Entrepreneurial Psychological Contracts: Shaping the Future of Work in Times of Uncertainty

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Abstract: In the backdrop of a global work environment characterized by uncertainty, fragmentation, and precarization, this paper introduces the 'entrepreneurial psychological contract', a concept that reshapes our understanding of employment relations in new venture creation. The paper responds to the need for reimagining employment in an era where standard, stable employment is increasingly an exception. By extending psychological contract theory with insights from incomplete contracting literature, a nuanced perspective is provided on how entrepreneurs navigate the inherent uncertainties of new ventures to establish employment agreements. The paper is conceptual, and it reveals that entrepreneurial psychological contracts are markedly different from traditional bureaucratic contracts, characterized by their procedural, associational, constitutional, and polyarchic nature. This distinction is pivotal in comprehending the adaptive employment strategies in entrepreneurial environments, which mirror the global trends of work fissuring and employee precarization. This paper contributes to the broader discourse on how work and employment should be reorganized in contemporary capitalism. It offers theoretical advancements in entrepreneuring, human resource management, and contracting under uncertainty, and presents practical insights for entrepreneurs in crafting flexible and resilient employment relations. The paper aligns with the call for broadening perspectives on work, promoting sustainable organizational practices, and envisioning new ways of mobilizing workers in the face of global challenges.

Keywords: Employment Relations; Entrepreneurial Psychological Contract; Entrepreneurship; Psychological Contract, Uncertainty.

1. Introduction

This conceptual paper ventures into the uncharted territory of employment relations in entrepreneurial contexts, a critical area of study in the contemporary discourse on the future of work and employment. As the global work landscape undergoes significant transformations marked by uncertainty, fragmentation, and the precarization of labor, understanding how new ventures navigate these challenges becomes imperative. The paper directly addresses the call for papers' emphasis on reimagining work from the bottom up, by examining the unique dynamics of employment agreements in the context of entrepreneurship.

The interactions between employer and employee, and the informal, unspecified obligations generated as a result can be examined through the lens of psychological contracts. A psychological contract is a set of beliefs about what each party is entitled to receive, and obligated to give in exchange for another party's contribution (Levinson, et al., 1962; Rousseau, 1989; Schein, 1965). These beliefs arise from the expectations of each party and the obligations that arise as employers and employees exchange promises during the recruitment and early socialization stages of psychological contract formation (Rousseau, 2001).

The proposed and developed concept of the 'entrepreneurial psychological contract' lies at the core of our conceptualization. This novel construct extends traditional psychological contract theory by incorporating elements from incomplete contracting and uncertainty literatures, thereby offering a fresh lens through which to view employment relations in new ventures. This approach is particularly relevant in a world where traditional, stable employment is increasingly rare, and where work arrangements are characterized by a high degree of flexibility and adaptability.

Furthermore, global challenges, such as COVID-19 pandemic, point towards the need for stronger and more effective support for entrepreneurs in the times of uncertainty. Giones et al. (2020) explore the necessity of revising entrepreneurial action in response to the COVID-19 pandemic, emphasizing the importance of planning, frugality, and social support in navigating unprecedented uncertainty. This underscores the potential for psychological contract theory to provide a framework for understanding and managing the expectations and obligations between entrepreneurs and their stakeholders in highly uncertain environments, suggesting a valuable research direction for examining psychological contracts in entrepreneurship settings during crisis conditions.

Our exploration is timely and aligns with the call for understanding how work and employment are being reshaped in response to global crises and systemic challenges. By shedding light on the complexities of forming employment relationships in uncertain entrepreneurial environments, our study contributes to the broader conversation about sustainable and equitable work practices. We provide theoretical and practical insights that are crucial for reimagining organizational structures and mobilizing workers in ways that are responsive to the current economic and social realities.

The paper is structured in the following manner. First, recent literature on the topic is addressed, and the research gap defined. Second, theoretical background is introduced. Third, the paper moves into the development of a conceptual structure. Finally, we conclude with the discussion and contributions.

2. Review of Literature and Research Gap

Recent literature on psychological contract research, particularly in the past three years, has shown a limited but evolving focus in the context of entrepreneurship. Kozhakhmet et al. (2023) performed a bibliometric analysis of the field, highlighting the development and intellectual framework of psychological contract research, which aids in understanding the field's evolution. Crick & Crick (2022) examined psychological contracts in entrepreneurial coopetition among wine producers, underscoring their importance in managing competition and collaboration dynamics.

In entrepreneurial settings, few studies have delved into integrating psychological contracts. Notably, Kickul (2001) explored the impact of unmet promises by small business organizations on employee attitudes and retention. Nadine and Cassell (2007) examined how the size and conditions of small firms influence psychological contracts. Atkinson (2008) applied a psychological contract framework to study small firm employment relationships. Parhankangas and Landström (2004) addressed responses to psychological contract violations in venture capitalist-entrepreneur relationships, focusing on the active behaviors of venture capitalists.

Anggraeni et al. (2017) analyzed the impact of psychological contracts on the commitment and behavior of millennial employees in small and medium enterprises. Karen & Nowell (2018) investigated new venture teams, highlighting the influence of psychological contracts on team dynamics, particularly in trust and control aspects during venture formation.

Overall, these studies indicate a growing but still nascent integration of psychological contract theory in entrepreneurial contexts, suggesting an opportunity for further exploration and development in this area.

Establishing effective employment relations is a key part of entrepreneuring, which is the organizing process of creating a new venture (Gartner, 2016; Hjorth, 2014; Katz et al., 1988). Mutual agreements, in the form of implicit or explicit contracts, are a cornerstone of the employment contracts and work arrangements of employment relations. These agreements are by definition incomplete, since it is not feasible to specify every possible work behavior or condition (Lopes, 2018; Rousseau, 2001). The high degree of uncertainty surrounding new venture creation heightens this inherent incompleteness; yet, entrepreneurs do successfully build workforces for their new organizations. We examine how entrepreneurs accomplish this organizing feat by using a framework that extends psychological contract theory with concepts from the literatures on incomplete contracting, and contracting under uncertainty.

Psychological contracts are key building blocks of the mutual agreements anchoring employment relations (Levinson, et al., 1962; Rousseau, 1989; Schein, 1965). However, current psychological contract theory does not address the role of uncertainty, and makes little distinction between new ventures, or organizations-in-creation, and established firms (Rousseau, 2001; Rousseau, Hansen & Tomprou, 2019). Therefore, we utilize concepts from the incomplete contract literature (Grandori, 2010; Grandori & Furletti, 2019) to extend psychological contract theory. In doing so, we illustrate how uncertainty impacts the establishment of employment agreements, and advance a new construct, the entrepreneurial psychological contract.

3. Theoretical Background

Individual employees have implicit and unwritten expectations as they seek employment. These expectations include desired outcomes and goals, and arise from personal preferences, previous employment experiences, and institutional sector norms (Lopes, 2018; Rousseau, 1989, 2001). Similarly, employers have implicit expectations, as well as desired outcomes and goals as they seek employees, and these expectations arise from the productive activities of the firm, experience with previous employees and institutional sector norms. A mutually held psychological contract is an implicit, unwritten agreement between an employer and an employee regarding the reciprocal rights and obligations of each party (Levinson, et al., 1962; Schein, 1965). This mutually held psychological contract serves as the basis for other employment agreements (Rousseau, 1989, 2001).

A mutually held psychological contract and other employment agreements are characterized by two major sources of incompleteness. First, the difficulty of fully specifying all aspects of a job and all contingent possibilities of employment prevents any agreement from being truly comprehensive (Lopes, 2018; Rousseau, 2001). Second, the promises in terms of behavior that are implicit in employment agreements are largely unenforceable (Lopes, 2018).

In stable environments with low to moderate levels of uncertainty, specific terms and actions can be included in the mutual psychological contract because the future states of the firm and the ensuing employment relationship can be reasonably predicted. Most of work in employment relations and psychological contracts has concentrated on established firms. The predominant focus on the aftermath of psychological contract violations, with more recent studies considering how these unwritten contracts evolve and change over time (Rousseau, 2001; Rousseau, Hansen & Tomprou, 2019). implicitly assumes that the firm operates in a relatively stable external environment with fairly consistent repeatable routines. These routines provide a set of knowable future states of nature and permit interested parties, such as employees and employers, to reasonably assess the probability of any given future state of nature. We define these types of contracts as bureaucratic psychological contracts.

However, uncertainty is heightened during entrepreneuring and in entrepreneurial environments. In the context of entrepreneurship, where risk-taking and handling uncertainty are paramount, van Hugten et al. (2021) discuss how psychological flexibility, which includes acceptance, defusion, mindfulness, self-as-context, values, and committed action, enables entrepreneurs to better manage setbacks and uncertainty. They argue that higher levels of psychological flexibility lead to more effective decision-making in the face of risks and uncertainties, directly impacting entrepreneurs' satisfaction.

In their recent research, Muñoz et al. (2023) reveal that in the entrepreneurship setting, mismatches between entrepreneurs' expectations and their actual experiences across purpose, autonomy, and achievement lead to a diminished sense of control, direction, and worthiness. This compounding of incongruences fuels a cycle of negative emotions such as anxiety, isolation, shame, and guilt, illustrating a critical process through which self-worth deteriorates in the face of uncertainty inherent in entrepreneurship.

Strong form uncertainty (Knight, 1921) pervades entrepreneurial contexts, since the future states of nature of the new firms being created are unknown and the probability of any given state of nature is also unknown (Knight, 1921). In addition, knowledge is distributed, so that no one actor, and in particular, no one central actor, can know what the best actions are, either before or after the relevant states of nature have been observed (Thompson & Tuden, 1959; Perrow, 1967). Specific terms and actions can no longer be reasonably predicted.

These contextual characteristics resemble those found in discovery-intensive and design-intensive industries such as pharmaceuticals and biotechnology (Grandori & Furletti, 2019). Firms in these industries engage in contract agreements for innovation and R&D projects that remain robust under strong Knightian uncertainty (Grandori, 2010; Grandori & Furletti, 2019). We propose that these forms of contracting for innovation and discovery provide insights into how psychological contracts differ in uncertain entrepreneurial settings.

4. Towards a Conceptual Framework

In their analysis of a large international database of multi-party projects governing innovation, Grandori (2010) and Grandori and Furletti (2019) found that these agreements enabled the participating parties to commit substantial resources over sustained periods of time in the face of high levels of uncertainty. These contracts specified the rights and obligations of each party, what resources they will commit and own, and how the parties will decide what to do. They avoided trying to spell out multitudinous possible states of nature and the specific corresponding actions. Consequently, they were effective under uncertainty, and represented a shift from contingent contracts over actions to non-contingent contracts over resource commitments (Grandori, 2010; Grandori & Furletti, 2019).

Their findings indicate effective contracting in uncertain contexts is indeed possible and demonstrate that contracting on resources and assets and on decision rules rather than on specific actions is a viable alternative to incomplete contracts among boundedly rational parties and complete contingent contracts among omniscient actors. These types of contracts have the following characteristics: 1) procedural instead of substantive, 2) associational instead of transactional 3) constitutional instead of operational, and 4) polyarchical instead of hierarchical.

We argue that a similar approach is applicable to psychological contracts and employment agreements under conditions of high uncertainty. Here we illustrate how these findings apply to employment relations in entrepreneurial settings.

In these settings, employees can be described as joiners with entrepreneurs assuming the role of employers. Entrepreneurs and joiners create contracts on resources and assets when joiners commit resources in the form of their time, talent and expertise, and entrepreneurs commit resources in the form of equipment, space, compensation and opportunities without either party knowing the future states of the new venture-in-creation. They rely on decision rules for governing the new venture as new states of nature arise instead of delineating future specific actions or uses of resources. We now discuss how the four key features of contracts for innovation and discovery apply in the employment context.

4.1 Procedural Versus Substantive

Procedural contract clauses provide guidelines for deciding what to do while substantive clauses provide specific stipulations on what to do. In entrepreneurial settings, the procedural nature of these agreements is reflected in the expectation that joiners will “wear many hats”, will take initiative and be self-starters, and will do whatever needs to be done. These types of guidelines take the place of detailed job descriptions or formal duties that specify the tasks to be performed as in established firms in more stable environments. Although agreements of any complexity will contain both procedural and substantive clauses, we would expect the procedural content to increase relative to the substantive content in higher levels of uncertainty.

4.2 Associational Versus Transactional

Associational clauses define the resources each party will commit, and rights to and ownership of resources enjoyed by each party, while transactional clauses define how resources will be used. Examples of associative clauses are those that specify the ownership rights of joiners through equity stakes, profit-sharing and stock options but leave the detailed uses of resources unspecified. By defining rights over resources committed and the resulting outcomes, associational clauses allow joiners and entrepreneurs to discover optimal actions and uses over the course of time. In addition, these clauses provide joiners with incentives to maximize the use of resources while simultaneously offering the flexibility to pursue optimal strategies for resource use over any future states of nature. We anticipate that increases in uncertainty would lead to increases in associational clause content relative to transactional clause content in the mutual psychological contract.

4.3 Constitutional Versus Operational

A necessary complement to an agreement to associate is an agreement indicating who will make decisions and according to what procedures (Grandori & Furletti, 2019). Grandori and Furletti (2019) define the clauses that establish associations between parties, institute decision rules, and determine rights to control and rewards as constitutional. Constitutional clauses provide a set of rules for governing while operational clauses offer specifics on what to do. When joiners and entrepreneurs agree on a set of rules or norms based on the philosophy or ideology of the founders, then this is an example of a constitutional clause. These agreed upon norms can also include the burgeoning cultural norms of the new organization-in-creation. A higher proportion of constitutional clauses relative to operational clauses is expected to occur in highly uncertain environments.

4.4 Polyarchic Versus Hierarchical

Polyarchic clauses recognize decentralized sources of power while hierarchical clauses focus on centralization. In a pure hierarchy, decision rights are concentrated in one central actor, who is then entitled to choose optimal actions based on the relevant state of nature. In this instance, it is necessary for the central actor to hold the relevant knowledge and for the other parties to be relatively indifferent to the actions assigned to them (Simon, 1951). This concentration of knowledge is unlikely to occur in uncertain entrepreneurial settings since knowledge and capabilities tend to be broadly distributed and the type of knowledge required for any given state of nature is likely to be unknown ex-ante. In addition, joiners are unlikely to be indifferent to decisions made by a central authority since they are likely to have committed substantial resources in the form of time, talent and expertise, they may possess ownership rights, and they may be more knowledgeable about certain states of nature. Conversely, the decentralized authority of polyarchic clauses permit joiners to participate in decision-making based on their talent and expertise. These clauses also recognize that the capacity to tap into a wider knowledge base equips the new venture to more nimbly address a wider variety of states of nature. More polyarchic clauses are expected to be found in mutual psychological contracts in contexts with higher degrees of uncertainty.

5. Discussion and Conclusions

This conceptual paper suggests that the high degree of uncertainty in entrepreneurial contexts results in entrepreneurial psychological contracts which are more procedural, associational, constitutional and polyarchic than their bureaucratic counterparts which arise in more stable contexts. In addition, the proposed construct of entrepreneurial psychological contract illustrates how many of the employment options observed in entrepreneurial environments are the result of efforts to manage heightened levels of uncertainty. By explicating the link between uncertainty and particular contract characteristics, our attempt to broaden perspectives on work and uncertainty and to show how entrepreneurial psychological contracts can arise in highly uncertain environments within established firms such as skunkworks, special research and development projects and corporate intrapreneurship initiatives. Conversely, bureaucratic psychological contracts can exist in relatively stable, clearly defined areas in highly uncertain entrepreneurial environments, such as specific assignments for independent contractors and gig workers.

This paper also makes contributions to the entrepreneuring, human resource management, incomplete contracting literatures. The entrepreneurial psychological construct provides insights into how new ventures organize employment and work arrangements. Moreover, the insights of the paper may apply to reflect upon the broader issues, particularly the challenges posed by contemporary work environments, characterized by precarization, with many jobs becoming increasingly uncertain and short-term, and an increasing lack of meaningful and materially rewarding work. By highlighting how entrepreneurial psychological contracts adapt to uncertainty, our work offers a pathway for reimagining employment relations in a manner that can counteract the negative effects of uncertain work environments.

In addition, this construct provides additional theoretical grounding for the study of human resource management and employment practices in new ventures, and in small and medium-sized firms. It also responds to the call for broadening perspectives on work in organization studies, by presenting a nuanced view of employment contracts in the unique context of entrepreneurship. This perspective is critical for understanding the fissured nature of workplaces today and the resulting implications for worker rights and protections.

The application of incomplete contracting concepts to employment relations expands the scope of literature addressing contracting under uncertainty. Our findings contribute to envisioning new ways of mobilizing workers, especially in contexts where standard employment is no longer the general norm and where the labor force is increasingly subjected to various levels of precarity. On a more practical level, the construct of the entrepreneurial psychological contract can aid entrepreneurs who are in the process of recruiting and hiring their employees, by providing a framework that acknowledges and strategically addresses the complexities and uncertainties inherent in modern work environments.

Ultimately, the discussion herein and the construct of entrepreneurial psychological contract broadens the potential for theoretical and empirical insights that challenge and expand current understandings of work, employment, and organization in the face of global economic and social change.

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