

Leadership and Psychological Contracts

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Abstract

Leadership and psychological contract both have their bases in social exchange theory, have been studied by many, but none have explicitly related one with the other. This research paper fills the gap by proposing the relationships between leadership styles and psychological contract types. The discussion is based on the common underlying factors in both, such as trust and obligations and highlights how changing dynamics require psychological contracts and leadership styles to be flexible. Implications and future directions are provided.

Social exchange (Blau, 1964) has enabled us to better understand many organizational relationships; amongst these are leadership, and psychological contracts. Though these two have been discussed by many, no one has tried to show explicitly what possible links can exist between them, which is the very aim of this paper.

Leadership is a broad construct, incorporating many other constructs. Though studied by many, there has not been much consensus regarding definition of leadership, or whether it is a science or an art; and confusion and controversies prevail (Barker, 2001; Karmel, 1978; Bass, 1999; McElroy, 1982; Pfeffer, 1977). Barker (2001) elaborated that many authors take leadership and management as one and the same thing. With the various schools of thought leadership can be defined as “. . . the reciprocal process of mobilizing, by persons with certain motives and values, various economic, political and other resources, in a context of competition and conflict, in order to realize goals independently or mutually held by both leaders and followers” (Tourish and Pinnington, 2002). The paradox in the definition and theory of leadership is that all leadership definitions incorporate the term ‘change’, showing that leadership is needed in times of change while management is done in times of stability but the various types and styles of leadership encompass both change and stability. Thus this paper will look at both types of situations, and various types of leadership perspectives. The paper looks at leader and subordinate relationship, as conventionally theorized, and does not incorporate the effects of personal or organizational characteristics such as, personality type, organization size, and type. It does discuss traits, behaviours and situations, as these are a part of leadership theory.

Some theorists argue, whether leadership as theoretically stated, is really ‘leadership’. For instance Jones (2001) discusses that true leadership is when follower complies with a leader “. . .responding from the heart, experiences a freedom that could not be found in mere compliance.” [755]. But such a discussion is beyond the scope of this paper. The relationship between leader and subordinate may be merely transactional, or can be of mentor and protégé, one who guides another (Bass, 1999), it varies depending on level of trust between each party and how they relate with one another. If they share a strong bond

then, chances are that they would have high trust and feel obligated to one another which, is the very premise of this paper.

Obligations

All organizational relationships are inherently bound by obligations between parties. Obligation is the basis of all social exchanges, and the key component of psychological contracts (Robinson, Kraatz, & Rousseau, 1994). Leaders and subordinates are obligated to one another, and have expectations regarding what subordinates need to do, and what the leader would be providing in return (Bass, 1999). Both psychological contract (Schalk and Freese, 1993) and leader- follower relationship (Avolio, Bass, and Jung 1999) are dynamic exchange agreements based on the beliefs of parties involved, driven by one sided perceptions regarding the relationship.

A psychological contract is “[a]n individual’s belief in mutual obligations between that person and another party such as an employer” (Rousseau & Tijoriwala, 1998: 679). “A psychological contract is set of beliefs held by a person regarding terms of an exchange agreement to which that person is party. Beliefs about mutual employment obligations, as seen by either an employee or an employer, constitute a psychological contract with respect to the employee-employer relationship.” (Robinson and Morrison, 1995: 290). There is lack of agreement on definition of both leadership and psychological contracts (Guest 1998; Guest and Conway 2002). Understanding both concepts enables us to better understand leader- follower relationship. Millward and Brewerton (1999) state that psychological contract help explain the implicit relationship between employee and employer, and by means of reciprocity enable us to better understand the exchange process. Both leadership and psychological contract incorporate some level of mutuality and reciprocity (Rousseau and Dabos, 2004). Mutuality is defined as “the degree to which the two parties agree on their interpretations of promises and commitments each party has made and accepted” (Rousseau and Dabos, 2004: 53) where as reciprocity is “the degree of agreement about the reciprocal exchange, given that the commitment and contributions made by one party obligate the other to provide an appropriate return” (Rousseau and Dabos, 2004: 53). Psychological contracts are based on trust (Robinson and Rousseau, 1994), “... this trust is implicit in the expectation that leaders will follow through on rewards promised for good performance or on the understanding that followers who work diligently towards a shared vision will receive contingent rewards.” (Goodwin, J. C. Wofford, J. Lee Whittington, 2001: 762).

Trust

An underlying key factor in the theory of social exchange (Mayer, Davis and Schoorman, 1995), leadership and psychological contract is trust (Goodwin et al. 2001). Trust comes in play when there is a risky situation and one is vulnerable to some one (Mayer et al. 1995). Trust reduces uncertainty (Tschannen-Moran and Hoy, 2000). It “...is the willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party” (Mayer et al. 1995: 712). Traits for trust worthiness are benevolence, ability, integrity. For subordinate to trust the leader, the leader must be knowledgeable (ability), should want to help the subordinate, aside from a self driven self benefiting motive (benevolence), and should adhere to some principles (integrity)(Tschannen-Moran and Hoy, 2000).

Trust is a psychological state where one is willing to be vulnerable, based upon positive expectation of the intention or behaviour of other (Rousseau, Sitkin, Burt, & Cramere, 1998). Therefore for followers to be able to identify and internalize with the leader they need to trust the leader, which enable them to perform extra role behaviours such as organizational citizenship behaviour i.e. is going above and beyond the call of duty (Podsakoff, MacKenzie, Moorman, & Fetter, 1990). Trust plays a key role in psychological contracts, and its theory, though it has been stated as an explicit or implicit underlying assumption, and not discussed as variable understudy (Robinson, 1996). Robinson (1996) in her discussion of psychological contract breach relates trust with two conditions, “judgement of integrity and beliefs in benevolence” [578]. When trust is lost (in case of breach), employee loses confidence in reciprocity from the side of the leader in future (Robinson 1996). Since trust is needed for reciprocation therefore if followers trust the leader only then they will reciprocate.

There are striking similarities between the psychological contract and leadership. Goodwin et al. (2001) in their study of contingent rewards found that implicit psychological contract and transformational leadership, while explicit psychological contract and transactional leadership are related. Both leadership and psychological contracts are based on concepts of mutuality and reciprocity; and social exchange (Grean and Uhl-Bien, 1995; Millward and Brewerton, 1999). The levels of mutuality and reciprocity may be different in case of various styles of leadership and forms of psychological contracts. Below I discuss the leadership as transactional, transformational, charismatic, and in leader-member exchange, and propose their relationship with psychological contracts, which are transactional, transformation and hybrid.

Transactional & Transformational Leadership

Burns (1978) was the first author to contrast transformational and transactional leadership styles. Transactional leaders are those who focus on time constraints, with concentration on efficiency, are risk averse and follow the convention (Bass 1985; Lowe, Kroeck, Sivasubramanian, 1996). The relationship is based on a reciprocal exchange where both subordinate and superior gain something of value (Kuhnert & Lewis, 1987; Yukl, 1981) and/or to meet their self-interests (Bass, 1999).

It may take the form of contingent reward in which the leader clarifies for the follower through direction or participation what the follower needs to do to be rewarded for the effort. It may take the form of active management-by-exception, in which the leader monitors the follower’s performance and takes corrective action if the follower fails to meet standards. Or it may take the form of passive leadership, in which the leader practises passive managing-by-exception by waiting for problems to arise before taking corrective action or is laissez-faire and avoids taking any action.”
(Bass 1999:10-11)

Psychological contracts are divided into three broad categories, transactional relational and hybrid contracts. “Transactional contracts involve specific monetizable exchanges between parties over a finite and often brief period of time” (Robinson et al., 1994: 139). “Transactional contracts are easy to exit agreements with relatively high

turnover” (Dabos and Rousseau, 2004: 54) with clear and well specified terms of performance (Dabos and Rousseau, 2004).

Transformational leadership refers to the leader moving the follower beyond immediate self-interests through idealized influence (charisma), inspiration, intellectual stimulation, or individualized consideration” (Bass, 1999: 11). Leaders who are more transformational and less transactional are more satisfying to their followers as well as more effective as leaders (Bycio, Hackett, & Allen, 1995). Transformational leaders aim at effectiveness rather than efficiency, are risk takers and try to change things rather than following them. (Avolio and Bass, 1998; Bycio et al., 1995; Lowe, Kroeck, Sivasubramaniam, 1996).

The second type of psychological contracts is relational. “Relational contracts ... involve open ended, less specific agreements that establish and maintain a relationship” (Robinson, et al. 1994: 139). “A relational contract can engender affective involvement or attachment in employee and can commit the employer to providing more than remunerative support to the individual with investments like training, personal and career development” (Millward and Brewerton 1999: 255). Dabos and Rousseau (2004) state that “... relational contracts exemplify many emblematic characteristics of paternalistic relationships” [54]. Relational contracts are likely to exist in case of long term relationship where there is high trust between the parties and they feel obligated to one another. Similar is the case of transformational leadership, such “... leaders motivate followers to achieve performance beyond expectations by transforming followers’ attitudes, beliefs, and values as opposed to simply gaining compliance” (Bass, 1985; Yukl, 1999a, 1999b). Transformational leadership and relational contracts both relate strongly with affective commitment as compared to transactional contracts (Bycio, Allen & Hackett, 1995, Dabos and Rousseau, 2004, Raja, John & Natialis, 2004). Where as in case of transactional contracts organizational commitment is low (Dabos and Rousseau, 2004). Similarly trust is higher among followers of transformational leaders as compared to transactional leaders (Bass, 1999). Similar is true for relational and transactional contracts respectively (Millward & Brwerton, 1999). From the above discussion it can be deduced that transactional leadership and transactional contracts have many aspects in common, while relational contracts and transformational leadership have many similarities. It is likely that transactional contracts will develop between transactional leader and his/her followers, while relational contracts will develop between transformational leader and followers. Thus I make the following propositions:

Proposition 1: Transactional leader will be more likely to have transactional contracts with their followers as compared to transformational leaders.

Proposition 2: Transformational leaders will be more likely to have relational contracts with their followers as compared to transactional leaders.

Some believe that transformational leadership is complementary to transactional, that the latter has to exist, for the existence of the former. Transformational leadership ‘augments’ transactional leadership such that it enables the followers to achieve above the basic expectations (Howell and Hall-Merenda, 1999; Lowe, Kroeck, & Sivasubramaniam, 1996; Waldman, Bass & Yammarino, 1990). Grean and Uhl-Bien (1995) discuss in their study of leader-member exchange that relationship begins with transactional social exchange and moves on to transformational social exchange. Similar to this concept, is what Millward and Brewerton (1999) debate, that employees first seek to have transactional requirements met

before they move on to relational contracts. Transactional contracts as stated earlier are more economic in nature and are time barred, whereas “[r]elational contracts involve both monetizable and non monetizable exchanges.” (Robinson, et al. 1994: 139). Just as transformational leadership requires transactional leadership to exist, similarly I propose that:

Proposition 3: For relational contract to exist, transactional contract must be present.

Some argue that the bipolar dichotomy of leadership, such as initiating structure and consideration, transactional and transformational styles, task versus relationship oriented etc. are not really bipolar, or uncorrelated (Schriesheim, House and Kerr, 1976). Effective leaders have to have a bit of both poles (Bass 1999; Denison, Hooijberg, Quinn, 1995) and should be able to respond to complex situations and paradox in environment effectively (Maruyama, 1976). Denison et al. (1995) further state that effective leaders have to show not only cognitive but behavioural complexity, i.e. they should be able to analyze which role to adopt in a certain situation, and be able to perform various roles. “Complexity implies the ability to respond to a host of ambiguous and contradictory forces, including simultaneous presence of opposites” (Denison et al. 1995: 526). Quinn’s model of leadership (Denison et al. 1995) elaborates that leader to be effective can and should play various roles, which exist simultaneously, such as director, mentor, facilitator, innovator etc. in case of different situations. Jacobsen and House (2001) have discussed that leaders are better able to express their dispositional attributes in weak situations as compared to strong ones. “Weak situations are those which lack norms, rules, guides, incentives, and prior learning with respect to enactment of normatively appropriate behaviours. Strong situations have the opposite characteristics.” (Jacobsen and House, 2001: 76). So different styles of leadership are needed in different situations, similarly changing circumstances also affect psychological contract. “In this climate of change, the traditional contract of long-term job security in return for hard work and loyalty may no longer be valid, and employees and employers alike are now reconsidering their mutual obligations” (Robinson, 1996: 574). Thus leaders have to reconsider their leadership style and followers have to reconsider their psychological contracts. In such conditions another type of contract, i.e. “... hybrid or balanced psychological contracts have emerged in recent years. Such contracts combine the open-ended time frame and mutual concern of relational agreements; with the performance demands and renegotiation of transactional contracts” (Rousseau, 2004: 122). In simple terms it combines both relational and transactional agreements, with high involvement and long term agreement and flexibility in terms of demands and performance (Dabos and Rousseau, 2004). Considering the inherent dynamism of situations, and their role in leader subordinate relationship, I propose:

Proposition 4: Effective leaders are likely to have hybrid contracts with subordinates, as compared to transactional or relational contract.

As discussed above, for leaders to be able to be effective situations also play a pivotal role. In weak situations leaders are better able to express themselves, because these are less structured and defined, as compared to strong situations (Jacobsen & House, 2001; Tourish & Pinnington, 2002). Therefore chances are that in weak situations, leader and members are likely to have relational contracts, while in strong situations, the contracts are likely to be transactional. Weak situations are inherently ambiguous and uncertain, where people are vulnerable. In such situations followers try to look for some they can trust, so contracts in such cases are likely to be high trust based rather than merely transactional. So I propose:

Proposition 5: Leaders will be better able to express their abilities in weak situations; therefore, it is likely that in such situations leaders will have relational contracts with their subordinates, as compared to transactional contracts.

Proposition 6: Leaders will be less able to express their abilities in strong situations; therefore, it is likely that in such situations leaders will have transactional contracts with their subordinates, as compared to relational contracts.

Charismatic Leadership

Charismatic leadership comes from the term charisma. Due to its mystic nature research remains scarce in this area (Conger & Kanungo, 1987). There is inconsistency in the definitions, and the scope of the definition. Different authors have related different attributes with it, such as transcendent vision, and acts of heroism, powerful aura (Willner, 1984), and ability to inspire (Bass, 1985). The commonly mentioned "...personal attributes of charismatic leaders are, vision, ideological goals, behaviours that instil confidence, an ability to inspire, self confidence, dominance, a need for influence, articulation ability and or counter normative behaviour" (Conger and Kanungo, 1987: 639). Whatever the definition of charismatic leader be, "...there appears to be little disagreement over the locus of charismatic leadership; a relational basis for charismatic leadership is widely accepted" (Conger & Kanungo, 1987: 639). Conger and Kanungo (1994) further elaborated that it is primarily an "attributional phenomenon"; followers' attribution and context play a strong role in a leader being considered as charismatic leader (Conger and Kanungo, 1987; Groves, 2005). Followers of such leaders, trust the leader, have affection for him/her, obey the leader (Conger and Kanungo, 1987) and are willing to perform above and beyond the call of duty (House and Howell, 1992).

Many authors use charismatic leadership and transformational leadership collectively and interchangeably. "Charismatic leaders differ from other leaders in their ability to formulate and articulate an inspirational vision and by behaviours and actions that foster an impression that they and their mission are extraordinary" (Conger, Kanungo and Menon, 2000: 748). Conger, et al. (2000) found that leader reverence is strongly related with charisma, and it mediates the relationship between charismatic leadership; and trust and satisfaction with the leader. They further elaborate that trust and satisfaction with the leader are a result of both cognitive as well as affective association with the leader. Conger and Kanungo (1994) in the C-K model elicit that how charismatic leaders transform existing state to future desired state by sensitivity to environment and member needs (Groves, 2005).

House and Howell (1992) discuss the paradox in charismatic leadership theory that it does differentiate between positive and negative charismatic leaders. Therefore they developed two forms of charismatic leadership, personalized and socialized charismatic leadership. The definitions of personalized and socialized charismatic leadership are based House and Howell (1992). Personalized charismatic leadership is based on personal dominance and authoritarian behaviour, serves self interest of the leader and is self-aggrandizing and exploitative of others. Socialized charismatic leadership is based on egalitarian behaviour, serves collective interests and develops and empowers other. Since personalized charismatic leadership is based on self interest, chances are that such leaders will want high compliance and control to attain their objectives. One could safely predict

that personalized leaders would not make affective relationships with subordinates, therefore I propose:

Proposition 7: As compared to socialized charismatic leaders, personalized charismatic leaders will be more likely to have transactional contracts with their followers.

On the other hand socialized charismatic leaders relate with their subordinates, try to work for collective benefits, thus they are likely to make long term, affective relationships with their followers. Therefore I propose:

Proposition 8: As compared to personalized charismatic leaders, socialized charismatic leaders will be more likely to have relational contracts with their followers.

Leader Member Exchange (LMX)

Just as there is no consensus on the universality of a definition of leadership similar is true for LMX (Dunegan, Uhl-Bien, & Duchon, 2002; Gerstner & Day, 1997; Schriesheim, Castro, & Cogliser, 1999). “The basic principle of leader–member exchange (LMX) is that leaders develop different types of exchange relationships with their followers and that the quality of these relationships affects important leader and member attitudes and behaviours” (Ilies, Nahrgang, and Morgeson, 2007: 269). “An offer will not be made and accepted without (1) mutual respect for the capabilities of the other, (2) the anticipation of deepening reciprocal trust with the other and (3) the expectation that interacting obligation will grow over time ...” (Graen & Uhl-Bien, 1995: 237; Schriesheim et al., 1999). Bass (1999) is of the view that “LMX unfolds in several stages in which trust, loyalty, and respect develop. In the first stage LMX is transactional. If the last stage is reached it is transformational”. [14]. LMX is positively related with transformational leadership and contingent rewards, where as negatively related to management by exception (active and passive), (the latter are components of transactional leadership construct (Graen, & Uhl-Bien, 1995). Ilies et al. (2007) further elaborate that leader member exchange works on dyadic exchange relationships where in high quality relationships, there is high level of trust, interaction and support; subordinates perceive obligation to reciprocate. Leader member exchange is categorized in two divisions: in-group and out-group. The in-group members have a relationship of high trust, support and interaction with their leader, whereas those in out group have a relationship based on low trust, support and interaction (Bass, 1999). The basic definition of leader-member exchange and psychological contract seem to have much in common. Authors have stated nearly the same thing about the two concepts. “... [T]he two constructs - transactional and relational – can be equated respectively to the notion of economic and social exchange” (Millward and Brewerton, 1999: 255). In LMX, “[I]low quality leader- member relations have been characterized in terms of economic (contractual) exchanges, whereas high- quality leader- member relations have been characterized in terms of social exchanges....” (Sparrowe & Liden, 1997: 523). Reciprocity is the core factor in both LMX (Schriesheim et al., 1999) and psychological contract (Rousseau 1989, Rousseau and Tijoriwala 1998, Raja et. al. 2004, Robinson and Morrison, 1995).

Since low quality LMX and transactional contracts are both low trust based, transactional/economic exchanges; where as high quality LMX and relational contracts are both long term, high trust based social exchanges. Therefore I propose:

Proposition 9: Subordinates who will be members of out-group, or have low- quality leader-member relationship, will likely have transactional contract with their leader.

Proposition 10: Subordinates who will be members of in-group, or have high- quality leader-member relationship, will likely have relational contract with their leader.

Implications and Future Directions

In order to better understand leader follower relationship in the light of psychological contract, the propositions put forward, require empirical testing. Firstly these propositions can be studied in different organizations, and can be related with the key performance indicators. This will enable us to know what kinds of relationships exist between leader and subordinates, and the best mix of the two. Secondly many have studied organizational citizenship behaviour (OCB) with leadership and/or psychological contracts. But aside from Hui, Lee and Rousseau (2004) none have explicitly related psychological contract with OCB. Organizational citizenship behaviours are discretionary behaviours, which are not mandatory, are constructive in nature, and are not paid for through the formal reward system of the organization (Organ and Konovsky, 1989; Allen and Rush, 1998). Organ (1988) defined OCB as “readiness to contribute beyond literal contractual obligation” [22]. “OCB theory has its foundation the existence of an employee-employer contract (Robinson & Morrison, 1995, 290).” OCB like psychological contract and leadership is based on social exchange theory. LMX is strongly related to OCB (Ilies et al. 2007), as these are likely “avenues of reciprocations” [269]. There is also strong research support for the relationship between transformational leadership and OCB (Rafferty and Griffin, 2004; Podsakoff, et al., 1990; Bass, 1999). Similarly in psychological contract literature OCB is “viewed as a form of behavioural reciprocation” (Coyle-Shapiro and Kessler, 2002: 83). Hui, et al. (2004) found in their study of psychological contracts and OCB in China, that transactional contracts had a direct link with OCB, and relational and balanced contracts were linked with instrumentality beliefs (i.e. these are required for showing commitment or gaining a reward). But I put an opposing view, because this study was based in China which has a collectivistic culture. As we know that trust is an underlying factor in psychological contracts (Rousseau, 1999) and OCB (Mayer and Groves, 2005). Relation contract are high trust based with high affective commitment, therefore chances are that those having relational contracts with the employer will be more likely to engage in OCB, as a means of reciprocation, than those with transactional contracts. But this view requires empirical research and support. Lastly psychological contract could be related to other leadership dimensions such as initiating structure and consideration, employee oriented vs. production oriented. Proposed directions of their relationships are given in figure A. Leadership and psychological contract have been studied by many, have been related to one another, but not explicitly. This research paper has added to the existing body of literature by proposing explicit links between leadership and psychological contracts.

		Nature of Psychological contract	
		Relational	Transactional
Leadership Style	Transformational		Transactional
	LMX In group member		LMX Out group members
	Charismatic		Non Charismatic

Consideration	Initiating structure
Employee oriented	Production oriented

Figure A

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