

3

Coming to terms with the employment relationship

Main tasks

- **Outline the employment relationship's enduring features**
- **Review the significant variations to be found in practice**
- **Consider the nature and extent of the impact of intensifying competition on the traditional model**

Summary

The employment contract involves a special form of exchange that brings benefits to both parties over and above the labour service equivalent. As well as receiving tangible and intangible rewards, employees are guaranteed a measure of security of employment, while the employer buys the right to use their labour and/or knowledge power largely at their discretion. Each of the disciplines applies its own adjective to describe the employment relationship: economic, legal, psychological, political and social. It is best understood, however, as a managerial relationship. This means there is great uncertainty, fuelling the prospect of divergent goals and interpretation. The relationship is also on-going, which means that there are more or less constant pressures on - and opportunities for - both parties to seek to adjust the exchange in their favour, and it is contradictory, in much as employees cannot be 'commodified' and employers have to pursue the potentially mutually-exclusive strategies of control and commitment. Complicating matters is that the employment relationship involves a complex 'governance' regime of institutions or rules, with scope for differences over both substance and process. Variations reflect two

main considerations. One, which depends on the occupation, involves the balance between ‘contract’ and ‘status’ and largely turns on the extent to which skills are general or specific. The other, which is cross-national, reflects fundamentally different conceptions of the work organisation – whether it is to be seen as a ‘nexus of contracts’ or as a source as well as consumer of human capital. These, in turn, are grounded in different varieties of capitalism and their associated civil law and common law legal systems. Even so, there are common trends. Everywhere, the employment relationship seems prone to ‘juridification’, i.e. the greater involvement of the law and the courts in employment relations matters. At the same time, the traditional model of the employment relationship faces major challenges in the light of competitive pressures in an increasingly global economy: the talk is of a shift in the basis of the ‘psychological contract’ from the ‘relational’ to the ‘transactional’; and the ‘fragmentation of the employment relationship’ resulting from different forms of ‘externalisation’ such as sub-contracting, outsourcing, business sell-offs, spin-offs and buy-outs. Yet management needs commitment as well as compliance. There are also limits to ‘fragmentation’ - managing an ‘extended organisation’ is fraught with difficulties.

Introduction

The employment relationship comes first in the 'matters' that the text deals with because it is central to both practice and theory. It has been described as ‘the characteristic institution’ of capitalism¹; along with limited liability, it is said to be one of the ‘two great inventions [that] lie behind the rise of the modern business enterprise’². Perhaps not surprisingly, therefore the employment relationship is far from being a straightforward concept. Terms such as ‘work’ and ‘employment’, for example, are very often used inter-changeably. In discussing the employment relationship, however, they need to be clearly distinguished. Work can be defined as ‘purposeful activity directed at producing a valued good or service’, whereas employment is a particular form of ‘work that is performed under contractual arrangements and that involves material rewards’³.

There are also three main types of such arrangements. In the first, the employer hires workers on a service contract to undertake a

EMPLOYMENT RELATIONS MATTERS

specified task or set of tasks - it could be a builder, for example, or an architect or a solicitor. In the second, they hire workers on employment contracts to undertake a range of tasks largely at their discretion or managers who are their agents. The third type of employment relationship may be described as trilateral or multilateral. One employer subcontracts responsibility for providing labour services by entering into a service agreement with another employer, which puts the relationship at second remove. Here the traditional 'binary divide' between dependent and independent employment becomes blurred. Workers may be employees, but 'The traditional functions of the employer may be split between a number of separate entities'⁴: in the case of 'agency work', for example, the employer who pays is not necessarily the one who coordinates.

In most countries the direct or dependent employment contract is by far and away the dominant form of the employment relationship. Indeed, this is so much so that the terms 'employment relationship' and 'employment contract' are used inter-changeably as they are in this text. As the previous chapter pointed out, in the UK, at the end of 2009, according to the Office for National Statistics, just under 29 million or something approaching six out of ten of the population above the age of 16 were regarded as being in 'employment'. Of these, just under 25 million people or 86 per cent were classified as 'employees' and nearly 3.9 million as 'self employed'. Even if every one of the 3.9 million or so self-employed were involved in labour service contracts, which is most certainly not the case, it would still mean that more than eight out of ten were involved in a contract of employment.

The great majority of 'employees' were also on permanent contracts, with 1.4 million or 5.8 per cent on temporary fixed term contracts, which is a proportion that has not changed, contrary to some punditry about developments in atypical working. If there has been a change, it is the balance between full-time and part-time employment. In the same year many more were part-time, i.e. just over a quarter. Arguably, though, this more to do with shifts in employment structure, notably from manufacturing to services, than changing views about the employment relationship.

It is difficult to be precise about the size of the workforce involved in multi-lateral arrangements. It seems safe to conclude,

however, that it remains in the minority. In the UK, the Business Services Association (BSA), which represents companies providing outsourced services, estimates its members employ 350,000 workers producing a turnover of £14.3 billion⁵. Agency workers in the UK, the BSA adds, number some 1.3 million.

Enduring features

A special form of exchange

The reason why the employment contract is the dominant form of the employment relationship is that it involves a special form of exchange that brings benefits to both parties over and above those involved in the labour services agreement. In a phrase, the employment relationship involves a trade-off between employees' need for security and employers' requirements for flexibility⁶.

Tangible and intangible rewards. In the case of employees, most attention focuses on the tangible rewards that come from employment, i.e. wages and conditions such as holidays and pensions. There are two main reasons. One is practical. Not only are such rewards critical in living standards but, being quantifiable, and thus generalisable across all manner of jobs, they are the common focus of policy makers and practitioners alike⁷. The second is their significance to employers as well as employees. For wages and conditions, hours of work, holidays and pension rights are not just what the employee receives. They are also 'a price which represents the total cost of enjoying its use'⁸

Intangible rewards have both an internal and external dimension. In Edwards' words, 'what goes on within the employment relationship is crucial, not only in terms of the pay that is earned but also the condition under which it is earned: the degree of autonomy the employee is granted, the safety of the work environment, the opportunity for training and development, and so on'⁹. Fairness has also been a major focus of attention. Externally, employment brings the opportunity for social contact and social status as well as a sense of purpose and personal identity.

Less attention has focused on what is perhaps the greatest intangible of the employment contract: the relative security that comes from a measure of continuity of employment. The point can best be

EMPLOYMENT RELATIONS MATTERS

made by contrasting the employment contract with the labour services agreement. Clearly, the labour services contract also brings both tangible and intangible rewards. Indeed, at first sight, it might be thought that they would be superior on both dimensions. Being one's own boss brings much greater discretion as well as the possibility of higher economic rewards. The great disadvantage of the labour services contract is that it brings little or no employment continuity - which is fundamentally important if the individual has no other source of income. The self-employed also forgo a number of the practical advantages of the employment contract. Arguably, payments for holidays, sickness and pensions are simply a form of deferred pay and provision for them accommodated in higher fees. Their organisation, however, takes time and effort.

Residual control rights. The benefits that employers receive from the employment relationship very rarely receive the attention they deserve and yet are critically important if the full significance of the employment relationship is to be appreciated. In both the labour services agreement and employment contract, employees sell their labour and/or knowledge power. Whereas the labour services agreement spells out the work that is to be done in return, however, the employment contract is relatively silent; in one well-celebrated phrase, the employee in effect signs a 'blank cheque'¹⁰. The point is that the employer does not acquire a specific or quantifiable amount of labour from the employment relationship - if they wanted this, they might just as well opt for a labour service agreement. Rather the employer buys the employee's capacity to work (commonly known as 'labour power' following Marx's original formulation), which requires direction. In the language of transaction cost economics, the employment contract gives the employer 'residual control rights' over employees, which are ex post rather than ex ante.

Transaction costs thinking also helps us to understand the benefits. The would-be employer can be seen as being confronted by a choice between different 'governance' regimes. Other things being equal, the assumption is that they will seek to organise their activities on the basis of market contracts. To do so, however, they have to cope with three main problems: the difficulties of search and information costs occurred in acquiring adequate information about available reliability and price ('bounded rationality'); the costs required to come

Coming to terms with the employment relationship

to an acceptable agreement and draw up an appropriate contract with the other party; and the policing and enforcement costs of making sure the other party does not renege on the terms of the contract ('opportunism'). Also the more specific the skills are to the employer ('asset specificity'), the more acute these problems are likely to be.

In these circumstances, the open-ended employment relationship, coupled with a managerial hierarchy, has traditionally had considerable advantages over the labour service agreement, helping to explain what has been described as the 'historical tendency towards the internalisation of employment relationships'¹¹. To paraphrase Marsden¹², the employment contract is more flexible – managers do not have to specify everything in advance of the act of hiring, which means, in turn, that it is possible to vary detailed assignments in the light of changing circumstances. It is more efficient – it cuts down on the three types of costs (information, bargaining and enforcement) that managers would otherwise incur. It means that managers are able both to develop specific skills that cannot be secured on the 'external' labour market and to ensure an adequate return on that investment. It also means that managers are able to exercise greater control over enforcement of the agreement along with issues such as cost and quality, subject only to the constraints imposed by the law or collective agreements or societal norms.

In short, in the case of the labour service agreement 'governance' is contract-based – the assumption is that the agreement is self-enforcing, with the courts adjudicating in the light of any dispute. In the case of the employment relationship, 'governance' is hierarchy-based – it is managers who determine 'how much work is performed in that time, at what specific task or tasks, who has the right to define the tasks and change a particular mix of tasks and what penalties will be deployed for any failure to meet these obligations'¹³

A managerial relationship

Each of the traditional disciplines applies its own adjective to describe the employment relationship. Thus, for economists, the employment relationship is essentially an economic or market relationship; for lawyers it is a legal relationship; for politicians it is a political or power relationship; for sociologists it is a social relationship; and for psychologists it is a psychologist one. For the most part, however,

each discipline ploughs its own furrow without reference to the others. Very often, too, as Chapter 1 observed, the primary concern is with confirming the theoretical propositions or methods of the discipline rather than helping to understand the employment relationship itself.

Arguably, although each of these perspectives highlights an important dimension of the employment relationship, helping to explain why its study is multi-disciplinary, none of them captures the essence. For the feature that distinguishes the employment relationship from the labour services agreement is that it is a managerial relationship¹⁴. This is because, to repeat the argument of the previous section, in entering into an employment relationship, the employer does not acquire a specific or quantifiable amount of labour. Rather they require the right to direct employees. An important corollary, as Chapter 1 pointed out, is that to talk in terms of a labour market gives a very false impression of what is at stake in the employment relationship. Hiring and firing is not even the half of it.

The employment contract may have advantages over the labour services agreement. But managing the employment relationship is far from being straightforward. There are a number of intrinsic features reflecting the trade-off between employees' need for security and employers' requirements for flexibility that complicate matters considerably.

Indeterminate. First of all, the employment relationship is *indeterminate* or *incomplete*. Many of the benefits that employees receive from the exchange can be set. This is particularly true of wages and conditions, helping to explain why they are so often the focus of attention. The residual control rights that employers receive in return are a very different proposition, however. In Collins' words¹⁵, contracts of employment are 'incomplete by design', in the sense that the details of the work to be done are largely left to be decided by managerial direction. Consequently, nothing is automatic about the employment relationship. 'The act of hiring ... is not sufficient to ensure that the job gets done in an acceptable way ... The employee has to be motivated – by encouragement, threats, loyalty, discipline, money, competition, pride, promotion, or whatever else is deemed effective to work with the required pace and care'¹⁶. Managers also need employees to do more than simply comply with instructions. They need their co-operation and commitment to continuously

improve performance. The sting in the tail is that the motivation and commitment so critical to performance reflect not just the economic return, but also the job satisfaction and emotional reward that people derive from their work. As Chapters 5 and 6 explain in more detail, the upshot is that negotiation and the exercise of domination or power 'over' are integral to the conduct of the employment relationship, regardless of the presence of trade unions.

Continuous. The employment relationship is not a one-off exchange as in the case of the labour *services* agreement – it is *continuous* or *open-ended*. This means that it is a relationship that has a history and a future, in which learning and socialisation play important roles. Moreover, the longer the employee is involved, the more experienced and socialised they become, with responses to an immediate situation reflecting this experience and socialisation.

Being *continuous* also means that there are more or less constant pressures on and opportunities for the parties to seek to adjust the exchange in their favour, reinforcing the importance of negotiation and the exercise of power. Most obvious are the occasions of pay reviews that have typically come to take place annually. Any increases in pay, be they individual or collective in coverage, are likely to be linked to expectations of improved performance. Yet more or less any change in the environment can generate pressures on and opportunities for the parties to seek to adjust the basis of the exchange. Historically, it was employees and their trade unions that were most associated with such change and the focus was on terms and conditions. More recently, with intensifying pressure on business performance, it is managers who have come to the fore, with the emphasis shifting to 'continuous improvement' and 'smarter working'.

Exploitative. This term is used in both derogatory and literal senses. In the derogatory sense, it is a value judgment about the conduct of the employment relationship in a specific instance. Typically, it is used to describe a situation where the employer pays less than the going rate. In the literal sense, it is a statement of fact about the employment relationship in general. In the words of the Oxford Dictionary, to exploit is to 'utilise (person etc.) for one's own ends'. Employers 'exploit' employees in as much as they deploy their labour and/or knowledge power in order to meet their objectives which, in the case

of private sector companies, is to generate a surplus. Unlike the independent worker, moreover, many employees have little or no say in how their labour or knowledge is deployed. As Chapter 6 explains in more detail, this is because the employment relationship is asymmetric or unequal. Superficially, there are two equal parties – the employer and employee. In practice, these parties are very unequal. Domination or power ‘over’ is a design feature of the employment relationship, being implicit in the basis of the exchange discussed above. Also the employee is a single individual usually with very limited resources who does not have much choice – he/she needs to work in order to secure income. By contrast, the employer is typically a corporate entity very often with substantial resources at its disposal.

Contradictory. Another key feature of the employment relationship is that it is *contradictory*. An underlying assumption is that, in as much as they 'sell' their labour and/or knowledge power to be used at the discretion of the employer's agents, the employment relationship involves employees in an act of submission or subordination, regardless of any job satisfaction or material rewards. Yet, unlike other resources, ‘human resources’ are embodied in people - labour differs from other commodities in that ‘it is enjoyed in use and is embodied in people’¹⁷. To carry on in Edwards’ words, ‘A machine in a factory is also enjoyed in its use and for what it can produce. Yet how it is used is solely up to its owner. The 'owner' of labour, the employer, has to persuade the worker, that is the person in whom the labour is embodied, to work. Managerial relations are the relationships that define how this process take place ...’ As Chapter 1 pointed out, for many employees in democratic societies, the contrast between their organisational and civil lives could hardly be sharper – on the one hand, ‘political democracy’ and, on the other, ‘economic autocracy’¹⁸.

The employment relationship is also contradictory for those who have to manage it. Employees represent both a cost and an investment, which means constantly making compromises. Motivating employees to do what managers want is also nowhere as simple as it is often portrayed. In Edwards' words again, 'managements have to pursue the objectives of control and releasing creativity ... [and] the problem is that these involve very different and conflicting strategies'¹⁹. Very tight monitoring is not only costly, but also can reduce the prospects

Coming to terms with the employment relationship

of employees using their initiative. But lax control can mean that different groups and/or individuals may pursue aims and objectives that are incompatible with one another.

Co-operative and antagonistic. It is because of these features that the employment contract locks employers and employees into a relationship that is at one and the same time *co-operative* and *antagonistic*. It is *co-operative* in as much as neither party can secure their goals without the cooperation of the other - employers and employees are mutually dependent on one another. Employers may own the capital, but it is employees who deliver the goods or services. Equally true is that employees cannot secure their means to a livelihood unless they help the employer to make a surplus and/or keep costs to a minimum. Similarly, they risk denying themselves opportunities to develop new skills and abilities as well as fulfil themselves.

At the same time, however, the employment relationship is *antagonistic* because it is exploitative and contradictory – in Edwards' words, there is an in-built 'structural antagonism'²⁰. Importantly, this does not necessarily mean that there is a general conflict of interest - employees have many interests that the employment relationship may serve. It does mean, though, that the potential for specific conflicts of interest is ever present and that the expressions of such conflicts, be they over the fixing of wages and conditions or the exercise of the employer's discretionary rights, is not just a matter of faulty procedures, 'bad' management or wilful employees. In the UK, recent high profile Employment Tribunal cases in investment banking also confirm that employees at every level of the organisation are affected.

Disputes are the most manifest expression of the conflicts of interest and can be individual or collective, involving a grievance or an appeal to an Employment Tribunal or a strike or collective action short of a strike, such as an overtime ban or 'work to rule'. Other expressions of these conflicts range from the voicing of discontent in attitude surveys, through absence and resignation, which can be regarded as ways of 'exiting' from a relationship regarded as unsatisfactory, to so-called 'organisational misbehaviour' such as theft and sabotage. Chapter 7 deals with the changing pattern of disputes in more detail.

Variations on a theme

So far the discussion has focused on what might be described as the generic features of the employment relationship. As Chapter 1 emphasised, however, the workplace is not an island unto itself and conduct of the employment relationship depends on the specific social and institutional context. Employees can have very different expectations of their employment relationship as the 'psychological contract' literature discussed later suggests. They can have very different 'orientations to work' as the older sociological studies clearly demonstrated²¹, with very different emphases placed on income, status, identity and social opportunity. The behaviour of managers also reflects the organisations in which they work. For example, the parent company may have a very well-defined philosophical approach to managing people that it extends across its businesses or it may have very strong affiliations to a particular sector that are influential. Of the main dimensions, two main ones stand. One is the occupation. The other is the national system.

Contract and status

To make sense of the differences between types of occupation, there is useful distinction to be made between 'contract' and 'status'²². The distinction has both a specific and general meaning. Thus, in Germany, the relationship between career public servants (*Beamte*) and the state is not a private contractual one, but is defined by public law. Disputes are settled by administrative courts rather than labour ones.

More generally, the distinction reflects the differences between the labour services agreement and the employment relationship referred to in earlier. A key consideration is the degree of 'asset specificity'. The more general the skills are, the more likely is the tendency towards 'contract'; the more specific the skills, the greater the tendency to see employees as an investment for the longer term with a special 'status'. Employment relationships based on 'contract' are very close to labour services agreements - indeed, the employees involved are very often the ones whose work is subcontracted, the extreme case being the so-called 'spot market' for daily labourers.

Coming to terms with the employment relationship

At first sight, 'contract' and 'status' roughly equate with the 'transactional' and 'relational' types of employment relationship that feature in the psychological literature²³. 'Contract' and 'status' are not concepts along a single continuum, however. Rather they comprise several dimensions. Some of these involve a continuum - career is an example. Others represent contrasting types such as 'numerical' and 'functional' flexibility. Table 3.1 illustrates.

Such a framework also does not necessarily mean equating low skill with 'contract' and high skill with 'status'. As already indicated, much depends of the degree of specificity of the skills: a lawyer or financial accountant, for example, may be highly skilled, but their skills are of general rather than specific application. Employees in occupations where the profession offers greater career prospects than the individual organisation – for example, lawyers, financial managers and computer specialists - may incline to the 'contract' model. Some of the trends are also contradictory. Many unskilled groups have only recently been moving towards the 'status' model with the extension of pensions, sick pay and other fringe benefits - indeed, as Jacoby reminds us, many of the features associated with the 'status' model are much more recent than often assumed, with different forms of subcontracting being dominant in many sectors until the end of the 19th century; they also reflect legal pressures and employee demands as much as they do managerial strategy²⁴. Meanwhile, some high 'status' groups, such as senior managers, have experienced the imposition of very tight targets and performance controls considerably reducing their discretion. There can also be reversions. Some subcontracted work is being brought back in house as practice confirms the importance of having workers under managerial control – maintenance on the national rail network is an example. The situation can also differ significantly between different workplaces. A part-time worker in one of the UK's top supermarket chains such as Tesco or Waitrose may enjoy greater de facto employment security than a high 'status' individual in a less successful organisation.

The 'contract-status' formulation is especially helpful in making sense of many of the changes supposedly taking place in employment relationships. It may be true that employers feel under pressure to make increasing demands on flexibility and greater sharing of the risk²⁵. Yet this does not necessarily mean a coherent shift in approach

that characterises many interpretations. Rather industrial relations emphasise an eclectic mix as employers grapple with the contradictions arising from their need for commitment and control discussed earlier²⁶. Thus the two approaches can co-exist in the same workplace in the form of the so-called 'core-periphery' model – core employees usually fall into the 'status' category, while the periphery are closer to the 'contract' equivalent.

Varieties of capitalism - competing views of the organisation

As Chapter 2 observed, even though the employment relationship has many common features, there are considerable cross-national differences. In every country, the state has become the 'guarantor of the employment relationship' and yet legal frameworks differ considerably in the nature and extent of the legal protection that is afforded to it in areas such as the formation of individual contracts, their relationship to collective agreements and their provision for termination. These, in turn, reflect contrasting views about the nature of the work organisation, which are grounded in the wider legal, political and social context.

On the one hand is the doctrine of the firm as a 'nexus of contracts', which has been described as the 'dominant legal and economic perspective' in the UK and the USA²⁷. Largely developed as the result of economists grappling with the need to accommodate the organisation into neo-classical thinking, it starts from the proposition that the firm is a legal fiction to which the term ownership cannot be meaningfully applied - it is a 'contracting site at which the parties to a business enterprise agree the terms on which they are prepared to supply the firm's inputs and which they are to be rewarded for doing so'²⁸. Crucially important for present purposes is that the employment contract is seen as being no different from other contracts – it is purely a market relationship and the parties owe no responsibilities to one another beyond those expected of participants acting in good faith. The mutual advantages of the employment contract over the labour services agreement are effectively ignored as are its implications. Thus, in the words of Alchian and Demsetz²⁹, who were responsible for much of the initial thinking, the organisation is merely 'the centralised contractual agent in a team productive process – not some superior authoritarian directive or disciplinary process'. Exclusive

residual rights are vested in shareholders on efficiency grounds and managers are responsible to them only, the share price representing the best value the market can put on the company. Market competition is the key to governance with the emphasis on ‘pay for performance schemes such as stock option grants, an active market for corporate control, and the fiscal discipline of leverage’³⁰. The approach, suggest supporters, avoids potential confusion of objectives associated with the alternative stakeholder model that sees managers having responsibilities to multiple interests; it is important in increasing efficiency - in particular it prevents the ‘managerial empire-building’ associated with the growth of large diversified conglomerates in the 1960s and 1970s; and it helps to insure that resources are re-allocated to new initiatives³¹.

One other hand is the variously described ‘capability approach’ or ‘resource-based view’ that informs the thinking behind HRM, the ‘learning/knowledge organisation’ and ‘high performance working’. It also approximates to the thinking in a number of EU countries and is associated with the EU social model. As Table 3.2 outlines, the starting point is that the firm or business is a social organisation, with success largely depending on the ability to satisfy markets for products and services. Management is a key resource as well as process, with responsibilities for coordinating, developing and enabling the skills and talents of other employees. The employment relationship involves market and managerial relationships and its conduct is critical. The key to governance are institutions in the broad sense of the term. In the words of a summary of the position, work organisations are seen as ‘capability structures’³². The focus is on how the organisation, ‘an authoritatively structured set of relationships’, creates ‘distinctive capabilities through establishing routines that coordinate complementary activities and skills for particular strategic purposes’³³.

These perspectives are grounded in a recognition that capitalism does not exist in a vacuum. Rather than a single form, there are ‘varieties of capitalism’ with very considerable differences from country to country in the way that economic activity is organised. This is above all true of the way in which the organisation of production at firm level is linked to the support provided by the external institutions at many levels of the political economy. ‘Markets’ and ‘hierarchies’, it

argued, are not the only coordination ('governance') mechanisms for economic behavior: 'social networks', 'association', and 'state intervention' can also be important. Overall, businesses are said to be 'embedded' within social contexts with the relationship being mediated by institutions that shape the collective supply of inputs (e.g., skills, capital) available to firms and other economic actors with significant implications for the various economic outcomes (e.g., growth, efficiency, innovation)³⁴.

A voluminous 'varieties of capitalism' literature has emerged with many different strands. Most attention has focused on the suggestion that there are two main types: the 'liberal market economies' (LMEs) of the Anglo-Saxon countries with their 'shareholder' or 'outsider' systems and the 'co-ordinated market economies' (CMEs) found in Japan and some continental European countries characterised by their 'stakeholder' or 'insider' systems. 'Outsider' systems are associated with dispersed networks of shareholdings, greater reliance on external sources of finance, highly developed stock markets and an active market for corporate control - companies are largely discrete economic actors - 'islands of planned co-ordination in a sea of market relations'³⁵ - primarily accountable to shareholders. In contrast, 'insider' systems, are distinguished by interlinked networks of corporate, institutional or family shareholdings, a financial system based on long-term bank credit, less developed stock markets and constraints on hostile take-over. In this case, companies' ability to act independently is restricted by ties of mutual obligation to and dependence on various stakeholder groups, including employees.

There is a considerable degree of congruency with another binary model that is rooted in differences in legal systems: CLEs tend to be characterised by 'civil law' systems and LMEs by 'common law' ones. To paraphrase Colling, 'civil law' systems are driven by the desire for one common statement that is applied universally and takes precedent over the wishes of the contracting parties³⁶. The courts also play important roles in diffusing these general principles through the influence their decisions exert with widespread implications for commercial and inter-firm relations. The result is that both the substantive and procedural content of employment contracts are affected, with deviation from generally applied business conventions generally frowned on. By contrast, in common law systems the courts

have a much bigger say in the development and application of legal principles. They also prioritise the freedom of social actors to reach the contracts that they want, with the result that precedent is applied through fragmented case by case processes. Thus, whereas in 'civil law' systems the incorporation of the terms of collective agreements is more or less automatic, in 'common law' ones it is selective depending on the prevailing custom and practice

These binary classifications can be criticised for glossing over the very considerable differences between countries in the same category. This is especially so in the case of the CLEs. The role of the state, for example has been fundamentally different in, say, the Latin countries as opposed to Germany or Sweden: in the first case, descriptions such as 'state-led' are appropriate, whereas 'collaborative' or 'consensus' fits the second better. Similarly, while the banks have been the main source of funding in Germany, investment foundations have played this role in Sweden. Also the LMEs are not as homogenous as they appear: for example, there are considerable difference in the common law systems of the UK and the USA - in the UK collective agreements are binding in honour only, whereas in the USA they are deemed to be legal enforceable contracts.

Much depends on different conceptions of how institutions constrain and relate to actor behaviour, which takes us back to Chapter 1 and the different types of institutional analysis. Those who advocate the binary model tend to come at the issues from a 'rational choice' perspective and favour parsimony. By contrast, those inclining to a broader categorisation tend to come from the 'historical institutionalist' approach and emphasise complexity.

Arguably, however, it is not so much the typologies that are important for present purposes. Rather it is the dimensions or basic building blocks that different authors draw on that deserve the attention. In drawing this section to a close, therefore, Table 3.3 draws together the main institutional features that enable and constrain different sorts of business systems, which might also be seen a summary of the influences on the conduct of the employment relationship. In simple terms, the configurations of variables in column 1 are seen as strongly encouraging management to opt for one or other of two main combinations of business strategy/form of work organisation that, in turn, shape the management of the employment

relationship.

The traditional model under threat?

There is something of a paradox about developments in the employment relationship. Everywhere the employment relationship seems prone to the process known as 'juridification', i.e. the greater involvement of the law and the courts in employment relations matters. This is above all true of the UK, where there has been a considerable increase in legislation that shapes the substance of the employment relationship as well as the processes dealing with it. One factor is the coming of the EU – for reasons that Chapter 10 spells out in more detail, the price of having a 'Single European Market', was a considerable extension of individual employment rights. Another is the decline of collective bargaining: the less the coverage of collective bargaining, the greater is the tendency to look to legal regulation to fill the gaps. More generally, what has been described as 'law's allure'³⁷ can be seen as part of a wider process in society in which legal rules are introduced to help deal with risks and uncertainties that might otherwise result in conflict if actors were left to their own device. Here, contrary to what might have been expected, 'market liberalisation' has been a major cause of 'juridification'³⁸; covering for risk has also been a significant factor in the increase in occupational licensing. In any event, the notion of the employment relationship being an essentially private one no longer holds true if it ever did.

At the same time as the law would seem to be minimising the uncertainties associated with the employment relationship, however, there are other developments that are calling into question the stability and security that have come to be associated with it. The mainspring is intensifying competition in an increasingly global market place leading to more or less continuous change and 'permanent restructuring'. Employers, it is proposed, are introducing new organisational forms in place of traditional bureaucratic structures; they are seeking a range of flexibilities – numerical, functional, financial and temporal; they are introducing new forms of agency, temporary and fixed term contracts; and they are focusing more and more on the individual employee, with the adoption of stretching targets and rigorous appraisal and surveillance of performance³⁹.

Arguably, much of this has to be taken with a considerable grain salt. As the figures quoted earlier suggest, temporary working is very much the exception rather than the rule. Many supposedly new organisational forms, as Chapter 8 will argue in greater detail, do not involve serious change in work organisation. There are also limits to the flexibility that managers can bear. There are two areas, however, where the implications have to be taken more seriously. These are the ‘changing psychological contract’ and the ‘fragmentation of the employment relationship’.

A changing psychological contract?

There is an on-going debate about whether changes are taking place in the ‘psychological contract’ involved in the employment relationship⁴⁰. As the outline of what the ‘psychological contract’ entails in Table 3.4 suggests, the starting point is the recognition that, for all the talk of managerial hierarchy, employment law and collective agreements, individuals cannot be left out of discussions of the employment relationship: the day-to-day conduct of the employment relationship depends very much on perceptions and expectations, reflecting the enduring features of the employment relationship discussed earlier. Indeed, given the imprecision of the employment relationship, these perceptions and expectations may play a more important role than the formal contract. This is above all true of countries such as the UK, where the ‘individualisation’ of the employment relationship has gathered a pace as a result of the decline in proportion of the workforce in trade unions and/or covered by collective agreements as Chapter 9 will confirm.

It is what might be described as the ‘old core issues’ of careers and pensions that have loomed especially large⁴¹. Historically, these have been seen to be two critical elements in the ‘psychological contract’ in which employees trade off security for their loyalty. Increasingly, however, employers are said to be finding it increasingly difficult to honour these expectations – partly because of the pressure from intensifying competition and partly because of the rising cost of funding pension schemes due to longer life expectancy. Overall, the basis of the employment relationship is said to be moving from the ‘relational’ to the ‘transactional’, with employers seeking to avoid and/or shift the risk involved in some of the traditional features of the

employment relationship. In terms of pensions, it means a move from schemes with defined benefits to ones involving defined contributions. In terms of careers, it means an emphasis on 'employability' (helping employees to become as 'employable' as possible) and 'portfolio careers' (encouraging employees to think in terms of a number of careers with a number of employers rather than a single career with one employer).

For the UK, there is certainly considerable evidence to support the 'permanent restructuring' thesis, which will be discussed in more detail in Chapter 8. Stability is something that few managers can contemplate. Short-term pressures to maximise the share price or, in the case of public services, implement top-down policy changes from governments, mean that day-to-day management of organisations is constantly being disrupted. Adding to the problem in many organisations is the rapid turnover among managers – expectations raised and promises made by one manager can be quickly set aside or disabused by another. The redundancy that was historically associated with economic down-turns has become an accepted or normal way in which firms handle restructuring regardless of overall business performance⁴².

There is also no disputing the facts so far as pensions are concerned. In the UK, there has been a considerable decline in final salary pension or defined benefit schemes in which both parties pay and the employee is guaranteed a pension depending on income and years of employment. In their place have been substituted defined contribution schemes very often accompanied by a reduction in the level of employers' contribution. The result is that many more employees now face the uncertainty of defined contribution schemes with the outcome dependent on stock market performance of the pension fund(s) into which they contribute

The problem of pensions and their funding is universal, but the precise form depends on the balance of funding between employers and the state. In some countries, the proportion of older people's incomes coming from public sources is more than half, i.e. France (85 per cent), Germany (73 per cent) and Sweden (68 per cent). In others, the balance of public–private pension provision is the other way: in the Netherlands public provision accounts for 48 per cent, in the UK 49 per cent and in the USA 36 per cent. In countries where pensions

are predominately funded by the state, the issues are largely general ones. In those where they are they funded mainly by employers and employees, they mainly involve individuals⁴³.

There is less evidence to support the notion of the 'end of careers'⁴⁴. In the UK, overall job tenure remained relatively stable in the 1980s and 1990s with change being relatively small at between 2 and 5 per cent: the proportion in long term employment (ten years or more) also showed little change between 1994 and 2004, being just over 30 per cent in both years⁴⁵. A detailed breakdown suggests that it is particular groups for whom employment security has declined. Thus, the job tenure of men over the age of 50 declined as did that of men in lower paid jobs: the Commission on Vulnerable Employment⁴⁶ reports that average job tenure for men in the bottom income quartile was seven years, whereas it was 12 years for those in the top income quartile. Furthermore, tenure rates for the lowest-paid have also fallen – from nine years in 1982 to seven years in –.

Further evidence comes from the CBI Director General's telling of the 'remarkable story of what happened to employment numbers' in the UK in the most recent recession⁴⁷. Although they had been cutting costs wherever they could, many employers had decided to retain more people than they had need for, even though that temporarily pushed productivity down and unit costs up - output had fallen by 6.2 per cent from the peak, but unemployment was down just 1.9 per cent. The much greater reluctance to lay people off than was the case in the past, suggested CBI surveys, reflected two main considerations. One was the greater flexibility of wages. Such was the impact that, as well as voluntary unpaid leave and short time working, many employees had been willing to take a reduction. The second was that, since the early 1990s, the proportion of UK working age employees, above all in manufacturing, who have been through higher education had risen from around a fifth to a third. Skilled employees were harder and more expensive to hire and to lay off than others, with plenty of companies complaining of skills shortages before the recession hit⁴⁸.

It also seems that employers recognise that a general shortage of skills means they will have to do more to retain key employees. One consideration is the greater functional flexibility that many require from their employees. In the words of the CBI, 'There will ... be a trend to select and develop employees for a career within

organisations rather than for a specific job, reflecting businesses' preference for staff to be multi-skilled⁴⁹. A second is the priority that is being accorded to management and leadership skills. Shortages of these are also anticipated and dealing with them seen as a particular challenge to address given the timescale for investment returns – typically it can take 3-4 years to see a return on leadership training.

Limits to fragmentation?

Arguably, it is the second of the main challenges, 'fragmentation', that is the most threatening to the traditional model. 'Fragmentation' takes several forms. One is 'individualisation'. Not only has there been a considerable decline in trade union membership and the coverage of collective bargaining, but also a growth in individual performance pay and the like. In terms of pay, as Chapter 8 will argue in greater detail, it may not make a great deal of difference, but it means an undermining of a sense of 'occupational community' associated with trade union membership and collective action. Another form of 'fragmentation' might be described as 'occupational'. In the UK, for example, there has been a considerable growth in the number of 'assistant' jobs in fields such as teaching and nursing, which is blurring the boundaries of long-standing occupations

Perhaps most deserving of attention, though, is the 'fragmentation' that seemingly reverses the historical tendency towards the internalisation of employment relationships within hierarchies touched on earlier. The employment relationship, it seems, is increasingly the subject of 'externalisation'. One form is the subcontracting of some of a business' activities which have previously been undertaken in-house. In some cases, recalling the contract-status in a previous section, this involves the explicit adoption of a 'core-periphery' model, in which the organisation distinguishes between those employees who have skills that are very 'specific' to the business and those that are more 'general' in character. Another form is associated with what have been described as 'platform' companies - Apple and Dell are examples. In this case, the outsourcing of most activities is a key element of business strategy from the very beginning. A third type combines the first two and is to be found in the public sector. At the time of writing at the end of September 2010, Suffolk county council in the UK is proposing to make itself into a 'virtual' or 'enabling'

authority. It would not be providing public services itself, in other words, but commissioning them from social enterprises or private sector companies. In practice, this means that, instead of employing around 27,000 people as it currently does, the council would be responsible for but a few hundred primarily involved in contract management⁵⁰. On the face of it, there could hardly be a more extreme application of the 'nexus of contract thinking' discussed earlier.

Subcontracting and outsourcing are not the only types of 'externalisation', however. In the UK, organisations are said to be being subjected to a process of 'permanent restructuring'⁵¹. In part, such restructuring follows from the widespread adoption of 'divisionalisation' (the break-up of large-scale organisation into semi-autonomous businesses units or Executive agencies), 'budgetary devolution' (the allocation of responsibility for managing activities within financial resources or targets) and 'marketisation' (the greater application of market principles to decision making, e.g. in the form of 'competitive tendering' and 'market testing', joint ventures and partnerships). In part, it reflects a process of 'financialisation', in which competition is based not so much on products and services, but the returns on investment regardless of sector, leading to a variety of investment/divestment forms such as business sell-offs, spin-offs and different forms of buy-outs, along with merger and acquisition.

The result, as an earlier section pointed out, is that the traditional binary divide between contracts of employment and contracts for services is becoming increasingly blurred. Indeed, in the UK, the growth of trilateral or multilateral arrangements is leading some employment lawyers to suggest that it is time to replace the 'contract of employment' with the 'personal employment contract' as the core concept of labour law⁵².

Certainly the effects of 'externalisation' can be considerable as far as employees are concerned. Many find themselves working for very different organisations from the ones they joined, with significant implications for their pay, career prospects and pensions, not to mention their health and well-being. Some who were in permanent jobs are now in temporary ones, with the employer who pays often being different from the one who directs. Morale and commitment are also affected with implications for productivity and performance - collective or organised conflict in the form of strikes may have

declined, but individual expressions such as absenteeism show no signs of abating.

Establishing how widespread 'externalisation' is poses problems because of the variety of forms that it takes. Certainly, in the UK, there has been an increase in the number of workers involved in non-standard forms of contract such as temporary and fixed-term contract working; the same goes for agency working. There has also been an increase in subcontracting and self-employment⁵³. Much of this took place in the 1980s and 1990s, however. On the face of it, although the 'core-periphery' model mentioned earlier has been canvassed for around a quarter of a century, yet its extent appears to remain relatively limited. In 2004, according to WERS, 16 per cent of establishments reported having temporary agency workers, but these only amounted to two per cent of the combined workforce⁵⁴. Only one in ten had freelancers, very few of whom were engaged in the work of the largest occupational group. The great majority (86 per cent) subcontracted some services. Again, however, these rarely involved the largest occupational group - the mostly common subcontracted activities were building maintenance and cleaning affecting 59 per cent and 52 per cent of the total number of establishments respectively. Also it emerges that, over the previous five years, eleven per cent of establishments had brought in-house activities that had previously been provided by sub-contractors. Not to be forgotten either is that the number of self-employed remains very much a minority.

It may be that with the onset of the recession, there will be further increases, especially as a result of public expenditure cuts. This is particularly true of subcontracting and outsourcing, which appear to have considerable continuing appeal for employers as a recent CBI overview suggests in the case of the UK⁵⁵.

Yet there are grounds for being cautious in making such a prediction. The logic of subcontracting and outsourcing is clear enough. It is difficult to quarrel with the argument that managers need to focus their energies on the 'core' business. If they are running airlines or railways, for example, they should leave matters such as catering or maintenance to 'specialist' businesses. The 'market' will ensure that these businesses operate as effectively and efficiently as possible. It also means that pay and conditions will reflect those

prevailing in the sector rather than those of employees in the ‘core’ business. Perhaps even more basically, there is an understandable tendency to assume that, once activities are subcontracted or outsourced, managing the employment relationships becomes someone else’s problem - out of sight becomes out of mind.

Arguably, however, there are limits to ‘fragmentation’ that take us back to the earlier discussion of the enduring features of the employment relationship. The problem is that, while subcontracting and outsourcing may be fine in theory, managing the ‘extended organisation’ that they involve is far from straightforward – which is why companies brought many ancillary activities in-house in the first place and why others are doing the same presently. Like the employment relationship, subcontracting and outsourcing are not automatic in their effects – the contracting process can be time consuming and complex, while ensuring adherence to the contract requires skills in relationship management which few operational managers who managed the function before possess. Also, unless the main contractor is involved in managing the employment relationship throughout the supply chain, the danger is that they will experience many of the problems that can be incurred, but will not have the capability to deal with them. Indeed, if their relationship with their subcontractors is based simply on low cost, the problems are likely to be exaggerated – for the avoidance and shifting of risk affects employer-employer as well as employer-employee relationships. Not only is there likely to be a lack of commitment and/or identification with the parent company and its products/ services. There also likely to be costs to quality and reputation that are rarely fully considered. For example, organisations that do not seek to ensure that their supply chains maintain decent standards are likely to find themselves the increasing focus of ‘naming and shaming’ campaigns as has happened in the case of some of the large retail clothing chains in the UK which outsource manufacturing to developing countries.

Many examples of organisations experiencing subcontracting and outsourcing problems can be quoted. In the UK, recent high profile cases would include National Rail and London Transport, where maintenance has been brought back in house, and BA, which experienced considerable disruption as a result of the activities of Gate Gourmet, the company to which it outsourced its catering services.

EMPLOYMENT RELATIONS MATTERS

Perhaps, though, there can be hardly be a more dramatic illustration than that of Toyota. It was not just the scale of the problem that Toyota experienced, with the company having to recall over million cars world-wide in 2009-10 due to complaints about reliability. The 'Toyota' model had been universally recognised to be the supreme exemplar of 'lean production' not just in the automotive industries, but across the board. The main problem, as Toyota's chief executive publicly acknowledged, was that the company had become 'confused about some of the principles that had made the company great: its focus on putting customers first and its ability 'to stop, think and make improvements''⁵⁶. More specifically, it seems, the majority of problems originated in the 'tier-two' suppliers which provide individual parts or assembled components for Toyota and/or its 'tier-one' original equipment manufacturers. Break-neck expansion to overtake General Motors meant that many of these were from outside Japan and Toyota did not have decades of experience working with them as it had with its other suppliers. Making matters worse was that the company did not have enough senior engineers to maintain the levels of contract supervision that it had applied to long-standing suppliers.

Coming to terms with the employment relationship

Table 3.1 'Contract' and 'status'

	<i>Contract</i>	<i>Status</i>
tasks/ work organization	highly prescribed	some discretion
security of employment	low	relatively high
type of flexibility	mainly 'numerical'	mainly 'functional'
skill specificity	relatively low	relatively high
training and development	very little	some
career prospects	very limited	fairly extensive
'voice'	very little	some

EMPLOYMENT RELATIONS MATTERS

Table 3.2 Competing views of the work organisation⁵⁷

	Nexus of contracts	Resource-based
Role of the organisation	vehicle for contracting	providing goods and services
Role of managers	coordinate contacts	direct and support
Responsibilities	shareholders only	multiple stakeholders
Main focus	capital market	product market
Main form of competition	external/merger and takeover	internal growth/process and product development
Performance measures	share price	market share
Scope for coordinated action	limited	significant
Horizons	short term	medium/long term
Relationship between management and employees	purely market	market and managerial
View of labour	commodity whose cost is to be minimised	resource to be developed
Methods of securing commitment	financial/use of market type devices such as stock options maximisation	financial plus training and development/voice/consultation

Table 3.3 Varieties of capitalism: building blocks and links⁵⁸

<p>1 Role of the state</p> <ul style="list-style-type: none"> ▪ degree to which state relies on market regulation ▪ degree to which state encourages intermediary organisations <p>2 Financial systems</p> <ul style="list-style-type: none"> ▪ ‘capital-market-based’ v ‘bank-based’ ▪ ‘blockholder’ v ‘dispersed’ share ownership <p>3 Corporate governance arrangements (‘insider’ v ‘outsider’ control)</p> <p>4 Nature & extent of vocational training provision (balance between state, market, individual cos, co associations & co networks)</p> <p>5 structure of collective bargaining/ social dialogue</p> <ul style="list-style-type: none"> ▪ levels of bargaining/ social dialogue ▪ scope of collective agreements ▪ nature and extent of coordination <p>6 Nature & extent of employment protection legislation</p> <p>7 Nature & extent of employee ‘voice’ provisions</p> <p>8 Social security provisions</p> <ul style="list-style-type: none"> • level of benefits • balance of public–private pension provision • administration (government v ‘Ghent-type’ v company) 	<p>Balance between coordination mechanisms, ie</p> <ul style="list-style-type: none"> ▪ markets ▪ hierarchies, ▪ state intervention ▪ associations ▪ social networks 	<p>Nature of business strategy, ie extent to which</p> <ul style="list-style-type: none"> ▪ products/ services are standardised or customised ▪ competition is primarily via price or quality ▪ product/ service volume is high or low <p>Nature of work organisation, ie</p> <ul style="list-style-type: none"> ▪ ‘traditional’ ▪ ‘Taylorist’ ▪ ‘lean’ ▪ ‘learning’ 	<p>Governance of employment relationship</p>
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Table 3.4 The psychological contract

To paraphrase the Chartered Institute of Personnel Development (CIPD)⁵⁹, the psychological contract is a concept developed by the likes of Argyris, Levinson and Schein in the early 1960s. It has been defined as 'the perceptions of the two parties, employee and employer, of what their mutual obligations are towards each other'. These obligations will often be informal and imprecise: they may be inferred from actions or from what has happened in the past, as well as from statements made by the employer, for example during the recruitment process or in performance appraisals. Some obligations may be seen as 'promises' and others as 'expectations'. The important thing is that they are believed by the employee to be part of the relationship with the employer.

The psychological contract can be distinguished from the legal contract of employment. The latter will in many cases offer only a limited and uncertain representation of the reality of the employment relationship. The employee may have contributed little to its terms beyond accepting them. The nature and content of the legal contract may only emerge clearly if and when it comes to be tested in an employment tribunal.

The psychological contract 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. It may not - indeed in general it will not - be strictly enforceable, though courts may be influenced by a view of the underlying relationship between employer and employee, for example in interpreting the common law duty to show mutual trust and confidence.

The CIPD draws on Guest and Conway⁶⁰ to outline below the kinds of commitments employers and employees might make to one another:

Coming to terms with the employment relationship

Employees promise to:

Employers promise to provide:

Work hard

Pay commensurate with performance

Uphold company reputation

Opportunities for training and development

Maintain high levels of attendance and punctuality

Opportunities for promotion

Show loyalty to the organisation

Recognition for innovation or new idea

Work extra hours when required

Feedback on performance

Develop new skills and update old ones

Interesting tasks

Be flexible, for example, by taking on a colleague's work

An attractive benefits package

Be courteous to clients and colleagues

Respectful treatment

Be honest

Reasonable job security

Come up with new ideas

A pleasant and safe working environment

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