

# Emerging Employment Relationships: Issues & Concerns in Psychological Contract

Archana Tyagi & Rakesh Kumar Agrawal

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*Against the background of a changing business environment, the psychological contract between the employer and the employee is susceptible to be broken. It is important for managers and supervisors in organizations to have a proper appreciation of the nature and dynamics of the psychological contract and its implications on employee behavior and attitudes. This paper examines the theoretical underpinnings of the concept of psychological contract and the effects of its breach or violation. The implications on organizations and on the employer-employee relationship are also discussed. The paper also proposes a framework for further investigation of the transactional and relational elements of psychological contract construct.*

*Archana Tyagi* is from University of Business & International Studies, Geneva. E-mail: archana.tyagi@gmail.com. *Rakesh Kumar Agrawal* is Associate Professor (OB & HR). Institute of Management Technology, Ghaziabad, India 201001. E-mail: rkagrawal@imt.edu

## Changing Employment Relationship

Today, we are living in a transition period, a chaotic period of a new age defined by global competition, rampant change, faster flow of information and communication, increasing business complexity, and pervasive globalization. This new environment is characterized by “more far-reaching technological advances and a consumer who has adjusted to this quicker pace and whose fickle preferences are revised with the speed of a television commercial” (Pasternack & Viscio 1999). With these rapid changes, new dimensions in business space are constantly created, while some are destroyed. Forces such as technological breakthroughs, economic growth, market evolution, and shifts in customer tastes, social changes, and political events can expand or shrink business space. The change creates great opportunities, as well as competition and chances of failures. As a consequence of the pace and the nature of changes and evolutions in the economic and social environment in which organizations operate, the nature of the employment relationship is undergoing fundamental changes. Changing technologies,

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reengineering, shifting markets, global expansion, downsizing and many other factors have contributed to rapid changes in existing jobs and the creation of new ones. The role and composition of teams has expanded. Organizations are increasingly using contract labour and temporary staffing as a strategy to cope with cyclical changes as well as to manage costs and efficiencies. There are no fixed job definitions. Functional flexibility is the rule of the game. Project based teams are often the basic building blocks of the organizational structure and new methods of managing multiple generations are required.

These changes have implications in human resource management, both for the organization as well as for the employees. Companies no longer assure lifetime employment to their employees; neither do employees profess complete loyalty to the employer. In this context, considering that a talented and committed human resource base can be a competitive advantage, organizations must increasingly focus on designing policies and programmes to retain and motivate the workforce. They need to invest in talent knowing fully well that it could be the riskiest of investments. In the process of managing this risky investment, employers often make promises that are likely to be met only if the pace of growth in the business continues steadily

(Roehling et.al 2000, Schalk & Freese 1995). Expected growth in profitability and in opportunities is the fuel that feed the deal that employers might be able to offer employees. Yet recent economic downturns have evidenced the fact that growth may not be uninterrupted or steady, and managing of human resources may have to re-adjust to satisfy other stakeholders, particularly shareholders, by cutting down on promises made earlier. As a consequence, the nature of relationships between the employee and the employer is impacted.

In this scenario, managing changing employer-employee relationships has become one of the critical challenges facing organizations. Psychological contract presents an opportunity to examine the fundamental aspect of this employee-employer relationship. Interest in understanding the implications of psychological contract has blossomed due to its potential to describe, understand and predict the organizational implications flowing from employer-employee relationships. Research on the antecedents of psychological contracts has demonstrated that promises can come from a variety of sources, including organizational agents (e.g., recruiters, managers), actions (e.g., training, praise), and documents (Rousseau & Greller 1994, Rousseau & McLean-Parks 1993, Shore & Tetrick 1994). This paper seeks to examine the emerging employment relationships in organizations. Specifically, it seeks to elaborate upon and discuss the issues and concerns in psychological contract.

### **Psychological Contract: Definition & Dynamics**

Psychological contract is playing an increasingly important role in helping to define and understand the contemporary employment relationship (Millward & Brewerton 2000, Schalk & Freese 1995, Turnley & Feldman 2000). Psychological contracts involve beliefs about obligations that are “predicated on the perception that a promise has been made” (Rousseau & Tijoriwala 1998: 679). Researches have noted that the psychological contract is dynamic and that it naturally changes over time as a result of changing needs and relationships (Smithson & Lewis 2003). It refers to the way the employment contract is interpreted, understood and enacted by employees at the interface between themselves and their employing organization (Millward & Brewerton 2000). Psychological contracts emerge when individuals believe that their organization has promised to provide them with certain rewards in return for the contributions that they make to the organization (Turnley & Feldman 2000).

Psychological contract was first referred to by Argyris in 1960 in terms of the relationship between employer and employee. 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 organizations and their employees (Shore & Tetrick 1994). Psychological contracts are dynamic, once formed they

do not remain static but are constantly evolving through organizational experience. Rousseau, for example, who has been influential in psychological contract research, provides a much narrower definition, “The psychological contract is the employees’ perception of the mutual obligations existing with their employer” (Rousseau 1990:391). According to Rousseau (1995), psychological contracts can change without any formal effort to alter their terms. Contract ‘drift’ refers to internal changes, which happen naturally over time as part of the maturation process, personal development, ageing and the contract’s duration.

Basically, psychological contract offers a metaphor, or representation, of what goes on in the workplace and highlights important but often neglected features. It offers a framework for addressing ‘soft’ issues about managing performance; it focuses on people, rather than technology; and it draws attention to some important shifts in the relationship between people and organizations. It helps build the people dimension into thinking about organizational strategy. If people are bottom-line business drivers, their capabilities and needs should be fully integrated into the business process and planning. The purpose of business strategy becomes how to get the best return from employees’ energies, knowledge and creativity (CIPD 2009).

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### **Trust as Integral to Psychological Contract**

Valuing psychological contract implies that both employers and employees should value trust in the relationships. Trust can be conceptualized as a 'psychological state comprising the intention to accept vulnerability based upon positive expectations of the intentions or behaviour of another' (Rousseau et al. 1998: 395). Specifically, employers should pay attention in building employees' trust in their organizations. This means clarifying what is on offer, meeting commitments, or if necessary, explaining what has gone wrong and monitoring employee attitudes on a regular basis. Non-fulfillment of perceived obligations diminishes trust by compromising the values of integrity and benevolence which are important building blocks of trust (Mayer et al. 1995). Congruence between what has been promised and what the employees receive from the organization strengthens trust in the employee-organization relationship (Rousseau 1995).

### **Social Exchange in Psychological Contract**

While reviewing and understanding the psychological exchange model and discussing trust, it is important to understand the role of social exchange. According to the social exchange theory, a precursor for the development of positive employment relationships is that parties abide by certain rules of exchange (Blau 1964). The content of the exchange process can be purely eco-

nomie (e.g. money, goods and services) or more social in nature (e.g. information, advice and positive regard). If employees feel as though their outcomes are less than what they were promised (or that they are giving more than they are getting from the organization), they will restore equity by engaging in negative, withdrawn and/or counterproductive behaviors (Restubog et al. 2008). Research in organizational citizenship behavior (OCB) suggests that employees, when treated positively, do more than what is expected of them through the formal contractual relationship and engage in positive acts beneficial to the organization. For example, Organ's (1990: 63), "social exchange interpretation of organizational OCB", suggests that OCB's provide employees a means through which they might reciprocate the positive actions of employers who treat them well. In other words, social exchange theory suggests that employees are motivated to engage in extra-role behaviors when they perceive that their employment relationship is based upon the foundation of a fair social exchange (Moorman 1991, Organ 1988, 1990).

### **Psychological Contract Typology**

*Transactional Contract vs Relational Contract:* Psychological contracts can be categorized as either transactional or relational (Macneil 1985, Rousseau 1995). Transactional contracts are structured with emphasis on material rewards that have a short-term duration and relatively narrow in scope. Transactional contracts contain terms of exchange that can be given a monetary value, are spe-

cific, and exist for a limited duration of time. The essence of the transactional component of 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 1998)

*Relational contracts* are structured around less tangible rewards. These have a significant duration often without an implied end-date and are subject to the individual party's beliefs. Relational contracts contain terms that may not be easily monetisable, and broadly concern the relationship between the individual employee and the organization (Guzzo & Noonan 1994). This type of contract can be characterized by a focus on open-ended relationships and involve considerable investments by employees and employers.

The relational contract is seen as more valuable for firms dependent on employees for their future sustainability as they are encouraged to contribute their commitment and loyalty to the organisation in exchange for their professional development (Rousseau & McLean Parks 1993, Flood et al 2001, Thompson & Bunderson 2003). According to Sarantinos (2007), organizations need to strengthen their credibility in holding a sound transactional deal before attempting to establish a more long-term relational deal that requires considerable higher investments in trust and loyalty. Guzzo and Noonan (1994) suggest a hybrid combination of psychologi-

cal contracts, with both transactional and relational elements, as it is difficult to comprehend the employees' needs many times. Employees' needs tend to differ with the changing times. To avoid conflict and confusion, it is pertinent that the employer is able to understand the desirable kind of psychological contract being offered to the employees.

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*Psychological Contract Breach (PCB)*: An important attribute of the psychological contract is that it is inherently perceptual and "exists in the eye of the beholder" (Rousseau 1995: 6). Hence it becomes essential to understand the individual reciprocal obligation felt and understood by each individual. Psychological contract breach occurs when the employee perceives that the organization has failed to meet its obligations towards the employee (Conway & Briner 2005, Rousseau 1995). Breach is a cognitive experience where employees form judgments regarding the level of psychological contract fulfillment. Contract fulfillment is the opposite of contract breach; a fulfilled psychological contract indicates absence of contract breach.

*Psychological Contract Violation (PCV)*: Psychological contract violation

refers to 'the emotional and affective state that may under certain conditions follow from the belief that one's organization has failed to adequately maintain the psychological contract' (Robinson & Morrison 2000: 230). Psychological contract violation consists of various emotions resulting from the fact that expected outcomes did not eventuate (e.g., disappointment and frustration) and, at a deeper level, feelings of betrayal, anger, and bitterness due to broken promises (Morrison & Robinson 1997, Robinson & Morrison 2000).

Psychological contract breach does not necessarily lead to psychological contract violation (Morrison & Robinson 1997). Although psychological contract breach and psychological contract violation are correlated, previous studies have shown statistical evidence for the conceptual distinction (Robinson & Morrison 2000, Zhao et al. 2007). Researchers have identified two basic causes of psychological contract violations: renegeing and incongruence (Morrison & Robinson 1997, Rousseau 1995). Renegeing occurs when the organization knowingly breaks a promise to the employee, either on purpose or because of unforeseen circumstances. In contrast, incongruence occurs when the employee and the organization have different understandings regarding what the employee has been promised. Thus, in violations resulting from incongruence, the organization believes that it has lived up to its commitments, but the individual perceives that the organization has failed to keep one or more of its promises (Turnley & Feldman 1999).

## Organizational Consequences

*Psychological Contract Breach* can seriously damage the employment relationship. According to Rousseau (1989), the perception of PCB not only leads to negative feelings about the unmet expectations associated with specific promises, but also to more general feelings about the employee-employer relationship in terms of not being valued and respected by the employing organization. The perception of PCB signals to the employee that the employer is not committed to him/her, does not value the employee's contribution, and may not intend to continue the employment relationship (Coyle-Shapiro & Conway 2005). Although it may not be possible always to avoid breach of the psychological contract, employees are more likely to be forgiving when managers explain what has gone wrong and how they intend to deal with it. Here, the contract might need to be renegotiated.

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Psychological contract breach has been found to be negatively related to a wide variety of employee workplace attitudes and behaviors. For example, PCB has been found to be negatively related to job satisfaction (e.g. Robinson & Rousseau 1994, Tekleab et al. 2005, Turnley & Feldman 1998), commitment (e.g. Bunderson 2001, Coyle-Shapiro &

Kessler 2000, Lester et al. 2002, Raja et al. 2004), trust (e.g. Robinson 1996), in-role performance (e.g. Robinson 1996, Turnley & Feldman 1999), and organizational citizenship behaviors (e.g. Robinson & Morrison 1995, Turnley & Feldman 2000, Suazo et al. 2005). Turnley et al. (2003) found that PCB was negatively related to two forms of OCB: (i) OCBs directed at the organization, and (ii) OCBs directed at individuals in the organization. PCB has also been found to lead to increased cynicism (e.g. Johnson & O'Leary-Kelly 2003), turnover (e.g. Bunderson 2001), and intentions to quit (e.g. Raja et al. 2004, Suazo et al. 2005).

Zhao et al. (2007), in a recent meta-analysis, employed affective events theory to explain the relations between psychological contracts and attitudes and behaviors. According to affective events theory, a negative event at the workplace causes negative emotional reactions, such as anger or frustration (Morrison & Robinson 1997, Weiss & Cropanzano 1996). These emotions color the cognitive evaluations of one's job in such a way that experience of negative emotions will cause more negative job attitudes (Thoresen et al. 2003).

### **Consequences of Psychological Contract Violation**

Studies have also reported negative effects of psychological contract violations. Violation of the transactional obligations of the psychological contract (e.g., pay, benefits and promotion) results in a decrease in job satisfaction,

while violation of relational obligations (e.g. loyalty and support) result in a lowering of organizational commitment (Anderson & Schalk 1998, Guzzo & Noonan 1994, Robinson et al. 1994, Rousseau 1990). Low levels of commitment have been associated with increased incidences of absenteeism, tardiness and turnover which elevate expenses and lower productivity (Cooper-Hakim & Viswesvaran 2005, Farrell & Stamm 1988, Mathieu & Zajac 1990). It is interesting to note that an empirical study (Raja et al. 2004) has examined whether the relationship between psychological contract breach and work-related outcomes might be mediated by the employees' experience of psychological contract violation. The study found that psychological contract violation fully mediated the relationship between psychological contract breach and job satisfaction and intent to quit and partially mediated the relationship between psychological contract breach and affective organizational commitment. Morrison and Robinson (1997) argued that psychological contract violation mediates the relationship between perceptions of breach and attitudinal and behavioral outcomes. The mediating role of violation can be explained using affective events theory (Weiss & Cropanzano 1996, Zhao et al. 2007), wherein experiences at work are supposed to evoke affective reactions that, in turn, influence attitudes and behaviors.

A major research was conducted recently in six European countries and Israel, with data collected from 5288 employees (1981 temporaries and 3307

permanent employees) working in 202 companies of education, industries and retail sectors. Results of the study have shown that some variables had an important influence on workers' job satisfaction. Feelings of violation of promises made by the company reduced the job satisfaction. Other variables showed a moderate relationship with job satisfaction. Workers receiving support from their supervisor, having high autonomy at work and promising and fulfilling more promises to their company show higher satisfaction. The more promises made and fulfilled by the employee to the company, the more committed was the worker. Intention to quit was strongly related to violation of employer obligations and employee prospect variables (PSYCONES 2006).

### Implications for Organizations

Psychological contract breach and psychological contract violation have dysfunctional implications for organizations. Both contract breach and violation have negative influences on the work processes which, in turn, can result in an increase of the number of employees quitting, a higher staff absence and a reduced loyalty to the organization (Turnley & Feldman 2000). Rousseau (1995) has mentioned four principal reactions by employees to a perceived violation:

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- *Exit* implies voluntary termination of the working relationship either from the employer who lays off under-performing employees or from employees who prefer to leave an unreliable organization.
- Employees and employers can *voice* their opinions pertaining to violation of the contract, which may lead to an effort to negotiate the violated parts of the agreement and resolve potential problems that have arisen in a constructive fashion.
- *Silence* signifies a passive response with no reaction with the hope that conditions will change to more favorable terms in the future. However, in essence, it often ends in perpetuating the existing relationship.
- *Destruction/ Neglect* entails either passive indifference to ones duties in detriment to the interests of the organization, or even further, more active counterproductive behavior.

How an employee actually responds to a psychological contract violation is likely to be strongly influenced by the situational context surrounding that violation (Turnley & Feldman 1999). An individual's response to PCV is likely to be affected by the quality of the job alternatives available (Rusbult et al. 1998, Withey & Cooper 1989). Individuals who can easily find similar employment elsewhere may be less willing to continue working for an organization that cannot be trusted to keep its promises. In contrast, workers without attractive alternatives may feel that they have no

option but to maintain the existing relationships with their employers despite the psychological contract violations (Rousseau 1995). Robinson & Morrison (2000) also examine psychological contract violation through the lens of contextual influences; they find a significant increase in violation reports in instances of low organizational performance, lack of formal socialization process, lack of or inappropriate job previews, increased number of job options/offers (before choosing the job studied) and in instances where the employee has a history of psychological contract violation in previous employments.

**Trust in management tends to get weaker or even lost when psychological contract is violated.**

Another related issue is that of employees' trust in the organization and in organizational leadership. Trust in management tends to get weaker or even lost when psychological contract is violated. Employees feel a sense of betrayal and anger if they feel their organization has failed to keep its promises. Thus, the social exchange between employer and employee is no longer based on a solid foundation of trust, which has been shown to have a number of benefits for organizations, including positive effects on attitudes, perceptions, behaviors, and performance outcomes (Dirks & Ferrin 2001). Social fabric of the organization gets impacted by the negative behavior of its employees. It is perhaps due to this reason that OCB of the employees is negatively impacted (Suazo et al 2005,

Turnley et al 2003). Empirical evidence suggests that when employees perceive an imbalance in the exchange relationship with the employer, wherein the employee feels that he/she is giving more than he/she is receiving from the organization, the employee will reduce his organizational citizenship behaviors (Organ 1988, 1990, Organ *et al.* 2006).

In addition, non-committed employees may describe the organisation in negative terms to outsiders, inhibiting the organisation's ability to recruit high-quality employees (Mowday et al. 1982). It is important to note that transactional breach was not related to feelings of violation. In a qualitative study by Herriot, Manning, and Kidd (1997) it was found that the relational component of psychological contract was more frequently mentioned than was the transactional component and therefore seemed more important. Similarly, a recent meta analysis (Zhao et al. 2007) revealed that the relationship between relational breach and job satisfaction, turnover intentions, and organizational citizenship behaviors was stronger than was the relationship between transactional breach and these variables. Because of the similarity of the consequences of job dissatisfaction, organisational commitment and psychological contract violations, Turnley and Feldman (2000) suggest that satisfaction partially mediates the relationship between violation and commitment.

Given that the business conditions facing most firms are continuing to evolve rapidly, psychological contracts

must also be flexible enough to allow the company to adapt (for example, in response to changing markets, technology, etc.). It may also mean that firms need to be flexible and creative when unexpected events or drastic changes cause losses for employees. Looking for creative ways to offset such losses (e.g., generous severance packages, additional training, and extensive worker involvement in developing responses to change pressures) can pay dividends for the firm by reducing the likelihood that workers will feel that their psychological contracts have been violated (Rousseau 2004).

**Revenge can be a counterproductive way of coping with perceived transgressions, as it can lead to further retaliation and an escalation of conflict.**

Given the competitive pressures confronting most organizations and the resulting need for organizational changes, it may not be possible to fulfill every promise made to a job incumbent (Robinson & Rousseau 1994, Rousseau 1995). In such circumstances, organizations should strive to reduce the feelings of violation by providing adequate explanation for the causes of breach and redressing the loss to the employee by other means (Morrison & Robinson 1997). Revenge can be a counterproductive way of coping with perceived transgressions, as it can lead to further retaliation and an escalation of conflict (Bradfield & Aquino 1999). Managers can promote trust with their constituents

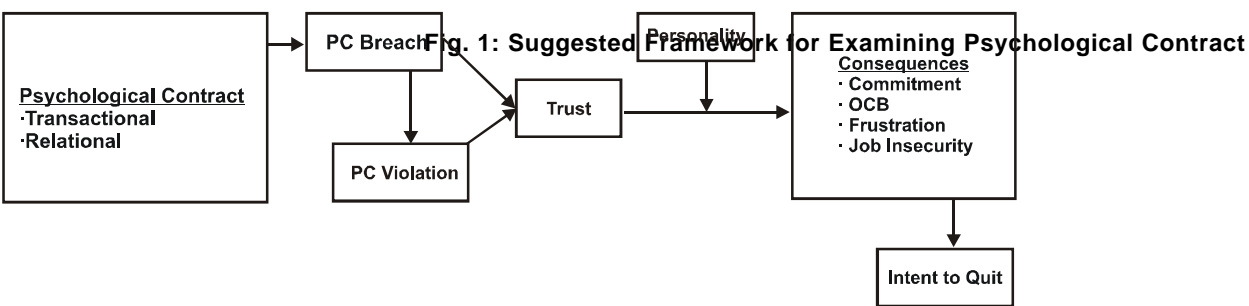
by expressing recognition, displaying sensitivity to their needs and concerns, and establishing effective communication channels (Handley et al. 2006).

Change management often focuses on the process. In uncertain times like ours, it is important to concentrate not only on the business results (what the people are able to accomplish), but also on the people processes (how people achieve). This might imply adopting a partnership approach between the employers and employees. A partnership would be a means for strengthening the psychological contract between organizations and employees. Researchers and employers need to work together to consider how mutuality in psychological contracts can be formalized and clarified in ways which lead to a “dual agenda” of work-personal life integration and organizational effectiveness (Rapoport et al 2002). To avoid decreases of trust, satisfaction, and commitment among employees, organizations should design and implement human resource policies and practices in such a way that psychological contract breach is prevented. This can be obtained through realistic job previews (Rousseau 1995), and tailoring human resource practices to age-related needs. The psychological contract is clearly an important ingredient in the business relationship between employers and employees and can be a powerful determinant of workplace behavior and attitudes, if handled properly. It is a new business reality which provides a potentially fruitful construct with which to make sense of and explore employment relationships.

### A Suggested Framework

While the negative implications of psychological contract breach and violations have been well reported, the relationship between perceived organisational obligations and perceived employee obligations is a research area that needs further attention. Most of the studies have focused on only one dimension of the psychological contract (mostly perceived organization obligations), hence a more detailed examination of both aspects of psychological contract needs to be undertaken. Psychological contracts are by definition exchange relationships, and both sides of the deal need to be researched and reported on (Freese & Schalk 2008). The degree of personal importance employees ascribe to particular benefits and experi-

ences may affect their reactions to promised and delivered inducements. Future research on breach and unmet expectations should explore reactions to inducements that are rated as more and less important to employees (Montes & Zweig 2009). There are other areas too that need to be addressed in future research. For example, greater depth of investigation is required to understand and interpret the role of more mediating and moderating variables. One can also examine the nature of psychological contracts in different industries, especially in the Indian context. Finally, additional research is needed to determine factors that exacerbate or attenuate the impact of PCB on workplace attitudes and behaviors, and on trust, turnover and retention. A comprehensive framework incorporating some of these variables is suggested by the authors in Figure 1.



It is significant to note that both transactional and relational elements are important to understand the implications of the psychological contract breach. Relational contracts were found to have more significant impact on the PCB and the PCV. The importance of relational contract was also supported by Herriot, Manning, and Kidd (1997), who found that the relational component of the psychological

contract was more frequently mentioned than was the transactional component and therefore seemed more important. Similar results were also found in a meta analysis done by Zhao et al. (2007), in which it was revealed that the relationship between relational breach and job satisfaction, turnover intentions, and organizational citizenship

behaviors was stronger than was the relationship between transactional breach and these variables. These imply that when promises to employees are broken, the employees are likely to feel violated and in turn they become less committed and trustful towards the organization. And ultimately out of sheer disenchantment, employees' intention of leaving the organization gets strengthened.

### Conclusion

Organizations trying to improve quality or efficiency of employees' work by the use of industrial/organizational psychology can gain a great deal when taking into consideration the psychological contract and its abundant implications. A strong culture and an effective psychological contract that are aligned with the vision and strategy of the company and honored openly by the organization can elicit the highest performance and retention of top talent, thus positioning the organization to effectively participate in an economic recovery (Dierking 2009). It is thus necessary to further examine the role *and* effect of psychological contracts in varied industrial settings for better management of human resources in organizations.

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