

## **The Influence of Psychological Contract on Turnover Intention through Work Engagement: Case Study of Pt. Indah Jaya Londrindo**

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### **ABSTRACT**

This research analysed direct and indirect effects of psychological contract towards turnover intention through its effect on work engagement in PT. Indah Jaya Londrindo. Data was obtained from PT. Indah Jaya Londrindo's 183 regular employees. Validity and reliability test, classical assumption tests, goodness of fit test, and SEM were used to analyse the relation between variables. Findings indicated psychological contract had a significant effect on work engagement and turnover intention individually; and that work engagement significantly mediated the relation between psychological contract and turnover intention. Thus, this study contributes to the knowledge of Human Resource Management by pointing to the importance of psychological contract and work engagement to turnover intention. This research also offers solution to PT. Indah Jaya Londrindo's 'increasing employee turnover intention'.

*Keywords:* Direct and indirect effects work engagement, psychological contract, turnover intention

### **INTRODUCTION**

Every organisation or company is built initially to fulfil a certain mission and to achieve goals. An organisation must have adequate resources to achieve its goals and missions. There are many types of

resources: tangible and intangible which are interrelated. It adds value and supports the organisation. Among the different types of resources, there is one that stands out - it is human resources (HR). The HR of an organisation is like the brains, organs and limbs in a human body – they are the essential, which keeps the organisation running.

According to George and Jones (2012, p. 25), "human resources are an organization's most important asset." It has become a

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major success factor for many successful companies and organisations. According to Lestari, Sugiarto, Simamora and Richter (2016), a company's performance influenced by leadership, training, and rewards. However, making a group of people able to work together to achieve the same goal is not easy. Every organisation consists of stakeholders who have needs, wants and, ensure their individual/collective interests, which is different and sometimes contradict one another. This clashing interest could cause trouble if not handled well. It could also lead to gradual loss of important company asset, namely human resources. This condition leads to an additional cost: direct cost (through recruitment, selection, training, etc.) and indirect cost (in the form of lost knowledge and reduced productivity) (Biron & Boon, 2013). Nickels and McHugh (2010, p. 256) said, "today the job of human resource management has taken on an increased role in the firm since qualified employees are much scarcer, which makes recruiting and retaining people more important and more difficult ." That is why "once an organization has invested significant dollars in recruiting, selecting, orienting and training employees, it wants to keep them, especially the competent, high-performing ones" (Robbins & Judge, 2014).

Therefore, this study examined the impact of psychological contract towards turnover intention through its effect on work engagement in PT. Indah Jaya Londrindo (PT. IJL). PT. IJL had chosen as research object because this company is part of a new industry in Indonesia, the Central

Commercial Laundry industry. The company started in 2012 by providing commercial laundry services to hotels around Jakarta, Tangerang, and other neighbouring areas. PT. IJL is popular for its modern-capital intensive factory with 24-hours service and their 99% almost perfect ironing quality. Although the company has been operating for almost five years, it has managed to gain popularity and becomes the market leader in the commercial laundry market within their first and a half year since the opening.

PT. IJL also invests in their human resources. First, engineers and workers. They are specially trained to handle and maintain those machines. Checkers are also trained to double check the laundry pick-up and also act as a liaison. They often become the first line to face and handle emerging problems with the client. The third is a few well-known marketing people who are trusted by hospitality industry for years. Those marketing people have knowledge about the hospitality industry and its connections that enable them to introduce WFL directly to the right people (decision makers) in hotels and clients' company as well as persuading them to realise that they need the service of PT. IJL. This offers many benefits to the company, and without them, hotels would not even consider PT. IJL's service.

Based on the initial study of the company, it is found that employees in PT. IJL did not feel they are being appreciated and respected by their superior, and some employees felt they were being micromanaged, and sometimes they are indirectly threatened to

be suspended or replaced. Employees felt they were being blamed for little mistakes they made, but never acknowledged when they did their job well or when they were proactive. Some said that the workload division was not fair. Additionally, some were the favourites of their managers and hence had normal workload; while those not in the good books of the managers had to contend with huge workload and were pressured by those managers.

Additionally, employees complained about their benefits because the company did not provide additional insurance other than the mandatory insurance by Badan Penyelenggara Jaminan Sosial (BPJS). Furthermore, since the company was

understaffed employees complained about being overworked.

Thus, PT. IJL's employees felt their expectations were not met. This psychological contract gap triggered the commitment issue employees have for PT. IJL. In the end, it caused the company to suffer from high employee turnover rate as suggested by the HRD records below.

From Table 1, PT. IJL's employee turnover rate is quite high and is on a steady increase. The employee turnover rate indicated that in every ten employees PT. IJL hired, at least three of them would not stay in the company in that same year. This is a huge percentage of employee turnovers.

Data was collected during the interview

Table 1  
*Employee turnover ratio*

Year	2013	2014	2015	2016
Average number of regular employees	76	92	118	195
Number of regular employees who quit	14	19	29	56
Regular employee turnover rate	18.42%	20.65%	24.58%	28.71%

Source: Processed PT. IJL's HR Records

with managers and supervisors who had also complained that within the last six months, some new employees who worked for not more than three months had requested to resign from the company. The processes of recruiting and re-recruiting employees led to additional cost for the company. Thus, a company which cannot retain their employees, as their resource of their competitive advantage, will face high cost in terms of recruitment. It can be concluded that the main source of problem is perceived

psychological contract violation, employee turnover, and work engagement.

**LITERATURE REVIEW**

An organisation's human resource department (HRD) plays a significant role. It aligns interests to reduce employee turnover intention. Jackson, Elenkov, Wright and Davis (2012) believed by aligning the employer's interest and needs with the employee's, HR Managers could maintain good employment relationship.

This “individual’s beliefs regarding the terms and conditions of a reciprocal exchange agreement between that person and another party is known by the term psychological contract” (Parzefall & Hakanen, 2010). In addition, “psychological contract is somewhat concerned with an individual’s subjective beliefs, shaped by the organization, regarding the terms of an exchange relationship between the individual employee and the organization”. It is subjective, unwritten, and often not discussed or negotiated. Also, it goes beyond any formal contract of employment (Wangithi & Muceke, 2012, p. 4)

Parzefall and Hakanen (2010) stated that the fulfilment of psychological contract has motivational effects. The statement aligns with the idea that the fulfilment of psychological contract affects employee’s turnover intention positively through the existence of employees’ work engagement. Effective work engagement is important in reducing turnover intention in connection with a psychological contract. Bal, Cooman and Mol (2013) found the relations of work engagement and turnover intention with the content of the psychological contract (i.e., employer obligations) to be much stronger than the effect of employer fulfilment on work outcomes. Their study highlighted the importance of work engagement as they stated: “employers offer resources to their employees to enhance their loyalty and productivity, and employees negotiate better psychological contracts through their loyalty and the effort they invest in their jobs.” Therefore, it can be said

that psychological contract and work engagement are very closely related to one another, especially regarding good employer-employee relationship.

Thus, a company’s ability to grow and retain good relationship with its employees by fulfilling its psychological contract is crucial in reducing employees’ turnover intention.

## **MATERIALS AND METHODS**

### **Research Object**

Wonderful Laundry (WFL) belongs to PT. Indah Jaya Londrindo (PT. IJL) which is one of the sub-groups of PT. Indah Jaya Textile Industry. The company began its operations in 2012 by providing commercial laundry services to hotels around Jakarta, Tangerang and other neighbouring areas. The PT. IJL is known for its modern-capital intensive factory, 24 hours service, and their 99% almost perfect ironing quality. Although the company has been operating only for six years, it has become the market leader in the commercial laundry market within its first and a half year since opening. Since then, PT. IJL has managed to double their laundering capacity up to more than 48 tons per day, from only 24 tons per day. PT. IJL managed to attain such achievement by always pushing themselves and pursuing the highest quality of service for their customers.

Initially, the company invested in the largest and latest laundering technology from German. Those technologies enabled PT. IJL to handle a laundering capacity of tens of thousands of kilogrammes

per laundering batch. It also enabled the company to achieve the-almost-perfect ironing-result that no other machine could do. Furthermore PT. IJL also invested in reverse osmosis (RO) water treatment installation which enabled the company to control and maintain the quality of water they use. The RO treated water benefited the company by making the laundry products retain its original colour and prevent any discoloration.

Apart from technological investment, PT. IJL also invested in their human resources. First, their engineers and workers were specially trained to handle and maintain those machines. Second, trained Checkers were trained to double check the laundry pick-up and also act as a liaison. They often become the first line to face and handle emerging problems with the client. The third is a few well-known marketing people who have been trusted by the hospitality industry for years. These marketing people have knowledge about the hospitality industry and its connections that enable them to introduce WFL directly to the right people (decision makers) in hotels and clients' company as well as persuading them to realise that they need the service of PT. IJL.

Even though PT. IJL is a technologically advanced company, they are still dependent on their HR. Both the owner and the General Manager (GM) of PT. IJL (who helped the owner develop the company from the start) are individuals who value loyalty and human relation. They hoped PT. IJL would eventually develop to be a paternalistic

organisation. That is why the founder had a vision to create a comfortable, close-knit and reciprocal relationship with the employees. However, it in reality, problems persisted in ensuring good employee-employer relationship. Those values and vision do not seem to be understood and implemented by other managers and supervisors in the company which has led may WFL's employees uncomfortable and insecure working in the company.

PT. IJL does not have a big pool of workers; instead it relies heavily on the small number of employees it hires. Hence, the role of HR is crucial for PT. IJL to ensure good output. That is why the issue of employee's engagement and the retention of good employees is crucial to PT. IJL.

### **Research Methodology**

This is a quantitative study and an associative-causal research to show the relations between psychological contracts, work engagement, and turnover intention. Figure 1 shows the research model.

Data was collected through observing, interviewing and distributing questionnaire to several PT. IJL's employees. The interview was unstructured and informal so that PT. IJL's employees did not feel intimidated, and the researcher could gain more personal information about the employees and their direct superior. Moreover, structured questionnaire in Likert scale was also applied to gather a formal (written) respond of PT. IJL's employees.

Pre-test questionnaires were distributed

to a small group of 30 (each time differing) subjects to find to what extent was the psychological contract and work engagement related to turnover intention issue on PT. IJL. The research population was all PT. IJL's employees, 187 of them. They consisted of regular employees and daily-paid worker. This research used consecutive sampling method. However, from the 187 questionnaires that had been distributed, only 183 were returned. Four employees did

not participate as they were either on sick leave or it was their day-off.

In this study, data was analysed and processed using SEM in SPSS AMOS 23. The data had to be verified in order to be tested using SEM. It was tested for validity, reliability, normality, multicollinearity, heteroscedasticity, and correlation test in SPSS 23.

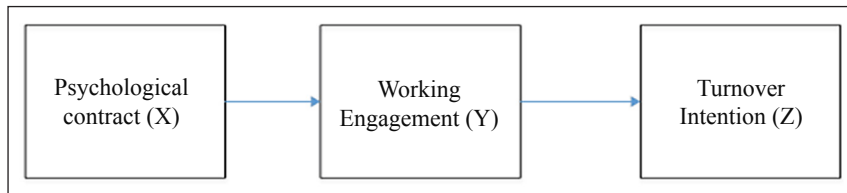


Figure 1. Research model

**RESULTS AND DISCUSSION**

This section explains the result of data analysis (refer Table 2).

SPSS Amos output for testing the association between psychological contract (X) and work engagement (Y) showed there was a significant positive association between perceived employer psychological contract fulfilment and employee's work engagement in PT. IJL. This result supported the hypothesis regarding "positive association." This estimated value also means that perceived

employer psychological contract fulfilment have the power to affect 54.1% of changes in employee work engagement. This is mainly caused by the "fair exchange" relationship trait of the psychological contract. When an employer provides their employee with both the transactional and relational psychological contract, the employee will feel that the employer had fulfilled their part of the perceived contract and therefore the former is willing to contribute their part by being engaged. Thus, psychological contract fulfilment leads to an increase in employee work engagement.

Table 2  
Partial direct effect test

	Estimates Value	p-value	Sign	Alpha Value	Conclusion
X → Y	.541	***	<	0.05	Significant, positive association
X → Z	-.590	0.001	<	0.05	Significant, negative association

The result of the association between psychological contract (X) and turnover intention (Z) test shows a p-value of 0.001. It means Ho hypothesis is rejected while Ha is accepted. There is significant negative association between perceived employer psychological contract fulfilment and employee's turnover intention in PT. IJL. In addition to that, test result also shows a negative estimate value of -0.590. This result is aligned with the hypothesis claim regarding negative association between psychological contract and turnover intention. This estimated value also means

that perceived employer psychological contract fulfilment have the power to change 59% employee turnover intention. This is caused by the "fair exchange" relationship trait of the psychological contract. As long as the employer provides their employee with both their transactional and relational psychological contract, the employee will feel that the employer is their source of psychological contract fulfilment. Therefore, employee will not have any reason to leave. Thus, fulfilled psychological contract reduces employee turnover intention.

Table 3  
Indirect effect test

	Estimates Value	CR	Sign	t-table	Conclusion
X → Y → Z	-0.242	2,223	>	1.973	Significant, negative indirect effect

The indirect effect test of psychological contract (X) and turnover intention (Z), through work engagement (Y) results in a |CR| value of 2.223. The |CR| value of 2.223 is larger than the t-table value 1.973 (under the condition of a  $\alpha = 5\%$ ). Therefore, there is significant positive effect of perceived employer psychological contract fulfilment (X) on work engagement (Y), which in turn reduces employee turnover intentions (Z) in PT. IJL. Additionally, test result also shows a negative estimate value of - 0.242. This estimated value indicates that every time psychological contract increases by one scale, it then will affect work engagement then turnover intention will be reduced by a scale of 0.242. This estimated value also means that

perceived employer psychological contract fulfilment has indirectly affected 24.2% of employee turnover intention through work engagement.

Perceived employer psychological contract fulfilment has a significant positive effect on work engagement, which in turn leads to reduced turnover intentions in PT. IJL. This is mainly caused by the "fair exchange" relationship trait of the psychological contract. When an employer provides their employee with both transactional and relational psychological contract, the employee will feel that the employer had fulfilled their part of the perceived contract and therefore, employee will willingly contribute their part by being engaged. Thus, psychological contract

fulfilment leads to (an increase in) employee work engagement. Furthermore, work engagement also has a “growing” trait, in which once an employee is engaged, they will seek higher level of work engagement. Employee’s feeling of the need to engage more and more eventually will cause them to be so attached to their work and the organisation that they will not find any intention to leave.

### **Recommendation for PT. IJL**

During recruitment interviews and orientation, recruiters should clearly and honestly communicate employee responsibilities and employer’s expectations and the reciprocal relationship. As psychological contract starts to form during the hiring process, it is necessary that the recruiter or user not to oversell the job, thereby setting unrealistic expectations which when violated may result in dissatisfaction and reduced employee commitment.

Regular performance reviews offers an opportunity for the employee to receive accurate feedback on their performance and may help prevent any false beliefs, of either party, that they have fulfilled their part of the psychological contract. Reviewing and renegotiating future responsibilities and expectations of the psychological contract on a regular basis will reduce psychological contract violations that are caused by misunderstanding between both parties.

Create and apply total reward/ compensation standards. This is to reward employees for short as well as long-term

achievements. Total reward includes transactional and relational compensation. Total rewards may be used to attract, retain, motivate and satisfy employees. The aim is to maximise the combined impact of a wide range of reward initiatives. Thus, compensation and reward distribution can become more fairly distributed across all organisational hierarchy layers and also across all the different departments.

Appreciate employees for simple achievement and initiatives. PT. IJL can implement “Employee of the Month” programme. It is simple and does not require additional cost for the company. However, it means a lot for employees to be acknowledged and appreciated for their extra effort they put into the company.

Open and honest communication between managers and employees is vital and managers must make time for that. This is to prevent or at least minimise psychological contract violation by explaining the circumstances of the breach. Managers could explain that although promises were made in good faith, circumstances beyond the control of the organisation make it impossible for those promises to be kept for the time being, but that the management team will make it right. Moreover, open and honest communication could be a channel to build trust between the employer and employees.

### **CONCLUSION**

Based on the result of this research, it can be concluded that perceived employer psychological contract is significantly



positively associated with work engagement in PT. IJL. Moreover, perceived employer psychological contract is significantly and negatively associated with turnover intention in PT. IJL.

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