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Leadership, Human Resource Management and the Content of the Psychological Contract

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Leadership, Human Resource Management and the Content of the Psychological Contract



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ABSTRACT

This paper argues that, in combination, management leadership styles (transactional versus relational) and human resource management practices (flexibility versus commitment) play an important role in formulating the orientation and content of the psychological contract. The paper presents a theoretical framework of how this occurs, drawing upon and integrating prior research to develop a typology of psychological contract obligations based on a two-by-two matrix, with leadership style and HRM systems on opposing axes. The resultant obligations are termed as partnership, paternalistic, market-based and dynamic. Implications are discussed from the viewpoint of both individuals and organizations. Crucially, the paper posits that a failure to match leadership styles and human resource (HR) practices may lead to mismatched expectations between employees and employers. This may have negative consequences for an organization's performance as, under the psychological contract, a breach of perceived obligations to employees by employers can have consequences for employee attitudes and behaviors.

Key Words: Psychological Contract; Leadership; Human Resource Management

INTRODUCTION

Although the concept of the psychological contract originated in the field of economics, it has now become a major analytical device in social and organizational research. The psychological contract concerns researchers and practitioners alike, as both seek mechanisms through which they can influence positive employee behaviors. Although the definition of the psychological contract remains contested (Cullinane & Dundon, 2006; Anderson & Schalk, 1998), the recognition that employment relationships are influenced by formal and informal factors which can lead to both explicit and implicit expectations, has led to insights into the factors affecting employment relationships, expectations and obligations; and the negative consequences for employee behaviors, attitudes and organizational performance when such expectations are breached.

The literature on the psychological contract has grown significantly over the past decade. According to Cullinane and Dundon (2006), much of this literature has focused on the obligations perceived by individual employees, reflecting Rousseau's (1989; 2001) focus, and the implications of the fulfillment or otherwise of these obligations. However, some writers have been critical of this narrow perspective. In an evaluation of the worth of the construct, Guest (1998, 2004) called for a return to the exploration of the psychological contract as a two-way exchange, and the inclusion of an employer perspective. In addition, Rousseau (2001) called for research that identifies the specific factors that influence the content of the psychological contract. This paper addresses these calls.

From an organizational perspective, 'HR practices send strong messages to individuals regarding what the organization expects of them and what they can expect in return' (Rousseau, 1995: 162). While some authors (e.g. Tsui et al, 1997) have emphasized the impact of business strategy on the psychological contract, this paper focuses attention on HR practices, which can be influenced by the business strategy adopted (Schuler & Jackson, 1987). HR practices represent communications, 'calculated messages' or 'intended signals' regarding the relationship between the employer and employee (Guzzo and Noonan, 1994). HR practices are enacted through social interactions, making leadership style a further significant signaling factor in organizations (Rousseau, 1995). Despite this, the psychological contract literature faces a considerable deficit of knowledge regarding the combined influence of leadership style and the organization's HR practices on the formation and perceived violation of psychological contracts. Hence, in this paper we explore the role of leadership style (transactional versus relational) and the role of HR practices (flexibility versus commitment) on the content of psychological contracts.

In developing our typology, we assume that organizational leadership (transactional versus relational) may vary from individual to individual but the HR practices of organizations are relatively more stable and institutionalized. For instance, the practices of organizations such as Nucor (e.g. high job security, teamwork, egalitarianism, and group incentives), Lincoln Electric Company (e.g.

piecework incentives, job security, and horizontal career mobility) and Proctor & Gamble (e.g. global talent management and brand management) are more or less stable and institutionalized, regardless of leadership characteristics or leadership change. Given this assumption, we argue that the interplay between the firm's HR practices and the leadership style of the line manager or supervisor may influence the content of the psychological contract. Specifically, we focus our attention on the following dimensions: job security and the nature of the employment contract (short or long-term); career development; skills development; performance management; incentives, and employee withdrawal behaviors. Several studies on the psychological contract (e.g. Coyle-Shapiro & Kessler, 2000; Flood et al., 2001; Kraimer, Wayne, Liden & Sparrowe, 2005; Paul, Niehoff, & Turnley, 2000; Sapienza et al., 1997) have suggested that these dimensions are important for employees. In developing a typology of the psychological contacts engendered by the interplay between leadership style (relational and transactional) and HR practices (flexibility versus commitment) we propose four potential types of psychological contract: partnership; paternalistic; market-oriented; and dynamic obligations. Next, an overview of the pertinent literature is provided, as a precursor to the presentation and discussion of the typology.

LITERATURE REVIEW

The literature review begins by exploring the nature of the psychological contract. It then considers research pertaining to the relationship between leadership, HR practices and the psychological contract. In integrating these traditionally disparate areas of research, the section concludes with a proposed typology of four psychological contract configurations, premised on the interplay between leadership styles (relational versus transactional) and HR practices (flexibility versus commitment). The content of each configuration is explicated, prior to the closing section of the paper, which discusses the implications of the typology for employees and employers.

The Nature of the Psychological Contract

The psychological contract refers to an individual employee's "belief in mutual obligations between that person and another party such as an employer" (Rousseau and Tijoriwala, 1998: 679). Such obligations include both transactional and relational components (McNeil, 1985; Rousseau, 1989). The transactional component of the psychological contract includes economic or monetary exchanges that take place between an organization and its employees (Morrison & Robinson, 1997, Rousseau & McLean Parks, 1993). Relational components, on the other hand, refer to non-monetary obligations in an employment relationship and include factors such as trust and good faith (Rousseau, 1990). The transactional aspect of the contract tends to be relatively narrower in scope and has a shorter-term orientation, while the relational aspect tends to be broader and has a longer-term orientation. Some authors (e.g.,

Sapienza, Korsgaard, & Schweiger, 1997) suggest that psychological contractual obligations may arise due to explicit and/or implicit promises, while other authors (e.g., Briner & Conway, 2006) assert that psychological contracts are entirely implicit in nature and hence different from explicit employment contracts. This issue remains unresolved. However, in this context, it is assumed that while the psychological contract is more implicit than explicit, implicit assumptions are influenced by explicit promises, and creating an opposition between the two is therefore unhelpful. Hence, psychological contracts may be influenced by explicit contractual obligations or organizational procedures, such as those exemplified in employment manuals and HR practices or the implicit actions of organizations such as public statements, historical decisions, organizational norms or leadership styles.

Much of the research into the psychological contract has, to date, been concerned with the implications of the breach or fulfilment of such contracts. This body of work has shown that the perceived fulfillment or otherwise of psychological contractual obligations significantly influences employee attitudes and behaviors such as job satisfaction (Cuyper & De Witte, 2006; Raja, Johns, & Ntalianis, 2004; Sutton and Griffin, 2003), citizenship behaviors (Othman et al, 2005), organizational commitment (Cuyper & De Witte, 2006; Flood, Turner, Ramamoorthy & Pearson, 2001; Lemire and Rouillard, 2005), turnover intentions and actual turnover (Flood, Turner, Ramamoorthy & Pearson, 2001; Sturges et al, 2005), perceived job security (Cuyper & De Witte, 2006; Kramer et al, 2005), and motivation and performance (Lester et al, 2002). Since the breach of a psychological contract has more intense emotional implications than fulfillment, it is likely to have a proportionally greater impact. However, as yet, the differential effects of the breach or fulfillment of transactional relative to relational components are inconclusive (e.g. Coyle-Shapiro & Kessler, 2000; Raja, et al., 2004). Nonetheless, what is increasingly clear is that the attitudinal and behavioral outcomes explored in the research cited above (e.g. job satisfaction, citizenship behaviors, organizational commitment, turnover intentions, motivation and performance), are closely related to the HR practices and leadership styles emphasized in this paper – both of which may have a significant influence on the content of the psychological contract. The ensuing section considers the sparse literature on the relationship between leadership and the psychological contract.

Leadership and the Psychological Contract

Studies on leadership emphasize the transactional and relational dimensions of leadership behaviors. While transactional leadership, based on an exchange model, focuses on rewards and punishment for good and poor performance respectively, the relational aspects of leadership behaviors focus on employees and their needs. The most prominent stream on relational aspects of leadership stems from the transformational leadership area (Bass, 1985; Burns, 1978; Waldman, Javidan, & Varella, 2004). However, the relational orientation is also an important component in other models of leadership, such as the managerial grid (Blake and Mouton, 1985).

Transformational leadership is defined as a relationship between a leader and follower(s) based on a set of leader behaviours perceived by subordinates as exhibiting idealized influence, motivational inspiration, intellectual stimulation, and individual consideration (Bass, 1985; Waldman, Javidan, & Varella, 2004). It emphasizes employees' identification with the social unit or the work unit in which the leadership takes place. Transformational leaders rely on individualized consideration by paying attention to their subordinates, by adjusting the magnitude and type of attention, rewards, support, encouragement and coaching (Bass, 1985; Howell & Avolio, 1993). A number of studies have shown a strong positive relationship between this leadership style and desirable outcomes including organizational commitment, job satisfaction, and decreased employee turnover intentions (e.g., Barling, Webere & Kelloway, 1996; Bycio, Hackett & Allen, 1995; Judge et al., 2004; Kane & Tremble, 2000; McDaniel & Wolf, 1992).

As an example of the magnitude of leadership influence on the attitudes and behaviors of employees, a study of 25,000 workers across a variety of firms by Wilson Learning, a US based management training company, found that 69% of employees' job satisfaction related to the leadership skills of their bosses (Davids, 1995). A significant productivity lag was associated with a lack of or poor leadership. On the basis of this finding, Davids (1995) asserts that the days of the heroic leader who gets things done by people are numbered, to be replaced by the post-heroic leaders who get things done with people. Hence, mutual understanding, trust and strong communication skills have been growing in importance as factors in the leader-follower relationship. Further extrapolating, Wilson Learning has advised that, with employers no longer able to guarantee employment, a new psychological contract must be created in organizations. Within this new contract, leaders and employers must enhance employability by giving the employee sufficient skills and experience so that 'they want to be there'. Although the above strongly suggests a link between leadership styles and the pervasive psychological contract, the two have yet to be linked in published research. [Rather, recent literature has explored psychological empowerment as a mediator in the relationship between leadership and organizational commitment (Bhatnagar, 2007; Avolio et al, 2004).]

In summary, the type of leadership style – relational versus transactional – would appear to be a factor that may influence the content of the psychological contract. In addition, we also believe that a firm's institutionally embedded HR practices may either facilitate or hamper leadership effects on the content, formation and/or the perceived breach of the psychological contract. That is, the firm's HR practices may moderate the relationship between the leadership orientation and the psychological contract orientation. In the subsequent section we discuss the relationship between HR systems and the psychological contract.

[Insert Figure 1 about here]

Human Resource Management Systems and the Psychological Contract

‘The distinctive feature of HRM is its assumption that improved performance is achieved through the people in the organization.’ (Guest, 1997: 269) The psychological contract construct has been repeatedly used (as explicated in the review of the nature of the psychological contract above) in attempts to explain how HR practices mediate the relationship between employee behaviours (e.g. employee satisfaction, effort and output) and organizational performance. In addition, recent research suggests that the HR practices of firms have an influence on the content of the psychological contract (e.g., Pathak, Budhwar, Singh & Hannas, 2005).

Despite the positive effects of fulfilled psychological contracts on employee attitudes and behaviors, the literature on HR practices and employment contracts indicates that present day organizations face a dilemma in terms of commitment to their employees and the need to remain flexible (Kulkarni & Ramamoorthy, 2005). That is, organizations need to balance the competing dilemmas of flexibility in contracting and commitment to their employees, whether implicit or explicit. Further, unlike leadership orientation, which may vary from individual to individual, the HR practices of organizations, such as Nucor’s team-management, Lincoln Electric’s incentive systems or Proctor & Gamble’s employee rotational policies, are often embedded and institutionalized. The core characteristics of HR practices are often difficult to change and may influence the contents of the psychological contracts and perceived employers’ and employees’ obligations. Hence, we believe that the interplay between the leadership orientations (relational versus transactional) and the HR practices (flexibility versus commitment) may have different implications for psychological contract formation and development. Figure 2 presents a diagrammatic representation of our proposed typology, based on a two-by-two matrix. Table 1 presents the four different psychological contract configurations that emerge from the potential combinations of the relational-transactional orientation to leadership and the flexibility-commitment orientation to HRM. The characteristics of the HR systems associated with each leadership-HRM orientation are discussed below.

[Insert Figure 2 about here]

Relational-Flexibility Orientation: In a system with a relational-flexibility orientation, the human resource objective is to have needs-based flexibility. While the leadership orientation tends to be relational, the HR practices tend to emphasize organizational flexibility. Such a system may create a psychological contract premised on a partnership-type philosophy. Partnership is characterized by a ‘set of reciprocal commitments and obligations between the organization and the people working in it’ and ‘this principle of mutuality’ provides coherence to the employment relationship within business (Guest & Peccei, 1998:6). The leadership of the firm is committed to its employees but allows for flexibility in HR practices. Such systems may

encompass the following critical contractual obligations: (a) The organization's commitment to its employees is limited to intra-organizational allocation of human capital thus providing limited employment, rather than job security; (b) The organization may invest in employees to develop generic skills that may be used both within and outside the organization, thus exhibiting a commitment to employee development; (c) Consistent with the allocation of human capital philosophy, the firm may provide more horizontal career mobility within the organization; (d) Incentives and rewards may be based on short-term output-based performance that may negate any expectation or obligation of continued association with the firm and/or long-term employment; and (e) When the mutual arrangements are not sustainable, turnover is typically voluntary. Therefore, the psychological contract tends to contain short-term limited partnership obligations.

Relational-Commitment Orientation: The relational-commitment system focuses on a long-term employer-employee relationship with an obligation to provide job security on the part of the employer and a commitment/ loyalty obligation on the parts of the employees. As the goal of the system is to have workforce stability, the psychological contract orientation may tend to reflect paternalistic type obligations. Relational-commitment HR systems may encompass the following critical contractual obligations: (a) The organization's commitment is limited to providing long-term, typically life-long, employment with a high degree of job security; (b) The organization may invest in employees to develop firm-specific as opposed to generic skills, that may be used primarily within the organization and may be consistent with the goal of preventing inter-organizational mobility; (c) Consistent with the developmental philosophy of human capital, the firm may provide narrower, vertical career mobility within the organization; (d) Incentives and rewards may be based on long-term measures and may often focus on behavioral and attitudinal dimensions such as loyalty, longevity, and commitment to strengthen the "bond" between the firm and its employees; and (e) typically, employee separations tend to be through retirements or death. Such systems tend to be characterized by job security. The contents of the psychological contractual obligations may tend to reflect a paternal obligation where the organization is expected to take care of its employees in return for their loyalty and commitment.

Transactional-Flexibility Orientation: Transactional-flexible systems tend to be premised on "arms-length" contractual arrangements between a firm and its employees. Most often, the employee pool consists of part-time, temporary or contractual labor. In such systems, which are characterized by a HRM objective of service flexibility, we may expect no psychological contractual obligations as firms primarily outsource the contractual obligations. The firm and the provider of the service (e.g., contract employees, labor suppliers, and temporary work agencies) rely on the market mechanism for exchange relationships. The mutual obligations are

defined and interpreted in terms of the market and legally binding contracts rather than through a system of psychological ownership.

Transactional-Commitment Orientation: Transactional-commitment systems are characterized by a HRM objective of skills-based flexibility. Such systems may encompass the following critical contractual obligations: (a) The organization's commitment is limited to providing short-term assignments such as projects with little or no job security; (b) The organization may not invest in employee development of skills because the responsibility for developing and acquiring new skills rests primarily with the employees. In such circumstances, while inter-organizational mobility is possible, the firm's commitment may be limited to providing the employees with the new company-specific skills that it may need. The decision to acquire or not to acquire these new skills rests with the employees; (c) Incentives and rewards are primarily market-based, yet the firm tends to foster relatively stable relationships with its employees; and (d) typically, employee separations tend to be through obsolescence of skills. Thus, the psychological contract tends to reflect dynamic and changing obligations between the employer and the employees.

[Insert Table 1 about here]

In summary, we propose that the interplay between leadership orientations and HRM styles may produce different types of psychological contractual obligations. While paternalistic obligations are more stable and long-term oriented, partnership obligations are relatively stable and short-term oriented. Similarly, market-based obligations tend to be purely economic in nature and short-term oriented, whereas dynamic obligations are market-based yet relatively long-term oriented.

DISCUSSION

Prior research on the psychological contract has examined the role of leadership style on the relationship between psychological contracts and employee attitudes and behaviors. Whilst acknowledging that the psychological contract is more implicit than explicit, we propose that future studies should empirically examine the role of HR system characteristics and how they facilitate or mitigate the relationships between leader behaviors and psychological contracts. While studies have looked at the breach of psychological contracts and the resultant consequences for critical aspects of employment relationships such as job security, performance management, human capital development and opportunities for growth, the core philosophies of HRM within the firm may have a profound impact on the development of perceived mutual obligations.

We propose that transactional contracts may be more prevalent than relational contracts among firms pursuing a strategy of flexibility in HRM. In parallel, relational contracts may be more prevalent among firms pursuing a strategy of commitment in

HRM. In this paper, we further propose that commitment may have a short-term or long-term orientation. That is, rather than viewing commitment as a long-term phenomenon, under certain conditions, commitment may also take the form of short-term orientation. To the extent that the firm's HRM philosophies and practices are clear in defining the firm's obligations to its employees (flexibility versus commitment; short-term versus long-term) and defining its expectations of employee obligations, we may well find that both transactional and relational contracts produce desirable results for the firm and the employees. For instance, firms operating in a very stable environment may benefit when the psychological contract is one of paternalistic obligations, and firms operating in a dynamic environment may find desirable consequences when the psychological contract is based around dynamic and/or market-based obligations.

A second issue that we would like to emphasize is the contingent nature of leadership effectiveness. For example, a transactional leadership orientation coupled with a HRM system with paternalistic obligations may be viewed by employees as a major breach of trust and viewed more negatively than a transactional leadership orientation under conditions of dynamic or market-based obligation types. Studies on leadership and psychological contracts (e.g. Judge et al., 2004; Kane & Tremble, 2000; McDaniel & Wolf, 1992; Raja et al., 2004) indicate that transformational leadership results in positive attitudes such as job satisfaction, commitment, and lower employee turnover. While such a relationship may be true, we also believe that the strength of this relationship may be stronger under conditions of paternalistic obligations than under the other types of obligations proposed in this paper.

Studies on HRM practices and firm strategy suggest that an alignment or fit between a firm's business strategy and its HRM strategy is a necessary precondition for success. Given this, firms may not only vary in terms of its commitment versus flexible HRM philosophy at a given point in time but may also adopt different HRM strategic objectives during the course of its existence. For instance, studies on psychological contracts show the dynamic nature of psychological contract by examining the effects of re-engineering (Sapienza, et al., 1997), mergers and acquisitions (Bellou, 2007), and nature of employment (e.g. Cuyper & Witte, 2006; Kraimer, et al., 2005) on changes in the psychological contracts and their effects on attitudes and work behaviors. In our typology, it may also be interesting to study how firms manage not only the psychological contracts at one time but as they move from one type to another during the course of its existence and due to changes in business environment. Such exploration may have significant implications for management development.

Finally, our proposed model may also be useful in analyzing how different firms in the same industry manage their psychological contracts for competitive advantage, under different leadership styles. For instance, Japanese auto manufacturers tend to pursue a model of paternalistic obligations yet other firms such as Ford or General Motors tend to follow a model of transactional commitment orientation. Further,

studies on culture suggest that leadership styles of American and Japanese companies are quite distinct and different. It may also be interesting to study how such differences in leadership and HRM practices of firms operating in the same industry affect the perceived obligations and employee attitudes. In our belief, the use of global measures of psychological contracts may not be adequate to fully understand the nature, content, and dynamics of this very useful concept.

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TABLES AND FIGURES

Table 1: Psychological contract configurations (Leadership – HRM Philosophy)

HR Dimensions and HRM System Characteristics (Psychological contract content dimensions)	Relational-Flexible Orientation	Relational-Commitment Orientation	Transactional-Flexible Orientation	Transactional-Commitment Orientation
Nature of Psychological Contract	Partnership Obligations	Paternalistic Obligations	Market-based Obligations	Dynamic Obligations
HR Objectives	Need-based flexibility	Workforce stability	Service flexibility	Skills-based flexibility
Nature of Employment Contracts	Career-based employment-at-will	Life-time employment orientation	Outsourcing/Arms length contracting	Project-based employment-at-will
Skills Development	Firm investment on generic skills	Firm investment on firm specific skills	Emphasis on buying; no developmental activities	Individual investment on generic skills
Compensation	Internal-equity based on job	Internal-equity based on seniority and longevity	External-equity based on contracted service	External-equity based on skills
Career Development	Broad career path with horizontal movements	Narrow career path with seniority-based vertical growth	No career developmental activities	Skill-based career development
Performance Evaluation	Output-based or results-based	Behavior-focused (e.g. loyalty, commitment) appraisals	Market-based output monitoring	Dynamic evaluation based on output/behaviors
Incentives	Short-term cash incentives based on pay for performance	Long-term incentives such as delayed vesting.	Market-based, dynamic, short-term incentives	Short-term, skills-based incentives
Turnover characteristics	Voluntary turnover due to reduction in workforce	Primarily involuntary through retirements	Turnover due to market-failure	Voluntary turnover due to skills obsolescence

Figure 1: Leadership Orientation, HRM Philosophy and HR Practices

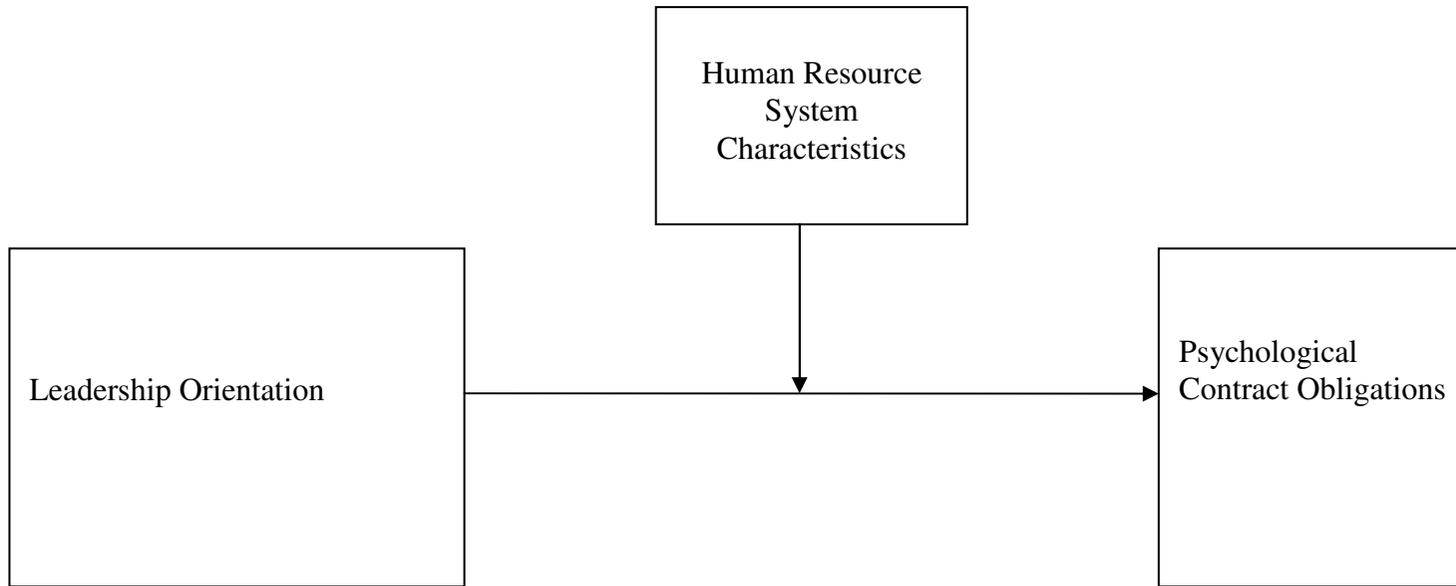


Figure 2: A Typology of Psychological Contract

