



## Psychological Contract in Small Firms: A Managerial Insight

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### Abstract

The psychological contract is a very well known topic amongst academics and practitioners. The majority of the literature sheds light to most of the areas of the psychological contract but lies heavily on larger organizations and mainly assessing the employee side. In this paper we investigate the existence of the psychological contract contrary to popular research in the field of small business while choosing small firms as our organizational setting. Through extensive interviews we attempt to draw conclusions about the existence, form and management of the psychological contract in this context.

**Keywords:** Psychological contract, Small firms, Managers

### 1. Introduction

The main focus of this paper is to use one of the models of the psychological contract mainly developed by Guest and Conway (1996, 1997, and 2004) and explore its existence and application in small businesses. Most of the theory on the psychological contract links the employment relationship with HR practices and discusses its application over multiple layers in organizations (Rousseau, 1995; Sparrow & Marchington, 1998). In most cases, when discussing about the concept, the picture is of an organization with an established HR department to cope with the problems that arise in the employment relationship (Rousseau 2000, Guest & Conway, 2004) which in essence implies an organization relatively large in size (Wilkinson, 1999).

Nevertheless, in the real business world there are numerous smaller firms which also have a number of employees and a level of management and thus the development of an employment relationship. The question now becomes how does the psychological contract can be applied in such a context? In this project we shall try to answer that through an investigation of a specific approach to the PC developed by Guest & Conway (1996; 1998; 2004) in a sample of 6 small firms in the electronic taximeter sector in Greece. The main focus is on obtaining the managerial insight as in small firms managers tend to play a very important role in formulating the ER (E.F.I.W.L.C, 2001).

### 2. Methodology

#### 2.1 Construction and background information

In order to investigate the existence and application of the Guest and Conway model of the psychological contract, a sample of 6 companies was selected from the electronic taximeter segment. The methodology was designed around the assumptions of the Guest and Conway (1997; 2004) model. Transforming the assumptions to questions, we are attempting to assess the existence of the PC elements according to the G&C model in a group of small firms. The process consisted of a series of face-to-face interviews with senior managers/owners at many cases and was directed to test the model's hypotheses against manager's experience and knowledge.

Table 1 introduces the main characteristics of the sample of companies selected to carry out the research. The size of the sample consists of six companies with an employee number ranging from ten to twenty people roughly the number literature ascribes to most small enterprises (Cully et. al 1999; E.F.I.L.W. C, 2001a). Information was collected from the managers themselves during the course of the interview. Equally, all companies belong in the same market segment, the selling and servicing of electronic taximeters for taxis. The fact that all sample companies belong the same sector in effect facilitated the conduct of the research allowing a degree of homogeneity circumventing at this stage the problem of heterogeneity spotted in most small firms comparison (Curran, 1991; Curran et. al 1993). There is also information about the educational background of the human resources of the companies with a significant rate of university level and technical expertise in both the management teams and the employee lines.

#### 2.2 Directions of the study

The interview was constructed firstly using the elements of the Guest & Conway model and the CIPD school of thought as we described it in the literature. Namely, the existence of trust, fairness, loyalty, commitment and job security in the working environment (Guest & Conway, 1997; 2002; 2004). Equally, the interview was designed to examine generally

the knowledge of management on the psychological contract and get their opinion overall about the employment relationship in their business in particular and overall for small businesses. The interview therefore attempted to highlight the following:

- (1) Defining the psychological contract offering definitions from the body of literature and measuring them against the managerial experience from their firms
- (2) Existence of trust in the business among management and employees
- (3) Sense of fairness in the employee line and its importance
- (4) Weight of loyalty for managers on behalf of the employees
- (5) Position of the job security and requirements of employees the recent years opposed to the past
- (6) Knowledge of the concept of the psychological contract and its main principles
- (7) Existence of organized HR practices to handle employment relationship that arise and what are the principles that govern the ER in small firms?

The interviews also sought to gather some additional information that were essential to crystallize the picture of small firms management. In particular, managers were asked about the decision-making process in their own companies and in competition. The later included queries about the structure of management in the firm, the proportion of owner being the general manager and the involvement of either the owner or management in total to the day-to-day running of the firm. The communication and level of proximity with among employees and the higher place in the hierarchy scale. In Exhibit 1 in the appendices we have attached the interview schedule.

There was direct access to the managers and after their insistence, the interviews were transcribed. Because the bulk of the model deals with qualitative elements and there were both defined points of the model needing answers but also the need to elicit additional information on the employment relationship in the specimen of small firms, a semi-structured interview was selected as most appropriate to accomplish that (Walliman, 2005).

The interviews consisted essentially of two parts. In the first section, interviewees had to answer a series of questions rated from 0 to 5 with an increasing positive scale a questionnaire. The second part of the interview consisted of a set of open-discussion questions where managers were asked to provide some background information in regards to their business in terms of size, management structure, employee retention, educational mix etc that are essential to understand environment in which this particular section of small firms operates. This is essential for practical reasons in conducting the research especially considering the lack homogeneity in various small firm sectors (Curran, 1991; Curran et. al 1993). Equally in this section, where managers were asked to explain in more detail their answers in the first set, giving their personal viewpoint and also reporting issues in the employment relationship they deemed important and perhaps were overlooked from the series of questions put to them into consideration.

## 2.2 Purpose

The purpose of selecting a semi-structured form of interviewing organized with one component using a weighting scale and a interrelated critical-analysis section supplementing the undefined elements, is firstly to capture solid data on the knowledge of managers on the model, its individual characteristics and the overall situation of the ER (Atkinson, 1984; Walliman, 2005). The initial stage is somewhat simplistic but is vital in providing some basic answers to our hypotheses backed by numerical reasoning as there are definite questions of the model that need to be answered straightforwardly Secondly, the project requires mainly qualitative input, therefore it was essential starting from broadening the straightforward questions used in section 1 to grasp the perception of managers, their views and further thoughts that would possibly bring to our attention further elements that would have been impossible to be highlighted from the first section of the methodology (Walliman, 2005).

## 3. Findings

### 3.1 Analysis of the data

In the first part of the interview, participating managers had to answer a series of questions with a weight from 0 to 5 with an increasing range of strengths (Note 1). As mentioned earlier, the questions at this stage were designed to assess firstly the existence of the constructs of the Guest & Conway model, to ascertain the applicability of this model of the psychological contract to small firms and also managements perception on the topic both if they are aware of it in theory or if they can see its existence in practice. The main focus is not to replicate the model but to ascertain its existence and application. Consequently, the questions are using the elements of the model described in the previous chapter but not reproducing them but rather putting them into small business focus

First question approached the issue of psychological contract definition. Managers were asked to recognise whether there is among themselves and employees cognition about the perceptions of both parties to the employment relationship- organization and individual- of the reciprocal promises and obligations implied in this relationship. They were further

asked to grade with 0 no relevance to 5 very high relevance the existence of this framework in the both parties mentality. Four managers graded the question with four (high relevance) and two managers graded with the highest grade, five (very high relevance).

The second question attempted to measure trust among employees and management and the importance managers ascribed to it. All the managers gave considerably positive answers on the ranging scale from score 4 (significantly important) to 5 (most important). This clearly demonstrates the view of executives that trust of employees towards management is a key issue in the employment relationship of small firms.

The third question weighted the role of loyalty and the significance managers feels it has for their firms. Again the responses gave strong signals of the importance attached to loyalty in the firms on the behalf of employees as the answers ranged again from 4 to 5 in the reply scale. As with trust, managers feel that the existence and loyalty is cornerstone for the course of the firm.

The fourth question asked managers to express their opinion about the commitment of employees to the firm and how important essential is for management to cultivate this into the mentality of the workforce. Following the pattern of the previous questions, managers rated both parts of the question with high positive scores 70 percent of the managers rating commitment with top importance and 30 percent with very high importance. Equally, 60 percent of the interviewees considered the need to cultivate commitment as of primary priority and 40 percent as very significant priority.

The fifth question addressed the issue of fairness, examining the impact and its importance that managers perceive it is necessary for employees to feel towards the company. Four out of the representatives of the companies interviewed responded marked with a five the importance of the sense of fairness to exist among the lines of employees. The remaining two representatives gave a four (very important) and a three (moderately important).

The sixth question was related more to the knowledge of the psychological contract concept per se by managers. It asked them to state whether they have heard before the concept as a theory and if they have come across its literature and characteristics in their education or professional career. Three of the managers commented that they have not heard or come across the psychological contract theory neither in the higher education background nor in their professional career. Two managers mentioned that brushed the literature of the psychological contract during their university years but with no application or appearance in the professional life. Only one manager reported awareness of the concept and an endeavour to apply its principles as a business methodology.

Managers were also asked the weight the negativity of changes in the workplace the last twenty years. In relation to theory, this question was asserted to gauge managements perception opposed to the negative form of the 'new psychological contract' (Hiltrop, 1995) and the more positivistic attitude of the Guest & Conway model (2004). Four managers graded with a 1 (imperceptible changes) and the remaining two graded the question with 2 (little negative changes have occurred).

In the beginning of the second section of the interview, managers were asked to provide some additional background information as it can be seen in table 2. Adding to table 1 seen earlier the information was gathered about the enterprises in terms of management style, structure and the decision-making allowing thus a more complete picture of the companies environmental background.

Noticing the management structure of the businesses, in three of them the main shareholder/owner are also the general manager which also translates in that most of the decision-making is done by the owners with the suggestions of the rest of the staff but in terms of authority core decisions are made by the owners As it becomes apparent, the role of owners is quite significant not only in the decision-making but also to a large extend in the actual control of the firms which also translates into active involvement in the daily running of the business. The role in the sense of owner/manager and the degree of involvement coincides with the literature about small firms pointing out exactly this, the directness of owners in the administration of the firms.

Expanding further on the questions and issues of first section, loyalty appears quite important. Five out of six managers in the open-discussion section mentioned that their employees in their vast majority are loyal to the firm. The generally accepted view was that it was not possible for someone to work in a 'familial' business environment and not be loyal to firm, provided that management treated employees with respect and professionalism. Furthermore, participating managers displayed confidence in their statements that due to their proximity and close relationship with their subordinates there is a high likelihood to screen out any signs of disloyalty or phenomenon such as agency costs (Prendergast, 1999).

In regards to commitment, managers discern it from loyalty in the sense that loyalty is connected more with staying with the company and the management under all circumstances whilst commitment is viewed more in the performance field. According to managers commenting on the open-section, committed employees translates to continuous efforts to perform best in their appointed tasks and in extension to contribute in the companies overall performance. Again, it was stated by the majority that existence of commitment is essential for the smooth operation of the business and at the same

time it is interrelated with the capability of management to work alongside employees infusing leadership to the employees and inspiring them with a feeling of security and guidance.

Assessing managers feedback on fairness, we could note in the reports about its importance a slight discrepancy from the previous elements of the model as a small proportion (15%) rated the importance of fairness with a mark of 3 in the significance scale, still the majority voted again highly (35% with four and 50% with five as the data from the first section demonstrated.

Also, in the open-discussion section, there was a general agreement that without the feeling of a fair treatment, employees could build a grudge against the business which could have adverse effects in individual employee performance but could also carry an impact to the collective performance of the labour in the company. Equally, managers appeared optimistic in their capacity to cultivate fairness in their employees through the close relationship they have with them allowing for a personal contact as managers apart from involving themselves in running daily operations can exercise 'justice' on the spot and solve problems often immediately.

For them this is opposed to the cold and remote picture of management in larger corporations and serves better the purposes of smaller businesses. It would be important to note that all managers interviewed brought forth the argument that the proximity with the employees and this involvement we described is a positive attribute for all the PC constructs of the model. This picture also corresponds to the relevant literature arguing that the 'familial' environment serves best the purposes of small businesses (Mihail, 2004). Nevertheless, we should not discount the fact that as PC theory assumes an important degree of subjectivity (Rousseau, 1995) the appropriateness of this relationship is open to interpretations both from employees of this sector and potentially from other managers in other small business sector.

Concerning the theory of the psychological contract, as mentioned earlier half of the respondents stated that have never come across the concept nor have ever heard of its principles before. Two of the managers mentioned that have come across the theoretical framework in their studies in the university but have never thought of applying it or that in effect it could exist in their business. Only one individual stated complete awareness of the psychological contract and thought he could discern a pattern of it in the actual running of the company and in the employment relationship. It is sensible to assume that the manager's prior knowledge of the concept as a theoretical framework facilitated him in recognizing it in the business setting and reporting it in the interview.

One of the important characteristics of the Guest and Conway model was that generally undertaken by the a large part of the CIPD school of thought was the call as we mentioned to use it as a tool to negotiate with employees the need for change without having to sacrifice the good relationship between the two parties, signaling thus that changes are inevitable but not panacea (CIPD, 2005). Consequently, instead of the mass leveling of the ER and the reshifting of the PC towards uncertainty, for employees the PC can be applied as a gradual change process with communication among employees and employers to strike a balance for both parties.

Managers were asked to comment on the work surrounding the past 20 years and give their impression on whether things in the workplace have changed so dramatically against employees that creates for them a time of uncertainty. Nevertheless, in spite of the positive feedback in regards to mediocre negative impact on employment relationship (see table 3) over the years it should be pointed that there is no response from the employee side which could produce some varying opinions. The scope and size of the project is such that only allows us to focus on the managerial outlook of the concept but there is a call for attention on the employee side, not only on the changes in workplace but for all the elements of the model. This is also discussed in the next sections of the project.

Asked to comment about the resemblance of the employment relationship with a situation where there is a reciprocal exchange of promises and obligations between employees and management, all participating managers agreed that there is a number of expectations employees hold from them and need to be kept in order for the co-operation to continue normally. Henceforth, there is a general convergence with the existence in the small firms of the default definition of the psychological contract although in theory as we saw earlier managers declared their ignorance of the concept.

Of course to a proportion this is anticipated as in a place where managers/owners and employees develop such a close relationship and with the informality that governs the environment (MacMahon, 1996; Matlay, 1999 E.F.I.L.W.C, 2001). Consequently it is not entirely surprising to have such an occurrence not only because the Guest and Conway model might be applied but also as it natural for such a mechanism to exist in a surrounding such as of small firms. Managers confirmed the existence of a reciprocal exchange of expectations in among themselves and employees pointing out that in the majority these unwritten promises include the characteristics discussed previously in the interview process namely, trust, job security, fairness and respect.

Equally, all managers pointed out the agreement of this type is openly negotiated with the employees due to the open nature of the business and the immediate interaction between workforce and management. Consequently, what expectations arise in the ER either material (e.g pay increase) or intangible (e.g trust) is brought forth directly to the attention of managers and as such the issues can be resolved relatively fast. We could argue nevertheless that managers in

small firms due to the power in their hands and the idiosyncrasy of their character could decide on issues contrary to employee volition. This again points that there is must some definite employee voice in small firms to ensure the right administration of issues.

### 3.2 Managerial perception of the ER

Managers were also interviewed in terms of their perception of changes the employment relationship has undergone the recent years pointing to a more fluid and insecure environment for companies due to globalization and thus an unstable environment without security for employees (Hiltrop, 1996). Four managers reported that indeed there has been significant changes the past fifteen to twenty years with the rise of technology, increased competition both on a domestic level as well as on a more global scale but expressed. In regards to the employment relationship they acknowledged the need for more talent in the workforce in order to meet the rising demands of the industry.

Nevertheless, they did not feel that this has such a large impact on the stability of the working environment indicating that whilst occasionally there is a renewing of the human sources of the companies, the number of employees has in fact increased through the past decade and that approximately half of the employees have been working in the company in excess of ten years. The remaining two managers were even more adamant on the stability of the working environment that has been maintained through the years actually expressing the opinion that it has been improved both for the company and the employees.

Following the structure of the management in small firms, executives were asked to describe the presence of HR practices in their businesses in order handle issues in the ER. Three managers stated they do not have a prescribed HR department but rather cope with their employees directly pointing to their previous reports about the close relationship between themselves and the workforce. In two companies, managers reported that they bring in external consultation through specialist HR consultants to supplement lacks in their ability and time constrain to handle all issues on personal level.

The last company reported that there is an appointed HR manager particularly for this purpose who although charged with other duties in the public relations of the company his main task is in the HR. There is a mix in terms of convergence with the theory. In most companies there the owner deals personally with most HR issues as theory suggest this is done in most small companies (Wilkinson, 1999; Hornsby et. al 1999). On the other end, two out of the six companies have adopted a more specialized route to handling HR issues. The difference in the approach could perhaps suggest the difference in managements mentality on this particular issues or could be related to sector-specific factors.

Managers were also asked to contribute their own personal views on any further issue pertaining to this line of debate emanating from their experience, knowledge and aspirations. All managers reported that importance of employment law and its inequalities. It was completely accepted among them, that although employment legislation is rigid for small firms in regards to the financial contributions firms are obliged to make to the countries national insurance institutions (Note 2) with increasing contributions that burden the capability of firms to provide salary increases and inflexibility for employees as they do not have the option to select their own insurance plan.

Furthermore managers reported inequalities in the government control mechanisms as many firms avoid paying the insurance contribution by not registering their employees leaving them thus in essence uninsured. (E.F.I.L.W.C, 2005a) The general argument was for a need of more flexible and pursuing employment legislation that will give both the employees and the workforce more opportunities that reflect modern demands. Table 4 concentrates the main themes put into the managerial focus and the feedback received.

## 4. Conclusions

Recapping the main points, both from the defined questionnaire and the open-discussion section there is a strong convergence between the main elements of the G& C model the perception of managers in the sample companies. Nevertheless we should point that this is the viewpoint of managers and as the theory of the PC suggests there is a large rate of subjectivity in the field (Rousseau, 1995; Arnold, 1996; Beardwell et. al 2004). As a result, employees might have contrary views, a principle that could apply for managers in other small firms in the same or other sectors.

This does not diminish the findings but it also important to be aware of various factors that could affect the investigation and could not be pin-pointed from the managers, an issue that will be analysed in more detail over the next sections. Secondly, the PC literature also can provides us with information on the actual uptake of the PC from firms. As such, in regards to real-time examples there are limits especially in the lack of empirical comparisons.

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**Notes**

Note 1. Indicative Grade scale- 0=not important, 1=little importance, 2=moderately important, 3=important, 4=very important, 5=most important

Note 2. <sup>1</sup> In Greece it is mandatory that every company insures its employees on the appointed government insurance institute. In the case of small business that is know as TEVE

Table 1. Characteristics of the sample of companies

	<b>Characteristics of the sample companies</b>
Size of sample	6 firms
Employee number	Ranging from ten to twenty
Educational background of workforce	Management teams: All members posses university level education and at least one member at each team hold a postgraduate qualification  Employees: 60 percent of the workforce in all of the sample was educated at a university level and the remaining forty is in possession of qualifications from technical institutions.
Market segment sample companies belong	Electronic taximeter market
<i>Country of origin</i>	Greece

Table 2. Management's response to the constructs of the C&amp;G model

<b>PC Elements</b>	
Trust	20 % Grade 4 , 80 % Grade 5
Loyalty	25% Grade 4, 75% Grade 5
Fairness	15 % Grade 3, 35 % Grade 4, 50 % Grade 5
Commitment	20 % Grade 4 , 80 % Grade 5
Negativity on changes in the Workplace the last twenty years	66,6 % Grade 1, 33,3 % Grade 2.

Note: Grade scale- 0=not important, 1=little importance, 2=moderately important, 3=important, 4=very important, 5=most important

Table 3. Full company elements.

	<b>Characteristics of the sample companies</b>
Size of sample	6 firms
Employee number	Ranging from ten to twenty
Educational background of workforce	Management teams: All members possess university level education and at least one member at each team hold a postgraduate qualification  Employees: 60 percent of the workforce in all of the sample was educated at a university level and the remaining forty is in possession of qualifications from technical institutions.
Market segment sample companies belong	Electronic taximeter market
Country of origin	Greece
Management structure	3 companies owner is the general manager; In the rest 3. a hybrid mix with a small board of directors with owner at the central role.
Management style / Decision making	Most of the authority is concentrated in the owners and the managerial outlook is dependent on their idiosyncrasy. Ensuing, most of the decision-making falls in their responsibility

Table 4. Summary of findings

<b>Issues put into focus</b>	<b>Feedback</b>
Awareness of the PC as a theory	Relatively low
Recruitment /HR policies	High levels of informality, dependent on the authority of managers
ER as a mechanism of mutual expectations among employers and employees	Confirmation with such a parallel
Further issues of importance	Small firms present a ``warm`` family-type of relationship that offers advantage compared to impersonal larger organizations
Events resembling contraction violation , employee dissatisfaction etc.	Not frequent, usually is managed through the close relationship between management and the workforce.
Changing environment and consequences on job security	There have been changes but not entirely negative especially for employees. Employment is stable as is the working environment. More of an adaptive processes than sweeping changes.
Limitations	No employee feedback