

# Psychological Contracts and Strategic Leadership

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## INTRODUCTION

Employment is an economic exchange in which labor and directed effort are provided and money received. Employers often see employment primarily as the process of attracting, developing, and retaining the competent labor force that they require for the organization to survive and grow. However, employment is far more than a simple economic issue and has assumed considerable psychological meaning, social significance, and cultural value. Employees also see employment as a process of productive engagement, but additionally they appreciate that it impacts their economic and social worlds and has a direct bearing on their personal wellbeing (Dollard & Bakker, 2010; Linde, 2015; Shuck & Reio, 2014).

The complex exchange process between employee and employer is mediated by an informal cluster of assumptions, beliefs, and expectations that each holds about the other's anticipated obligations and behavior. This informal and unwritten *psychological contract* has been the subject of considerable debate, speculation, and research since it was first introduced into the organizational literature in the early 1960s (Argyris, 1960; Levinson, Price, Munden, Mandl, & Solley, 1962). The psychological contract provides a sense of stability for the employee because it seems to be based on a set of enduring values and reciprocated consideration. Over time, as the underlying economic systems and social attitudes towards employment shift, it is to be anticipated that there will be changes and re-formations of the psychological contract. These changes are expected to take place gradually and in a negotiated manner; sudden and unilateral changes are always problematic, and "unexpected deviations from the limits of acceptance and tolerance can have drastic consequences, not only for the contract as perceived by the individual, but also for the level of commitment and subsequent organizational behaviors" (Schalk & Roe, 2007, p. 178).

It is important to acknowledge that "the psychological contract that gave security, stability and predictability to the relationship between employees and employers has dramatically altered in the past decades" (Hiltrop, 1995, p. 286). In the decades that Hiltrop refers to (towards the end of the 20<sup>th</sup> century) other things also changed dramatically: unprecedented increases in strategic discontinuities, a blurring of the boundaries that had previously separated businesses, a new ferocity in competitive markets, and an accelerated and conspicuous move towards globalization. To address these complex and disruptive issues – and to successfully navigate the turbulent white-water of the new age – Hitt (1998) called for a re-invigorated and thoughtful application of *strategic leadership*.

A decade later, assessing the record of strategic leadership, Hitt and others noted that although there had been disappointments. They conceded that it had "brought the US and world economies to the precipice of failure"; nevertheless, they continued to believe that "the potential for positive strategic leadership not only exists, but is indeed the way forward" (Hitt, Haynes, & Serpa, 2010, p. 441). These authors were not alone in advocating the power and potential of strategic leadership. As a theory, practice, and promise strategic leadership has become the most widely advocated leadership approach for organizations in our complex and troubled 21<sup>st</sup> century (Dinh et al., 2014; Rainey, 2014; Rowe & Nejad,

2009). Certainly, the power and potential of strategic leadership is much discussed, but evaluations of its application and success are significantly few (Elenkov, Judge, & Wright, 2005; Nishii, Gotte, & Raver, 2007). In particular, one important question remains unanswered: How does strategic leadership impact the psychological contract?

This brief chapter is better seen as articulating this question, rather than as definitively answering it. The first section of the chapter provides background by examining the nature and dynamic of the psychological contract. The second section discusses the formation, implementation, and the utility of the psychological contract against a framework of strategic management and strategic leadership. The third section suggests research initiatives that are considered important, while the final section summarizes the main points of the chapter.

## BACKGROUND

Work and employment are situated in multiple domains. They are most obviously an integral part of an economic system in which goods and services markets are linked to the resource markets (including labor markets), which allow those products and services to be created. Work and employment are crucial in a macroeconomic and market-centered process of exchange; however, work and employment are also embedded in prevailing social norms and cultural matrices. Thus, work and employment have social dimensions such as power and authority, patterns of differential status, social exchange relationships, assumptions of mutuality and reciprocity, and expressions of trust and confidence (Coyle-Shapiro & Shore, 2007; Shore, Coyle-Shapiro, Chen, & Tetrick, 2009; Song, Tsui, & Law, 2009).

Within this economic and social complexity some have identified an implicit *social contract*, which is understood to be “the ensemble of the promises which play the role of obligation between the employee and the employer” (Rousseau, 1995, p. 5). Others have gone further, advancing the construct of the social contract to include not only normative social expectations, promises, and obligations, but also the psychological domain of the employee-employer interface: the *psychological contract*. This more expanded approach seeks to understand how employees perceive the employment relationship, how they respond behaviorally to those perceptions, and the extent to which these informal contracts “provide the employee with order and continuity in a complex employment relationship, allowing for predictability and control” (Shore & Tetrick, 1994, p. 95).

It is, however, somewhat disingenuous to differentiate too rigidly between a distinct social contract and an equally distinct psychological contract because “the social is psychologically invested and the psychological is socially formed, neither has an essence apart from the other” (Frosh, 2003, p. 1555). Nevertheless, it is widely understood that *psychological contracts* do come into existence and that they are molded by broad social factors and by perceptions and anticipations of organizational behavior (Coyle-Shapiro & Parzefall, 2008; Guest, 2004). Rousseau (1995) defines the psychological contract as a construct that encompasses all of the “individual beliefs, shaped by the organisation, regarding terms of an exchange agreement between individuals and their organisation” (p. 9). More recently, Linde (2015) has defined it as “the experience of employee and employer obligations through perceived promises made in the reciprocal employee-organisation relationship” (p.11).

The psychological contract is constantly being reformulated, in part because “the creation, regulation, and ending of employment relationships are embedded in societal institutions, laws, regulations, norms, and values” (Schalk, 2004, p. 304). As these norms and values shift, so does the psychological contract. For instance, there is considerable research work demonstrating that younger workers (e.g.,

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