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# The psychological contract

Examines the history, state and strategic implications of the psychological contract

## Introduction

On its own, the legal contract of employment offers a limited understanding of the employment relationship, with workers contributing little to its terms after accepting them. In this sense, the psychological contract may be more influential. It describes the perceptions of the relationship between employers and workers and influences how people behave from day to day. At its core, the psychological contract is built on the everyday actions and statements made by one party and how they are perceived and interpreted by the other. Unlike the legal contract of employment signed by employers and workers, it's not tangible.

This factsheet explores the psychological contract within the context of the employment relationship. It identifies ways that managers can bolster the psychological contract and its impact on broader organisation strategy. The factsheet also considers the role of HR in managing the psychological contract.

## What is the psychological contract?

The term 'psychological contract' refers to individuals' expectations, beliefs, ambitions and obligations, as perceived by the employer and the worker. The concept emerged in the early 1960s and is core to understanding the employment relationship. Drawing on insights from psychology and organisational behaviour, it provides a powerful rationale for employers to pay attention to the 'human' side of the employment relationship. Although the notion of psychological contract describes the expectations and assumptions of employers of their workers and vice versa, the concept has been mainly studied from the perspective of the employee.

The psychological contract differs from a legal contract of employment which offers a limited reality of the employment relationship. The legal contract refers to an agreement, usually written and signed, about the mutual formal obligations of the employer and the

worker. The psychological contract, on the other hand, describes how the parties themselves understand their relationship, their own views of commitment and what they can expect to receive in return. The psychological contract isn't generally enforceable. However, courts may be influenced by a view of the underlying relationship between employer and employee, for example in interpreting the common-law duty to show mutual trust and confidence.

People's perceptions of employers' obligations are often informal and imprecise. They may be inferred from actions (even towards other employees), or from what has happened in the past. For example, an employee who observes a manager granting a flexible working request may expect similar treatment from their own manager. Another source of expectation is statements made by the employer to the individual. Examples of this might be seen in the recruitment process, in performance reviews, or publicly (such as in the statement of organisation's values).

## **What is covered by the psychological contract?**

There isn't a definitive list of expectations and obligations describing the content of the psychological contract. Instead, many scholars have chosen to focus on certain aspects, such as exploring the duration or stability of the exchange.

Broadly, the psychological contract may cover the following aspects of the employment relationship and how they interact:

- Job security.
- Career prospects.
- Training and development.
- Perceived fairness of pay and benefits.
- Manager support.
- Employer's reputation and impact on the society.

Employees in large organisations do not identify any single person as their 'employer'. Line managers are important in making day-to-day decisions, but employees are also affected by decisions made by senior management and HR. Employees may be unaware of who is personally responsible for decisions affecting their welfare or the future of the business. Unsurprisingly, attitude surveys confirm that employees' experiences at work are strongly affected by the quality of line managers who they see on a regular basis. It's fair to say that for many employees the psychological contract is largely the deal they have with their direct line manager.

## **The significance of psychological contract**

The quality of the psychological contract heavily influences how employees behave from day to day. When workers perceive that the contributions they make to the organisation and what they receive back from the employer are balanced, there can be positive outcomes. For example, workers who perform better, demonstrate more extra-role behaviours, and indicate a higher level of commitment to the organisation.

The psychological contract is based on employees' sense of fairness and trust, and their belief that the employer is honouring the 'deal' between them. A violation (or breach) of the psychological contract by the employer can have sudden and powerful consequences for people and organisations. It can lead to negatively affecting job satisfaction, commitment, performance, and increase turnover intentions.

Breaches of the psychological contract by an employer are not always avoidable. External factors like negative economic outlook can impact the 'deal' between the business and its people. However, organisations can avoid many negative outcomes if they demonstrate fairness in how they deal with the situation, even if they can't promise positive outcomes for all.

During a 'contract repair' process, individuals attempt to restore balance, either by seeking alternative ways to meet their expectations or lowering their expectations. For example, employees experiencing a 'relational' psychological contract (such as working additional hours in exchange for enhanced career opportunities) may withdraw their extra-role behaviours and transition to a basic 'transactional' deal. Others may react by displaying proactive behaviours, treating the situation as an opportunity to learn, to offset loss of position and uncertainty. To deal with contract repair successfully and avoid people leaving the organisation, individuals need to have the psychological and social resources, building resilience skills in advance. Read case studies from [Zurich Life](#) and [Isos Housing](#) about managing change in the employee proposition.

Managers need to remember:

- Employment relationships may break down despite management's best efforts. Nevertheless, it's managers' job to take responsibility for maintaining them.
- Preventing breach in the first place is better than trying to repair the damage afterwards.
- Where breach cannot be avoided, it may be better to spend time negotiating or renegotiating the deal, rather than focusing too much on delivery.
- Interventions aimed at building resilience skills will help individuals cope better with contract breaches.

## How is the modern employment relationship evolving?

The psychological contract is a dynamic concept that can be applied to understand varying employer-worker relationships. Yet, patterns and trends can be observed over time. For many years the traditional psychological contract focused on the promise of job security. Now it focuses much more on learning and development to ensure individuals remain employable over the course of their careers.

However, employers should not underestimate the impact of individual differences. Some people may not be interested in the concept of a job for life (and may want to move between jobs and change careers), whilst others still value job security.

Changes affecting the expectations of workers include:

- Uncertain economic conditions (for example, the impact of Brexit).
- Technological changes automating production processes and shaping skill demands.
- The rise in atypical contracts and the 'gig economy', creating a highly competitive global marketplace for some and offering extended career opportunities to others.
- More employees expecting to work flexibly.
- Organisations downsizing and delayering, putting more pressure on remaining employees.
- Collective bargaining is declining, with employers and individuals negotiating the relationship directly.
- Human capital being increasingly recognised as a source of competitive advantage.
- Traditional organisational structures becoming more fluid.
- The public nature of corporate scandals, enabled by the media, that can undermine employees' trust in their employer.

In this changing context, employers should pay attention to the key drivers of the employment deal, to be able to attract and retain key talent. To aid this, the psychological contract offers a way of monitoring employee attitudes and priorities on the dimensions influencing performance.

### **How are employers responding to the changes?**

Our research shows that despite the modern employment deal being based on the promise of employability, employers are highly selective about offering development and career opportunities. Other research shows that in three out of ten organisations,

opportunities to enhance careers were only available to some workers based on the value they could offer the employer. Those in roles needing high levels of skill, degree-level educated and those whose skills were hard to replace, were more likely to receive development opportunities and have some autonomy in their work.

While such an approach to distributing opportunities is reasonable, it does leave open the question of long-term sustainability:

- Firstly, there's a risk that employers' value-adding strategies lead employees to perceive the quality of the deal as highly transactional. It depends on their continuing ability to contribute, rather than one of mutual commitment. With loyalty of employees undermined, organisations may find they struggle to retain staff.
- Secondly, employers must consider the type of deal they are offering to groups of workers who are not considered to represent key talent. Disgruntled employees present risk of increased operational costs associated with high turnover and risk of reputational damage.

## People management and the psychological contract

The psychological contract is central to people performance and engagement at work. Successful management of employee expectations requires people professionals to have input to the broad organisational strategy, and to design and implement the people management and development practices that support it.

Specific areas of focus include:

- **Employer brand:** To be clear on what they expect of, and offer to, employees, many organisations have created a set of corporate values or a stated mission. This may be called an 'employee value proposition' or 'employer brand' which employees will recognise and relate to. In practice, the employer brand is an attempt by the employer to define the psychological contract with employees to help recruit and retain talent. Read more in our [employer brand factsheet](#).
- **Communications:** An effective two-way dialogue between employer and employees is a necessary means of giving expression to employee 'voice'. Our factsheets on [employee voice](#) and [employee communication](#) give more on these related topics.
- **Learning and career development:** Employability is a key employment offer to many workers. Employees expect their organisation to offer opportunities for skills

and career development. Yet, a third of employees in the UK were disappointed with their career progression in 2017.

- **Management style:** In many organisations, managers can no longer control the business 'top down' - they have to adopt a more 'bottom up' style. Line managers are also key to understanding and managing employees' expectations on what fair processes and outcomes look like in an organisation.
- **Managing expectations:** Employers need to make clear to new recruits what they can expect from the job. Managing expectations, particularly when bad news is anticipated, will increase the chances of building a realistic psychological contract.
- **Measuring employee attitudes:** Employers should monitor employee attitudes on a regular basis as a means of identifying where action may be needed in order to improve performance. A positive psychological contract typically supports a high level of employee engagement.

## Further reading

### Books and reports

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RAYTON, B. and YALABIK, Z. (2014) Work engagement, psychological contract breach and job satisfaction. *International Journal of Human Resource Management*. Vol 25, No 17, October. pp2382-2400.

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This factsheet was last updated by Wilson Wong.