

An evaluation of the nature and purpose of psychological contract: Recommendations for appropriate HR Practices to ensure a healthy psychological contract is developed and maintained

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Abstract: The psychological contract is a well-know concept amongst researchers seeking to analyze changes and management practices in the workplace. This paper examines the main theoretical underpinnings of the concept, attempting to establish its usefulness as a tool for scrutiny of the employment relationship. There is also attention on the linkage of the psychological contract with organizational practices and the uptake it has by HR managers. In the end we propose future directions for consideration.

Keywords: Psychological contract, HR practices.

Introduction:

Psychological contract was firstly used by Argyris in 1960 to describe the reciprocal obligations in the employment relationship and since then it has become the focus of numerous researches. This paper attempts to look firstly at the nature of the PC (psychological contract) by examining its definition and the dynamics in the relationship between the organization and employees. Additionally it takes a look at the types of psychological contract and examines their characteristics, comparing them with standard employment contracts.

In the next stage, the focus of the research turns to the alleged `new` psychological contract and the change of setting, from job security and stability offered to employees in return for loyalty, to a situation where organizations demand flexibility and skills and in return they can offer little stability. Substituting for the lack of security, organizations provide training and development in order for employees to raise their portfolio of skills and make themselves more employable. In this rather pessimistic picture, the burden on employees is indeed acknowledged. Nevertheless, PC is seen as a positive tool in the hands of HR practitioners and line managers to build trust and commitment in the ER (employment relationship) especially as some of the old principles of the PC such as trust to the organization have yet not faded. In light of these changes, the violation and breach of the PC is examined, the results it can have on employee morale and performance depending on the intensity of the perceived violation.

In the last part, the analysis turns to the role of HR policies in managing the psychological contract, promoting changes in the culture of the organization, introducing openness and two-way communication along with more particular measures such as realistic job previews and support for the `survivals`. The research concludes summarizing the main points, stressing that the PC is a powerful and applied concept not only analyzing the ER but also providing a framework to resolve problems that often arise. If managed correctly, along with a positivistic attitude it can provide to the organization a smooth transition for the changes that need to be incorporated in the employment relationship. At the same, it can help in maintaining commitment, avoiding potential violations and the adverse effects in performance that follows.

Psychological contract: Definition and dynamics

Trying to define the psychological contract, it can be seen as *“individuals beliefs, shaped by the organization, regarding the terms of an exchange relationship between the individual employee and the organization”* (Beardwell, Holden & Claydon, 2004:pg 520). The basis of this relationship is reciprocity between the organization and employees on the perceived obligations and expectations from one to another (Beardwell et. al 2004; Pointon, 2004). As the PC evolves around individual beliefs and perceptions, it is highly subjective and can be particular to each employee and exactly because of that is far more complex than any written contract.

In essence, the psychological contract constitutes an unwritten agreement between the organization and employees based on mutually accepted promises and obligations among the organization and the employees. We can summarize the main parameters of this relationship as¹:

- **What the organization provides** : Includes everything the organization is perceived to bring in the agreement, from financial rewards and fairness to the fulfillment of all its obligations
- **What the organization expects from employees**: Everything the organization believes its employees will add in the total value especially intangible elements such as work, honesty, loyalty, flexibility etc.
- **What employees bring to the organization** : Everything that employees are perceived to bring to the agreement such as effort, skills, commitment and of course, the fulfillment of obligations
- **What employees expect from the organization** : What employees expect the organization to provide including pay, job security, good working environment etc.

One of the major arguments in the PC theory is whether it can be regarded as a *“contract”* in comparison to formal contracts that have a stipulated content with fixed parameters. (Arnold, 1996). Contrary views argue that PC *“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”* (CIPD, 2003)².

Sparrow and Marchington (1998) claim that there is an interaction between employment contracts and the PC since legal terms and conditions will affect both parties perceptions. In terms of strict comparison, PC is an implicit reflection of the employment relationship resembling a legal contract only on a broad scale. In terms of power as it will be discussed later, the instance of a contract breach can cause adverse effects to the organisation and the employees, very similarly to the sanctions imposed to the violation of a written contract. There are differences between the two concepts but the similarities are enough to justify the use of the term as a symbol of the power it carries in the ER

Psychological contract typology:

Psychological contracts have been often defined according to their particular characteristics. For example Rousseau (1995) distinguishes PC as:

- Transactional- Contracts structured with emphasis on material rewards that have a short-term duration and are relatively narrow in their scope.
- Relational – Contracts structured around less tangible rewards, have a significant duration often without an implied end-date and are subject to the individual party's beliefs.

It is essential to comprehend which type of relationship is relevant in each case. The case could be that an employer offers a relational contract whilst employees demand is of a transactional. This could lead to confusion and conflict in the organization. Guzzo and Noonan (1994) suggested a

¹ Adapted by Pointon, 2004.

² CIPD staff, (2003). *“Managing the psychological contract”*, CIPD, <http://www.cipd.co.uk/subjects/empreltns/psycntrct/psycontr.htm?IsSrchRes=1>

hybrid combination of PC both with transactional and relational elements. This could also reflect reality, especially as organizations need to strengthen for example their credibility in holding a sound transactional deal before attempting to establish a more long-term relational deal that requires considerable more investment in trust and loyalty. One noticeable theme is the variation in psychological contract across people and firms (Rousseau, 2000).

Another interpretation of the PC was offered by Guest & Conway (1997;2004). The model starts from the antecedents of the PC, it moves to its content and lastly examines its consequences. This framework provides some interesting insights as it probes over the various individual characteristics, the organizational climate and influence of HR policies. The second stage tangles with the sense of trust, fairness and reciprocal fulfillment of the obligations and expectations among the contracted parties. In the last part, this produces attitudinal results such as work satisfaction and commitment, leading ultimately to employee behaviour judged by work performance and intention to quit. This interpretation offers a positivistic view of the PC emphasizing its role in analyzing the ER.

Both interpretations highlight different aspects of the psychological contract but also have common elements. Due its subjective nature and the numerous factors influencing its course, the PC is highly fluid and frequently merits redefinition and renegotiation (Rousseau, 1995;Guest & Conway, 2002; Pointon, 2004). Equally, trust between organization and employees along with commitment is as important as the perceived fulfillment of promises. Lastly, it is clear that HR practices are key in managing the PC effectively as it *“sends strong messages to individuals regarding what the organization expects of them and what they can expect in return”* (Rousseau, 1995: 162)

The new psychological contract:

Traditionally, it was believed that the main expectation of employees in return for their input to the company was a level of employment stability both in terms of working environment and job of security (Sparrow & Marchington, 1998;Martin, Staines & Pate, 1998; Beardwell et. al 2004). Nevertheless, the rapid changes in the economic and business life the last decades transformed organizations significantly. Intense competition on a global scale, political developments and numerous other factors forced organizations to adjust their structures towards a leaner, flexible more efficient approach that could withstand competitive pressures (Hitrop, 1995;Sparrow,1996) As a consequence, there was severe restructuring on people's management and corresponding changes in the employment relationship . As Sparrow and Marchington (1998) argue *“ many of the long-established roles having disappeared, and with the existence of fewer key roles, there was a need to re-establish clearly signposted career paths/themes ”* (pg 98).

In the past, organization expected loyalty and commitment over a lengthy period of time and employees expected job security and remuneration based over their long duration of service to the organization. Currently, there is a need for a flexible type of employees that will be able to constitute themselves more employable through skills and abilities they will accumulate through training and willingness to perform a variety of tasks. The latter will enable them to increasing their learning and adapt their portfolio of capabilities. By doing so, employees are deemed as more *“marketable”* , more efficient to the organization and more equipped to handle the pressures of the new marketplace (Herriot & Pemberton, 1995; Sparrow & Marchington, 1998).

This description is rather pessimistic for employees and the ER as a whole. Contrasting this picture, CIPD research quite convincingly argues that the changes have not been so dramatic and employees are not so fearful of losing their jobs or lost faith in organizations (Guest & Conway,2004;CIPD,2003& 2005).In summary, the current state of the psychological contract is pretty much the same as in the past. Employees in majority are satisfied with their jobs, four out of five employees are not worried about losing their jobs and commitment has not declined in broad terms the last years whilst trust in the organization has declined to an extend (CIPD, 2005a).

Concerning the *“new”* workplace *“undoubtedly there have been many changes in the nature of the employment relationship, largely reflecting global changes in product and labour markets, which*

employees need to be aware of. But these changes are more a continuous and gradual process of transition rather than a disastrous and irreversible shift into a new and intimidating future.³ The most interesting point in this theoretical framework is the recognition of the PC as a tool in the managerial effort to handle the employment relationship. It proposes a view of the PC as an instrument to assist employers in planting the seeds of change without compromising the co-operation and succor of their workforce in the process. It interprets the fluidity in modern business life as call for organizations to take the most out of their human capital. In accomplishing this, managers need to know what employees expect from their employers and PC offers the means to do exactly this. (Guest & Conway, 2002; CIPD, 2005; 2005a)

It would seem that truth lies somewhere in between. Ignoring the changing workplace and the impact it had to the psychological contract is impossible. New variables have emerged and the employee-organization input/expectation relationship has shifted. Nevertheless, leveling everything down is both pessimistic and equally unrealistic. For example, people might not be able to remain on to their works eternally but it seems unlikely that a corporation would invest in its human capital to `throw` it away so easily. Furthermore, PC is highly subjective, fluid and constantly redefined and thus in a respect it happens `` that employment practices have changed for some does not mean they have changed for all...the old psychological contract of long-term and secure employment never described the job situation for many workers.... the new psychological contract does not accurately describe the jobs of all employees either`` (Fisk, 2002: 768).

As the PC is constantly renegotiated, people and organizations will have to adapt and changes will always occur. Equally, reactions to changes in the PC will be dependent largely on whether HR practitioners adopt a positive approach towards ER. This can be promoted by facilitating the transit and minimizing reactions to the changes that are occurring in the workplace. Should this not happen, there could be difficulties in managing the relationship with the workforce and thus give cause for confusion and negative sentiments.

Psychological contract violation :

With the changes in the context of the PC and the renegotiated ER it is likely that some employees might feel that the organization is failing to meet its obligations and view their expectations not being realized. This could affect employee's overall loyalty and performance. This is termed as a violation to the psychological contract (Rousseau, 1995) although we can make a distinction in the various degrees the violation occurs. It is possible for employees to be aware of the employers inability to meet expectations or that parts of the contract have not been fulfilled timely and thus the reaction might be mild in light of a `perceived breach`. On the other side, a `violation` produces a much stronger and emotional response from the employees (Morinson and Robinson, 1997).

According to Rousseau (1995) there are 3 main types of contract violation:

- **inadvertent**→The result of divergent interpretations that were made in good faith
- **disruption**→ When either both or at least one of the parties wants to comply with the agreement but cannot
- **reneging**→ When both or at least one of the parties is unwilling to comply with the agreement

The effects of PC violation are strongly dependent on the emotional response they trigger to employees. Due to the subjective nature of employee expectations, the reactions in the event of a violation or breach can differ. As such a portion of the employees would end up with a strong sense of injustice on behalf of the organisation and another portion feeling less hurt (Deery, Iverson & Walsh, 2003). How will employees perceive a violation of their PC will also be dependent on personal factors such as age, education and past experiences and altogether could create differential perceptions about the employment relationship and perhaps to the degree a breach or violation is perceived (Rousseau, 1995; Deery, Iverson & Walsh, 2003). At the same pattern there can be variations to the

³ CIPD (2005a). `` Managing change: The role of the psychological contract`` pg 5.

way employees will react to a contract violation. According to Rousseau (1995) there are four principal reactions to a perceived violation employees can have:

- Exit – voluntary termination of the working relationship either from the employer who lays off underperforming employees or from employees who prefer to leave an unreliable organisation.
- Voice- The effort to negotiate the violated parts of the agreement and resolve potential problems that have arisen in a constructive fashion
- Silence – A passive response with no reaction in hope that conditions will change to more favourable terms in the future but in essence it often ends in perpetuating the existing relationship
- Destruction/ Neglect – It entails either passive indifference to one's duties in detriment to the interests of the organisation or even further, more active counterproductive behaviour.

Undoubtedly, HR practitioners are mostly worried of adverse effects in performance either in the form of absenteeism or neglect of one's duties or the loss of organisational citizenship- the willingness of employees to provide `extra` from their narrow role in the organisation. Courtesy, conscientiousness and other features that define the social interaction in the organisation and are necessary for the smooth running of the organisational life can also be harmed (Pointon, 2004). Besides decreased performance, another dimension is that the organisation's overall human asset and talent declines which also might make it difficult to recruit new candidates if word of dissatisfaction spreads. As a result, the organisation will be unable to capitalise on its intangible assets, hence losing an important competitive advantage (CIPD, 2005).

In spite of all the technical details in contract violation, the heart of the problem is the damage to the trust employees have for their employer. In simple words, if employees feel trust towards the organisation then it is possible they will be more inclined to forgive or overlook some perceived violations or at least be more receptive in the renegotiation of the PC. Whereas, if the sense of trust is less strong, the negative emotional response by employees will be magnified in the event of a perceived violation making thus the situation more difficult.

At this stage it is important to stress the role of the line manager. Line managers are the people that employees interact on a daily basis and to a large extent are considered as `the organisation's representatives` and thus a key part in the management of the ER (Purcell, Kinnie & Hutchinson, 2003). A large amount of perceived violations will come from the interaction with the line managers or more adequately put, how line managers behave plays an important role in the creation of perceived breaches of the PC and equally it can determine the intensity of the reactions. If for example, line managers are willing to listen and discuss the problems with employees (as in the voice reaction) then it is possible that reactions will be less tense. On the contrary, rigid behaviours from the line managers can trigger negative emotional responses by the employees. Recapping so far, it is clear that PC exists within one form or another in the organisational life and in fact is an inherent part of it. The benefits of a healthy PC are numerous for both parties. Table 1 in the appendices offers a summary of the main.

Towards a healthy psychological contract: Advice for HR practitioners

The main issue that emerges, is how to manage the PC given its subjective nature and the rapid pace of changes. Furthermore, the administration of the PC must be such to ensure a positive outlook in the eyes and minds of employees, inspiring trust in order to negotiate points of convergence when some elements need to be altered due to competitive and organisational pressures. As a consequence, it is largely on the HR practitioners responsibility to ensure that a healthy contract is maintained and violations and breaches are to be avoided given of course the constraints.

The starting point for the HR department is to acknowledge and recognise the state of the the psychological contract within the organisation for both parties and in relation to the wider business context. Naturally, the rapidly changing environment and the competitive pressures that cause redefinition of the former PC must also be taken into account. It is necessary to create a positive climate in the employment relationship so as not to thwart employees and build up their sense of

trust and commitment towards the organisation. As a starting point, we can see the need for adequate, two-way communication from the senior manager level down to the lowest layers of the organisation. Even further, communication needs to be honest and adopt a culture of openness since as mentioned, employees are more receptive to changes when told exactly what is going on in their working environment (Hiltrop,1995; Guest & Conway, 2002; CIPD, 2005).

At this stage, we can again see the role of line managers as the linkage between the upper and the lower levels of the organisation in the communication process. It is essential to ensure that line managers work efficiently and go at all lengths to speak with employees, discuss and explain to them the why's and how's of the decision-making inspiring to them the sense of trust whilst making them feel more involved in the running of the daily business. Some researchers are trying to find methods to cultivate commitment to employees through alternative channels based on the security-commitment model that characterises the old PC that but also reflects the renegotiated needs of the organisation. Such suggestions include⁴:

- **The creation of cross-functional teamwork** to build interdependence and co-operation among individuals. It also can create a smaller social surrounding where commitment is more likely to be borne out of sharing ideas and values with the other members and becoming socially involved in the group.
- **The creation of challenging work experiences** allowing them a level of autonomy permitting them to express themselves and thus feel a sense of accomplishment through their work. As result commitment and identification with the organisation becomes more pronounced
- **Improvement of the induction and the socialisation process.** Offering realistic job previews to new entrants in the organisation in order avoid inflated expectations
- **Build organisational pride and recognise Personal Values:** It is important to integrate organisational objectives and values with the individual. Employees should be stirred to take the sense of accomplishment a step further and take organisational pride and worth as their own thus working harder to achieve them.
- **Align HR policies and practices with social changes.** Adopting a culture of openness to allow employees to understand decision-making and strategic goals even if there are bad developments. Honesty and openness empower the bond between employees and organization.
- **Help those who are forced to leave the organization.** Especially older employees might be anxious about their fate. Suggestions include, extensive training to cope with cross-functional duties, potential outplacements to gain in knowledge and expertise or even career centers to offer advice about employment opportunities both within the organization and to other possible employers.
- **Invest in the survivors** .It is important handle the effects in the remaining employees. There must be communication and counseling to maintain the morale and not allow skepticism and negative feelings to thwart survivors

The previous measures although important are rather general. HR needs to apply more solid practices along these lines to manage the PC effectively. Undoubtedly, reward is one of the major aspects in the ER. Current demands from employees include features such as flexibility, precision and effectiveness. As a consequence, the remuneration system must reward these attributes sufficiently. Incentives should be offered in terms of rewards to make employees develop these competencies and excel in their line of work and beyond. In the spirit of decentralisation, individuals and groups should be given greater opportunities to participate in the appraisal process which on its turn should be based on continuous performance and improvement and not isolated events and previous accomplishments (Hiltrop, 1995).

⁴ Hiltrop, 1995;1996;CIPD, 2004)

The need for training and development was stressed both for individuals to develop marketable skills and competencies but also for the organisation as well in benefiting from the employees enhanced contribution. This calls for systematic training and development programmes such as in-company, cross-functional and non-hierarchical types that can succor not only in enhancing employees capabilities but also increase communication across the departments of the organisation (Hiltrop, 1995, cipd 2005a). Additionally, as working in teams is a necessary skill for employees, it is important to provide guidance and training to individuals in order to work well within groups. Simultaneously, managers must also be prepared accordingly to provide the leadership element in teamworking so as to reconcile differences and help resolve issues that may arise in the group (Hiltrop, 1995;Hutchinson,2005).

In essence, the sum of these practices is deemed to *increase loyalty and commitment of employees by setting up a system for establishing and discussing employee expectations early in the employment relationship, creating opportunities to check out whether the psychological contract is still valid at later stages, and renegotiating the contract if necessary* (Hiltrop, 1995:293). Undoubtedly, these methods can be very helpful for HR practitioners in tackling with the various problems from the changes in the ER and assisting the transition of the PC. The only issue that emerges is that the majority of these practices is based on the mentality that the new PC is sweeping away all the older principles of the employment relationship such as a sense of stability and relative security and the current environment is almost completely fluid.

The problem is that while the changes in the working environment and in the ER are important and indeed rapid as pointed earlier, employees still hold some of the values the new psychological contract advocates consider as a thing of the past (Guest & Conway, 2002; CIPD, 2003;2005;2005a).This is an important notion to keep in mind because all suggestions might be perfect in theory put when applied in reality they need also the proper mentality and focus to accomplish their objectives. This is even more accentuated as HR practitioners have to tackle with employees pressure and stress and the adoption of a pessimistic approach would only aggravate things (Marks, 2005). Managing the PC is by no means an easy task and in many cases the pressures will make the situation strenuous. Nonetheless, it is vital to maintain a positive disposition that will cultivate openness and communication with employees and will help strike a balance in their relationship with the organisation .

Conclusion :

The psychological contract is an unwritten agreement between the organisation and employees based on the mutual exchange of perceived obligations and expectations. Different from a standard employment contract , it describes far more widely the employment relationship but still includes many elements of what it can be considered a `contract`. It is highly subjective as it is shaped from individual beliefs in combination with the organisational climate and the particular HR policies. The literature suggests different interpretations but also agrees in that the PC is fluid, constantly renegotiated and adaptive. The shift from an old to a new format of the PC is also debatable. Indeed, the conditions in the workplace have changed but it cannot be said that all the constants of the PC have been altered as many values are still firm to the minds of employees.

HR practitioners are responsible to manage effectively the PC in light of all these changes. It is vital to maintain a positive attitude towards employees and as research suggests, the PC can not only be an analytical tool to assess the ER, but also then means through which to promote a spirit of co-operation in employees mentality. The specific tools and methods that can be applied are important but foremost needs to be the concept of maintaining a positive PC which without all endeavors are likely to fail . Only through these channels it is possible for HR practices to be effective and avoid violations or breaches in the contract and the adverse effects these could have for the organisation.

APPENDICES:

Table 1. Benefits from maintaining of a healthy Psychological contract.

- *Benefits for the organization* → Minimising employee disappointment that comes with PC breach, the organization manages to maintain the performance of its workforce at high standards and avoid potential decreases in overall efficiency
- The PC cannot only be seen as the reciprocal agreement to describe the employment relationship but also as tool to manage changes that occur in the organization and have an impact on employees. Building a positive PC can assist in a smoother transit allowing for a better adjustment in the new characteristics in the ER
- In an era where recruiting and retaining talent is vital, a positive PC will help organizations to take the most from their human capital and also to act as a beacon to attract further talent.
- *Benefits for the employees* → In the rapidly changing organizational life, a positive PC can help employees be a more proactive in the running of the company. Also, as employees are aware of the decision-making processes it likely they will develop a feeling of self-accomplished. Accepting the situation and co-operating with the management would allow them to exploit the opportunities for training, education, team-working etc to increase their portfolio of competencies hence making themselves more marketable inside their organization but also for other possible employers.

Source: Own created

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