences between old and new employment contracts as follows:

*Old*

Relationship is pre-determined and imposed

You are who you work for and what you do

Loyalty is defined by performance

Leaving is treason

Employees who do what they are told will work until retirement

*New*

Relationship is mutual and negotiated

You are defined by multiple roles, many external to the organization

Loyalty is defined by output and quality

People and skills only needed when required

Long-term employment is unlikely; expect and prepare for multiple relationships

The following ways in which psychological contracts are changing have been suggested by Hiltrop (1995):

*From*

Imposed relationship (compliance, command and control)

Permanent employment relationship

Focus on promotion

Finite job duties

Meet job requirements

Emphasis on job security and loyalty to company

Training provided by organization

*To*

Mutual relationship (commitment, participation and involvement)

Variable employment relationship – people and skills only obtained or retained when required

Focus on lateral career development

Multiple roles

Add value

Emphasis on employability and loyalty to own career and skills

Opportunities for self-managed learning



Hiltrop suggests that a new psychological contract is emerging – one that is more situational and short term and which assumes that each party is much less dependent on the other for survival and growth. He believes that in its most naked form, the new contract could be defined as follows:

There is no job security. The employee will be employed as long as he or she adds value to the organization, and is personally responsible for finding new ways to add value. In return, the employee has the right to demand interesting and important work, has the freedom and resources to perform it well, receives pay that reflects his or her contribution, and gets the experience and training needed to be employable here or elsewhere.

But this could hardly be called a balanced contract. To what extent do employees in general have ‘the right to demand interesting and important work’? Employers still call the shots, except when dealing with the special cases of people who are much in demand and in short supply. In Britain, as Mant (1996) pointed out, ‘people often really are regarded as merely “resources” to be acquired or divested according to short-term economic circumstances’. It is the employer who has the power to dictate contractual terms unless they have been fixed by collective bargaining. Individuals, except when they are highly sought after, have little scope to vary the terms of the contract imposed upon them by employers.

Perhaps one of the most important trends in the employment relationship as expressed by the psychological contract is that employees are now being required to bear risks that were previously carried by the organization. As Elliott (1996) notes: ‘The most profound change in the labour market over the past two decades has been the massive shift in power from employee to employer. This has not only meant that workers have had their rights eroded, but also that much of the risk involved in a business has been shifted from capital to labour.’

## THE STATE OF THE PSYCHOLOGICAL CONTRACT

But the dire warnings about the state of the psychological contract referred to above were not borne out by three research projects commissioned by the Institute of Personnel and Development. The research conducted by Guest *et al* (1996) established that the psychological contract (defined in terms of workers’ judgements of fairness, trust and organizational delivery of ‘the deal’) was in better shape than many pundits suggest. A follow-up survey (Guest and Conway, 1997) found that a very high proportion of employees (90 per cent) believe that on balance they are fairly treated by their employers and 79 per cent say they trust management ‘a lot’ or ‘somewhat’ to keep its promises. Job security is not a major concern – 86 per cent feel very or fairly

secure in their jobs. A majority (62 per cent) believe that management and workers are on the same side and only 18 per cent disagree. However, job satisfaction was only moderate (38 per cent express high satisfaction, but 22 per cent express low satisfaction), although commitment to the organization was high (49 per cent felt 'a lot' and 36 per cent 'some' loyalty to their organization).

A further survey (Guest and Conway, 1998) established that:

- there had been no significant changes in attitudes and behaviour since the previous survey;
- workers continue to believe that they are fairly treated – 67 per cent report fair treatment by management and 64 per cent say that they get a fair day's pay for a fair day's work;
- the number of progressive HRM practices in place is the key determinant of whether workers believe they are fairly treated, because they exert a major influence on work attitudes;
- people report that home is for relaxation, work is for challenge;
- feelings of security remain high – 88 per cent felt very or fairly secure in their jobs;
- people still expect a career – 60 per cent believe that their employer has made a career promise and of these, 65 per cent think that management has largely kept its promise (these feelings are more prevalent amongst younger workers).

The overall conclusion of the researchers in 1998 was that 'the psychological contract is very healthy'. On the whole, management is seen as fair, trustworthy and likely to keep its promises. The key influences on a healthy psychological contract are the use of progressive human resource practices, scope for direct participation at work and working in a smaller organization.

## DEVELOPING AND MAINTAINING A POSITIVE PSYCHOLOGICAL CONTRACT

As Guest *et al* (1996) point out: 'A positive psychological contract is worth taking seriously because it is strongly linked to higher commitment to the organization, higher employee satisfaction and better employment relations. Again this reinforces the benefits of pursuing a set of progressive HRM practices.' They also emphasize the importance of a high-involvement climate and suggest in particular that HRM practices such as the provision of opportunities for learning, training and development, focus on job security, promotion and careers, minimizing status differentials, fair

reward systems and comprehensive communication and involvement processes will all contribute to a positive psychological contract.

Steps taken to manage the employment relationship as specified in Chapter 15 will also help to form a positive psychological contract. These include:

- defining expectations during recruitment and induction programmes;
- communicating and agreeing expectations as part of the continuing dialogue implicit in good performance management practices;
- adopting a policy of transparency on company policies and procedures and on management's proposals and decisions as they affect people;
- generally treating people as stakeholders, relying on consensus and cooperation rather than control and coercion.

## STATE OF THE PSYCHOLOGICAL CONTRACT 2004

The 2004 Workplace Employee Relations Survey (WERS, 2005) covering 700,000 workplaces and 22.5 million employees, surveyed 21,624 employees in workplaces employing more than 10 people about their level of job satisfaction. The results are shown in Table 16.1.

**Table 16.1** Job satisfaction (WERS, 2005)

	<b>Very satisfied</b> %	<b>Satisfied</b> %	<b>Neither</b> %	<b>Dissatisfied</b> %	<b>Very dissatisfied</b> %
Sense of achievement	18	52	19	8	3
Scope for using initiative	20	52	19	8	3
Influence over job	12	15	28	11	3
Training	11	40	26	16	7
Pay	4	31	26	28	13
Job security	13	50	22	11	5
Work itself	17	55	19	7	3
Involvement in decision-making	8	30	39	17	6

The only area in which there was more dissatisfaction than satisfaction was pay. A higher proportion than might have been expected (72 per cent) were satisfied or very satisfied with the work itself, and equally high percentages were satisfied with regard to having a sense of achievement and scope for using initiative.

People will feel that they have been treated justly if management's decisions and procedures are fair, consistent, transparent and non-discriminatory, and properly consider the views and needs of employees.