The psychological contract

Employee relations
Revised May 2010

This factsheet gives introductory guidance. It:

- defines the psychological contract
- considers what research into the psychological contract tells us about the changing employment relationship
- looks at the strategic implications
- includes the CIPD viewpoint.

What is the psychological contract?

Research into the psychological contract between employer and employees has produced a number of important messages. Despite the academic origins of the term, many managers believe that the idea of the psychological contract offers a valid and helpful framework for thinking about the employment relationship against the background of a changing labour market.

The term ‘psychological contract’ was first used in the early 1960s, but became more popular following the economic downturn in the early 1990s. It has been defined as ‘...the perceptions of the two parties, employee and employer, of what their mutual obligations are towards each other’. These obligations will often be informal and imprecise: they may be inferred from actions or from what has happened in the past, as well as from statements made by the employer, for example during the recruitment process or in performance appraisals. Some obligations may be seen as ‘promises’ and others as ‘expectations’. The important thing is that they are believed by the employee to be part of the relationship with the employer.

The psychological contract can be distinguished from the legal contract of employment. The latter will, in many cases, offer only a limited and uncertain representation of the reality of the employment relationship. The employee may have contributed little to its terms beyond accepting them. The nature and content of the legal contract may only emerge clearly if and when it comes to be tested in an employment tribunal.

The psychological contract on the other hand looks at the reality of the situation as perceived by the parties, and may be more influential than the formal contract in affecting how employees behave from day to day. It is the psychological contract that effectively tells employees what they are required to do in order to meet their side of the bargain, and what they can expect from their job. It may not - indeed in general it will not - be strictly enforceable, though 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.

A useful model of the psychological contract is offered by Professor David Guest of Kings College London (see table below). In outline, the model suggests that:
• the extent to which employers adopt people management practices will influence the state of the psychological contract
• the contract is based on employees' sense of fairness and trust and their belief that the employer is honouring the 'deal' between them
• where the psychological contract is positive, increased employee commitment and satisfaction will have a positive impact on business performance.

A model of the psychological contract
(adapted from Guest³)

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<thead>
<tr>
<th>Inputs</th>
<th>Content</th>
<th>Outputs</th>
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<tbody>
<tr>
<td>employee characteristics</td>
<td>fairness</td>
<td>employee behaviour</td>
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<td>organisation characteristics</td>
<td>trust</td>
<td>performance</td>
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<td>HR practices</td>
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What happens if the contract is broken?

Research evidence shows that, where employees believe that management have broken promises or failed to deliver on commitments, this has a negative effect on job satisfaction and commitment and on the psychological contract as a whole. This is particularly the case where managers themselves are responsible for breaches, for instance where employees do not receive promised training, or performance reviews are badly handled. Managers cannot always ensure that commitments are fulfilled - for example where employment prospects deteriorate or organisations are affected by mergers or restructuring – but they may still take some blame in the eyes of employees.

Managers need to remember:

• Employment relationships may deteriorate despite management’s best efforts: nevertheless it is managers’ job to take responsibility for maintaining them.
• Preventing breach in the first place is better than trying to repair the damage afterwards.
• But where breach cannot be avoided it may be better to spend time negotiating or renegotiating the deal, rather than focusing too much on delivery.

What has persuaded people to take the psychological contract seriously?

Changes currently affecting the workplace include:

• **The nature of jobs**: more employees are on part time and temporary contracts, more jobs are being outsourced, tight job definitions are out, functional flexibility is in.
• **Organisations have downsized and delayered**: 'leanness' means doing more with less, so individual employees have to carry more weight.
• **Markets, technology and products are constantly changing**: customers are becoming ever more demanding, quality and service standards are constantly going up.
• **Technology and finance are less important as sources of competitive advantage**: 'human capital' is becoming more critical to business performance in the knowledge-based economy.
• **Traditional organisational structures are becoming more fluid**: teams are often the basic building block, new methods of managing are required.

The effect of these changes is that employees are increasingly recognised as the key business drivers. The ability of the business to add value rests on its front-line employees, or 'human capital'. Organisations that wish to succeed have to get the most out of this resource. In order to do this, employers have to know what employees expect from their work. The psychological contract offers a framework for monitoring employee attitudes and priorities on those dimensions that can be shown to influence performance.
Employer brand

Employees in large organisations do not identify any single person as the 'employer'. The line manager is important in making day-to-day decisions but employees are also affected by decisions taken by senior management and HR. Employees may have little idea who, if anyone, is personally responsible for decisions affecting their welfare or the future of the business. Unsurprisingly surveys confirm that employees tend to feel more confidence in their line manager, whom they see on a regular basis, than in members of senior management.

In order to display commitment, employees have to feel they are being treated with fairness and respect. Many organisations have concluded they need to create a corporate personality, or identity with a set of corporate values or a stated mission - 'an employer brand' - that employees as well as customers will recognise and relate to. In practice the employer brand can be seen as an attempt by the employer to define the psychological contract with employees so as to help in recruiting and retaining talent. For more information see our factsheet and details of our research into employer branding.

The changing employment relationship

The traditional psychological contract is generally described as an offer of commitment by the employee in return for the employer providing job security - or in some cases the legendary 'job for life'. The recession of the early 1990s and the continuing impact of globalisation are alleged to have destroyed the basis of this traditional deal since job security is no longer on offer. The new deal is said to rest on an offer by the employer of fair pay and treatment, plus opportunities for training and development. On this analysis, an employer can no longer offer security and this has undermined the basis of employee commitment.

But is this the case, and is there a 'new contract'? Research suggests that in many ways the 'old' psychological contract is in fact still alive. Employees still want security: interestingly labour market data suggest that there has been little reduction in the length of time for which people stay in individual jobs. They are still prepared to offer loyalty, though they may feel less committed to the organisation as a whole than to their workgroup. In general they remain satisfied with their job.

The kinds of commitments employers and employees might make to one another and reflect in an employment proposition are:

<table>
<thead>
<tr>
<th>Employees promise to:</th>
<th>Employers promise to provide:</th>
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<tr>
<td>Work hard</td>
<td>Pay commensurate with performance</td>
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<tr>
<td>Uphold company reputation</td>
<td>Opportunities for training and development</td>
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<tr>
<td>Maintain high levels of attendance and punctuality</td>
<td>Opportunities for promotion</td>
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<tr>
<td>Show loyalty to the organisation</td>
<td>Recognition for innovation or new idea</td>
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<td>Work extra hours when required</td>
<td>Feedback on performance</td>
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<td>Develop new skills and update old ones</td>
<td>Interesting tasks</td>
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<td>Be flexible, for example, by taking on a colleague’s work</td>
<td>An attractive benefits package</td>
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<tr>
<td>Be courteous to clients and colleagues</td>
<td>Respectful treatment</td>
</tr>
<tr>
<td>Be honest</td>
<td>Reasonable job security</td>
</tr>
<tr>
<td>Come up with new ideas</td>
<td>A pleasant and safe working environment</td>
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Many employers recognise employee concerns about security and indicate that compulsory redundancy will be used only as a last resort. However employers know they are unable to offer absolute security and employees do not necessarily expect it. Younger people - the so-called 'generation Y', or increasingly now 'millennials' - want excitement, a sense of community and a life outside work. They are not interested, as some of their fathers and mothers were, in a 'job for life', nor do they believe any organisation can offer this to them. They expect to be treated as human beings.
The state of the psychological contract

Early comments on the likely impact of labour market change suggested that employers were no longer able to provide 'careers' and that this was bound to sour the employment relationship. Research suggests that, while organisations have been de-layering and reducing the number of middle management posts, many continue to offer careers: and most employees have adjusted their career expectations of individual employers downwards. Many will be satisfied if they believe that their employer is handling issues about promotion fairly. They may also benefit from the opportunity to negotiate alternative career options.

Press reports have often suggested that UK employees are dissatisfied and insecure. Major national surveys, including those undertaken by CIPD between 1996 and 2004\(^2\), show that this picture is at best distorted with a majority of employees consistently reporting that they are satisfied with their job and not worried about losing it. However the recession has had an increasingly negative impact on employee attitudes, including in relation to satisfaction and job security. This suggests that managers will have a serious challenge to restore and maintain employees' commitment as organisations emerge from recession. Current statistics on these topics can be found in our quarterly Employee outlook surveys.

Other things being equal, a positive psychological contract will support a high level of employee engagement. However the concept of engagement goes beyond employees' attitudes and underlines the need for managers to draw out their discretionary behaviour.

For a full list of our annual surveys, and research on employee engagement and the psychological contract, visit our research projects pages.

How important is communication?

CIPD research into employee 'voice'\(^2\) shows the importance of communication and specifically of dialogue in which managers are prepared to listen to employees' opinions. See our factsheet on employee voice and employee communication for more information.

Managers need to manage expectations, for example through systems of performance management which provide for regular employee appraisals. HR practices also communicate important messages about what the organisation seeks to offer its employers. But employee commitment and 'buy-in' come primarily not from telling but from listening.

Employers are experimenting with a range of attitudinal and behavioural frameworks for securing employee inputs to management thinking as part of the decision-making process. This can be done face-to-face, for example through 'soap box' sessions, which encourage employees to speak their minds. Employee attitude surveys can also be an effective tool for exploring how employees think and feel on a range of issues affecting the workplace. In times of rapid change, managers and employees frequently hold contrasting opinions about what is going on. Two-way communication, both formal and informal, is essential as a form of reality check and a basis for building mutual trust.

Strategic implications of the psychological contract

Basically the psychological contract offers a metaphor, or representation, of what goes on in the workplace, that 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 organisations.

Most organisations could benefit from thinking about the psychological contract. The first priority is to build the people dimension into thinking about organisational strategy. If people are bottom-line business drivers, their capabilities and needs should be fully integrated into business process and planning. The purpose of business strategy becomes how to get the best return from employees' energies, knowledge and creativity.

Employees' contribution can no longer be extracted by shame, guilt and fear: it has to be offered. Issues about motivation and commitment are critical. Yet many of the levers which managers have relied on to motivate employees are increasingly unreliable.
The psychological contract may have implications for organisational strategy in a number of areas, for example:

- **Process fairness**: People want to know that their interests will be taken into account when important decisions are taken; they would like to be treated with respect; they are more likely to be satisfied with their job if they are consulted about change. Managers cannot guarantee that employees will accept that outcomes on, for example, pay and promotion are fair, but they can put in place procedures that will make acceptance of the results more likely.

- **Communications**: Although collective bargaining is still widely practised in the public sector, in large areas of the private sector trade unions now have no visible presence. It is no longer possible for managers in these areas to rely on ‘joint regulation’ in order to communicate with employees or secure their co-operation. An effective two-way dialogue between employer and employees is a necessary means of giving expression to employee ‘voice’.

- **Management style**: In many organisations, managers can no longer control the business ‘top down’ - they have to adopt a more ‘bottom up’ style. Crucial feedback about business performance flows in from customers and suppliers and front-line employees will often be best able to interpret it. Managers have to draw on the strategic knowledge in employees’ heads.

- **Managing expectations**: Employers need to make clear to new recruits what they can expect from the job. Managers may have a tendency to emphasise positive messages and play down more negative ones. But employees can usually distinguish rhetoric from reality and management failure to do so will undermine employees’ trust. Managing expectations, particularly when bad news is anticipated, will increase the chances of establishing 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 to improve performance. Some employers use indicators of employee satisfaction with management as part of the process for determining the pay of line managers. Other employers, particularly in the service sector, recognise strong links between employee and customer satisfaction. But employers should only undertake surveys of employee attitudes if they are ready to act on the results.

Managing change is a major challenge for organisations. HR professionals have a key role to play in contributing to top-level decisions about the direction and pace of change and in supporting line managers across the organisation in implementing them. The psychological contract can help HR managers to make the business case for incorporating effective people management policies and practices into the change management process at an early stage, and to successfully manage their implementation.

Our research evidence shows that:

- A majority of workers in both public and private sectors report major organisational changes taking place.
- Employees are not necessarily hostile to change but major changes – particularly leading to redundancies – tend to cause negative attitudes.
- Most people say change in their organisation is badly managed.
- Employee trust in organisations has declined and this can make the process of managing change more difficult.

See our Change Agenda *Managing change: the role of the psychological contract* and our factsheet on change management for more information.

Breach of the psychological contract can seriously damage the employment relationship. It won’t always be possible to avoid breach of the psychological contract but employees are more likely to be forgiving where managers explain what has gone wrong and how they intend to deal with it. The contract may need to be renegotiated.
CIPD viewpoint

Public interest in the psychological contract has been stimulated by fears about job insecurity. Survey evidence suggests that, although such fears have been exaggerated, employers should nevertheless be paying more attention to restoring employees’ trust in their organisations. 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. Employee engagement strategies can provide a useful framework for this purpose.

The psychological contract does not supply a detailed model of employee relations but it offers important clues about how to maintain employee commitment. With the decline in collective bargaining, attention is more clearly focused on relations between the organisation and individual employees. The psychological contract reinforces the need for managers to become more effective at the communications process. Consultation about anticipated changes will help in adjusting expectations and if necessary renegotiating the deal.

The psychological contract provides a convincing rationale for 'soft HRM', or behaving as a good employer. It offers a perspective based on insights from psychology and organisational behaviour rather than economics. It emphasises that employment is a relationship in which the mutual obligations of employer and employees may be imprecise but have nevertheless to be respected. The price of failing to fulfil expectations may be serious damage to the relationship and to the organisation.

References


Further reading

CIPD members can use our Advanced Search to find additional library resources on this topic. They can also use our online journals collection to view selected journal articles online. People Management articles are available to subscribers and CIPD members on the People Management website. CIPD books in print can be ordered from our online Bookstore.

Books and reports


Journal articles


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