From formal contracts to psychological contracts: a dual-contract process model of corporate governance

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Abstract

Purpose – This conceptual paper explains why legitimate governance arrangements can generate divergent relational consequences even without formal violation. It argues that governance operates through two contractual layers: formal arrangements allocating authority and accountability, and psychological contracts through which actors infer obligations concerning autonomy, candor, fairness and intervention.

Design/methodology/approach – Drawing on problematization and conceptual integration, the paper combines agency theory with psychological contract theory and insights from relational governance, signaling, trust and justice. It develops a recursive dual-contract process model linking formal architecture and relational signals to promissory interpretation, appraisal, multilevel enactment, repair and governance-system outcomes.

Findings – The model identifies promissory interpretation as the mechanism through which governance cues acquire psychologically binding force. Alignment can generate fulfillment, trust and relationship maintenance, whereas misalignment becomes breach only through judgments concerning salience, attribution, fairness and prior trust. Even then, a perceived breach does not in itself constitute governance failure. Individual appraisals become collectively consequential only through processes of convergence, framing, coalition formation, power mobilization, and formal enactment, while the resulting responses reshape subsequent governance signals and expectations. Governance-system failure emerges only when recursive deterioration materially impairs oversight, advice, accountability, coordination or credible communication.

Practical implications – Boards and executives should clarify contingencies surrounding autonomy, monitoring, consultation, information sharing and intervention. Procedural fairness, expectation recalibration and substantive repair can interrupt escalating distrust.

Social implications – Responsible authority depends not only on formal legitimacy, but also on how governance commitments are communicated, interpreted, recalibrated and repaired.

Originality/value – The paper offers a mechanism-based, recursive, multilevel explanation of governance maintenance and failure. It extends agency theory by showing that formal mechanisms have interpretive and structural consequences and extends psychological contract theory into a governance context of concentrated authority, multiple contract makers, competing obligations and collective enactment. By distinguishing misalignment from breach, breach from violation and relational deterioration from governance-system failure, the model explains why similar governance actions can stabilize one relationship yet destabilize another.

Keywords Agency theory, Psychological contracts, Corporate governance, Promissory interpretation, Contract misalignment, Governance failure

Paper type Conceptual paper

1. Introduction

Corporate governance scholarship has long addressed a central organizational problem: how can those who delegate authority ensure that those who exercise it act consistently with organizational interests and acceptable standards of conduct? Agency theory has provided one of the most influential responses by emphasizing incentive alignment, monitoring, and

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contractual safeguards as mechanisms for mitigating opportunism and controlling managerial discretion (Jensen and Meckling, 1976; Eisenhardt, 1989). This logic has shaped research and practice concerning boards, executive compensation, disclosure, auditing, ownership, and accountability.

Consider a board that appoints a chief executive with an explicit mandate to transform the organization and repeatedly assures that executive of broad strategic discretion. When performance later weakens, the board remains formally entitled to intensify monitoring, restrict delegated authority, and intervene in major decisions. Yet the executive may interpret these actions not simply as legitimate oversight, but as a withdrawal of trust and a failure to honor the autonomy previously communicated. The executive may respond by becoming defensive, withholding emerging concerns, or relying more heavily on formal authority. Directors may then interpret this reduced openness as evidence that tighter monitoring is necessary. What begins as a formally legitimate governance adjustment can therefore develop into a self-reinforcing cycle of distrust, escalating control, declining information exchange, and relationship deterioration.

Several established governance perspectives illuminate important elements of this scenario. Stewardship theory emphasizes trust and pro-organizational motivation (Davis *et al.*, 1997); resource dependence theory treats boards as providers of advice, legitimacy, and resources (Lewellyn and Muller-Kahle, 2024; Hillman and Dalziel, 2003); and behavioral governance examines boards as social and cognitive groups whose effectiveness depends on interaction, influence, and decision processes (Forbes and Milliken, 1999; Huse, 2005; Westphal and Zajac, 2013). Research on control and collaboration highlights tensions between monitoring and trust (Sundaramurthy and Lewis, 2003), while relational contracting shows that formal controls and informal norms can be complementary (Baker *et al.*, 2002; Poppo and Zenger, 2002). External governance research further locates board relationships within investor, regulatory, media, and stakeholder pressures (Goranova and Ryan, 2014; Aguilera *et al.*, 2015).

The starting point of this paper is therefore not that governance scholarship has ignored relational or behavioral processes. The unresolved issue is more specific: existing perspectives do not fully explain how formal arrangements and relational conduct acquire promissory meaning, become experienced as reciprocal obligations, and subsequently serve as standards against which governance actions are evaluated. They establish that trust, norms, cognition, and informal relationships matter, but provide a less developed account of why an unexpected action is sometimes accepted as legitimate adjustment, sometimes renegotiated, and sometimes experienced as betrayal.

Formal legitimacy and relational acceptance are therefore not equivalent. A board may act within its contractual rights while contradicting what an executive believes was promised. An executive may satisfy measurable targets while directors believe that obligations of candor, consultation, or stewardship remain unfulfilled. A governance reform may comply with regulation while appearing symbolic because later conduct contradicts the commitment it signaled. In each case, the formal and psychological layers point in different directions, and the consequences depend on how that discrepancy is interpreted.

This problem matters because governance breakdown does not always begin with weak formal mechanisms or explicit contractual violation. Organizations may possess independent boards, codified oversight procedures, formal disclosures, and specialized committees yet still experience defensive communication, information withholding, symbolic compliance, or credibility loss. These reactions are not governance-system failure by themselves. However, when they become recursive, they can impair monitoring, advice, strategic coordination, credible information exchange, and accountability. Governance failure may therefore emerge through deterioration in the relationships through which formal structures must operate.

Governance relationships can accordingly be understood as involving two interdependent contractual layers. The formal layer allocates authority, duties, incentives, monitoring rights, and accountability. The psychological layer comprises actors' beliefs about what another governance party has promised, what is reciprocally owed, and what conduct is appropriate. Formal authority may exist without relational acceptance, while psychological obligations may develop beyond written agreements. Psychological contract theory is useful because it distinguishes general expectations from beliefs about reciprocal obligations and explains how fulfillment, breach, and repair affect relational conduct (Rousseau, 1995; Morrison and Robinson, 1997; Coyle-Shapiro *et al.*, 2019).

Psychological contract research offers more than a vocabulary of informal expectations. It distinguishes perceived obligations from general preferences, cognitive breach from emotional violation, and static discrepancy from a dynamic process of attribution and response (Morrison and Robinson, 1997). Meta-analytic and longitudinal evidence associates breach with reduced trust, weaker commitment, withdrawal, and adverse behavior, while recent work emphasizes fulfilled promises, changing relational conditions, and post-breach repair (Zhao *et al.*, 2007; Rousseau *et al.*, 2018; Kiefer *et al.*, 2022). The theory has also been applied to multiparty arrangements, suggesting that obligations can be attributed to several organizational agents rather than a single employer (Lapalme *et al.*, 2011; Morf *et al.*, 2014).

Corporate governance is a theoretically significant setting for this extension. Board-executive relationships combine incomplete agreements, repeated interaction, substantial discretion, reciprocal dependence, ambiguity, power asymmetry, and consequential signaling. Multiple actors, including chairs, committees, controlling shareholders, and investors, may contribute to expectations that are contested or unevenly distributed. The paper therefore asks: How do formal governance arrangements and relational signals become psychologically binding, and through what recursive and multilevel processes do fulfillment and breach appraisals shape relationship maintenance, repair, deterioration, or governance-system failure?

The model does not claim that psychological contracts replace economic incentives, legal accountability, institutional legitimacy, or board cognition. It explains a narrower question that these perspectives leave underdeveloped: when do governance cues become experienced as obligations, and how do subsequent fulfillment or breach appraisals alter the relational capacity through which formal governance functions are performed? This focus permits a more precise definition of governance failure as impairment of governance functions rather than any episode of dissatisfaction or conflict.

To address this question, the paper develops a recursive dual-contract process model. Formal contractual architecture and relational governance signals provide cues from which actors infer obligations. Selected cues acquire promissory force and become psychological contract expectations. Later conduct is compared with those expectations, producing alignment or misalignment. Alignment can reinforce trust; misalignment may be tolerated, explained, renegotiated, or appraised as breach depending on attribution, fairness, prior trust, and relational history. Resulting responses feed back into governance structures, signals, and future expectations.

The framework also responds to a persistent difficulty in governance research: formally similar structures often produce different relational effects. Board independence, monitoring intensity, or delegated discretion do not carry a single meaning across relationships. Their consequences depend on prior signals, attributed obligations, and the way later conduct is explained. By theorizing this interpretive layer, the paper offers a mechanism for understanding heterogeneity that structural indicators alone cannot capture.

The paper makes three contributions. First, it identifies promissory interpretation as the mechanism through which governance cues become psychologically binding. Second, it theorizes governance failure as a recursive process, distinguishing misalignment, breach, violation, relational responses, deterioration, and system-level impairment. Third, it extends psychological contract theory into a multiactor governance context and explains how individual appraisals become collectively consequential through interaction, coalition formation, influential framing, and formal board decisions. The following sections position the theory, establish its psychological contract foundation, develop and apply the model, and discuss its research and practical implications.

2. Theoretical positioning and theory-building approach

2.1 Problematization and conceptual integration

This conceptual paper develops a process theory through problematization and conceptual integration. Problematization questions assumptions that organize a field, while conceptual integration connects compatible literature to specify constructs, mechanisms, and boundary conditions (Whetten, 1989; Alvesson and Sandberg, 2011; Sandberg and Alvesson, 2011; Corley and Gioia, 2011). Process theorizing explains how phenomena unfold through sequences of events, interpretations, responses, and feedback rather than through static associations (Cornelissen, 2017; Langley *et al.*, 2013).

Rather than portraying corporate governance scholarship as narrowly formal or economically deterministic, the paper focuses on a more specific theoretical limitation: existing perspectives do not fully explain how the relational consequences of governance arrangements emerge from actors' interpretations of authority, control, and conduct. Structural functions, signaling, trust, and informal norms each illuminate important aspects of governance, but they provide only a partial account of how governance cues become experienced as reciprocal obligations. Agency theory explains the allocation of decision rights, incentives, monitoring authority, and accountability, whereas psychological contract theory clarifies how actors interpret the obligations implied by those arrangements and by the conduct surrounding them. Integrating these perspectives therefore links the formal design of governance to the process through which authority is experienced, appraised, contested, and subsequently revised.

The resulting framework, termed the recursive dual-contract process model of corporate governance, is developed as a process explanation rather than as a series of discrete propositions. Its theoretical value lies in specifying an ordered yet recursive sequence through which governance inputs generate promissory interpretations, perceived obligations become evaluative standards, appraisals produce relational and behavioral responses, and those responses subsequently reshape governance structures, signals, and expectations. This form of theorizing is consistent with Cornelissen's (2017) view that process models constitute a legitimate mode of conceptual theory development when the phenomenon under examination is characterized by temporal progression, interdependent mechanisms, and feedback effects.

2.2 Relationship to adjacent governance perspectives

The dual-contract framework is positioned as a complementary extension of established governance perspectives, with each theory retaining its explanatory value while addressing a different part of the governance process. Agency theory explains control under divergent interests, but not when authorized control is interpreted as a broken promise (Jensen and Meckling, 1976; Eisenhardt, 1989). Stewardship theory explains pro-organizational motivation and empowerment, but not how empowerment becomes a perceived obligation or why its withdrawal becomes breach (Davis *et al.*, 1997). Resource dependence theory explains the board's advisory and boundary-spanning contributions, but not how expectations of advice or support become reciprocal obligations (Hillman and Dalziel, 2003).

These distinctions also prevent the paper from overstating its gap. Stewardship and resource dependence theories remain necessary for explaining managerial motives and board resources, while the dual-contract framework explains how repeated empowerment, support, advice, or consultation can acquire promissory meaning. A resource or supportive practice is not itself a psychological contract. It becomes relevant to the model when actors infer that continuation, reciprocity, or restraint has been committed and later evaluate conduct against that belief.

Behavioral governance shows that boards are socially situated groups shaped by cognition, status, influence, and norms (Forbes and Milliken, 1999; Huse, 2005; Westphal and Zajac, 2013). Relational governance explains how trust, shared norms, and repeated interaction support cooperation under incomplete contracting (Baker *et al.*, 2002; Poppo and Zenger, 2002). The dual-contract model adds an obligation-based sequence: actors interpret selected cues as promises, compare conduct with perceived obligations, attribute discrepancies, and revise behavior. A relational norm may facilitate cooperation without becoming a specific obligation, while an obligation can be perceived even in a relationship with limited trust.

The difference from relational contracting is particularly important. Relational contracts are generally informal understandings sustained by repeated exchange and the value of future cooperation. Psychological contracts are subjective beliefs about what a particular party owes, including cognitive and affective responses when that obligation appears unfulfilled. Relational governance can therefore exist without a specific perceived promise, and perceived obligation can exist even where the relationship is not strongly trusting. The dual-contract model focuses on this promissory and appraisal-based layer.

Signaling theory explains how observable cues communicate unobservable qualities or intentions, but not every signal creates a belief that reciprocal performance is owed (Connelly *et al.*, 2011). Promissory interpretation identifies the threshold at which source authority, specificity, consistency, reciprocity, and reliance convert a cue into an obligation. Trust theory explains willingness to accept vulnerability, while justice theory explains reactions to outcomes, procedures, voice, and treatment (Mayer *et al.*, 1995; Cropanzano *et al.*, 2007). In the model, trust and justice shape appraisal but do not substitute for the prior belief that an obligation existed. Legitimacy concerns broader social appropriateness, whereas psychological breach concerns nonfulfillment attributed to an identifiable party (Suchman, 1995).

External governance and institutional pressures remain part of the explanation, but mainly as conditions affecting expectation formation and amplification. Investors, regulators, media actors, and activists can create competing obligations, make inconsistencies more visible, and intensify the consequences of breach interpretations (Goranova and Ryan, 2014; Aguilera *et al.*, 2015). They are not automatically parties to the same psychological contract. The framework therefore retains an actor-specific conception of obligation while locating governance relationships within wider systems of scrutiny.

2.3 Distinctive mechanism and scope

The model connects five mechanisms usually treated separately: governance arrangements and conduct generate cues; selected cues acquire promissory force; later conduct is compared with perceived obligations; misalignment is appraised through attribution, fairness, and prior trust; and fulfillment or breach responses unfold recursively across individual, dyadic, board, and organizational levels. The model does not seek to explain all governance outcomes. It explains how perceived obligations affect the relational capacity through which actors monitor, advise, communicate, coordinate, and hold one another accountable. Its theoretical move is elaboration: formal mechanisms remain indispensable, but psychological contract theory specifies how formally legitimate actions can reinforce trust, invite renegotiation, or initiate deterioration.

This scope is intentionally narrower than a general theory of corporate governance. The model does not predict firm performance, valuation, innovation, or risk-taking directly. It predicts the condition of governance relationships and the capacity through which governance actors perform oversight, advice, coordination, and accountability. Performance effects may follow, but they are downstream possibilities rather than defining outcomes of the theory.

Parsimony is maintained by treating trust, justice, legitimacy, power, and external scrutiny as complementary conditions rather than additional core constructs. The core causal chain remains promissory interpretation, obligation formation, expectation-conduct comparison, appraisal, response, and feedback. Adjacent theories explain why particular appraisals or amplifications are more likely, but the dual-contract process remains the organizing mechanism.

3. Psychological contract theory and its relevance for governance

Psychological contract theory holds that exchange relationships are governed not only by formal agreements but also by individual beliefs about reciprocal obligations. A psychological contract is not every preference or expectation; it exists when an actor believes that another party has communicated or accepted an obligation within an exchange relationship (Rousseau, 1995; Coyle-Shapiro *et al.*, 2019). This distinction is essential in governance. A chief executive may prefer limited intervention without believing that autonomy was promised, while a director may value consultation without treating every unilateral decision as breach.

Formal and psychological contracts are related but distinct. Formal contracts specify enforceable rights and responsibilities; psychological contracts concern what actors believe has been promised, including obligations inferred from repeated practices and relational conduct. A signal becomes promissory when it is attributed to an authorized source, is sufficiently specific and consistent, implies reciprocity, and induces reliance. Promissory interpretation therefore connects signaling to psychological contract formation (Connelly *et al.*, 2011). Because interpretations are subjective, parties may hold different beliefs about the same exchange. Paired research demonstrates that employers and employees can disagree about both obligations and fulfillment (Coyle-Shapiro and Kessler, 2002; Dabos and Rousseau, 2004), a problem likely to be acute where governance authority is dispersed and obligations such as candor, stewardship, and restraint are difficult to codify.

A central distinction concerns transactional, relational, and balanced contract content. Transactional obligations are comparatively specific, economic, and measurable; relational obligations involve loyalty, support, trust, continuity, and socio-emotional commitment; balanced contracts combine continued relational commitment with explicit performance adjustment (Rousseau, 1995). Governance relationships often contain all three. Compensation, reporting schedules, and targets have transactional features, while candor, autonomy, consultation, and stewardship are relational. The contract's content influences whether monitoring is viewed as routine accountability or as withdrawal of confidence.

Morrison and Robinson (1997) identify two routes to breach. Reneging occurs when a party is perceived as recognizing an obligation but failing to fulfill it through unwillingness, inability, or neglect. Incongruence occurs when the parties hold different beliefs about what was promised. Governance relationships are especially vulnerable to incongruence because authority is dispersed across chairs, committees, directors, controlling shareholders, and formal rules. Breach appraisal therefore requires more than noticing inconsistency; actors must decide whether the discrepancy concerns a genuine obligation and whether responsibility can be attributed to an identifiable party.

Psychological contract theory draws important analytical distinctions among fulfillment, misalignment, breach, and violation, each of which occupies a different position in the relational appraisal process. Fulfillment refers to the judgment that a perceived obligation has been met, appropriately revised, or exceeded, whereas misalignment denotes a discrepancy between expected and observed conduct. Breach arises when the focal actor interprets that discrepancy as a failure to fulfill an obligation, while violation refers to the emotional response that may follow, including anger, disappointment, resentment, or betrayal (Morrison and Robinson, 1997).

Misalignment may result from reneging, where an acknowledged obligation is not fulfilled, or from incongruence, where the parties hold different understandings of what was promised. Whether such a discrepancy develops into breach depends on its magnitude, the attribution of responsibility, perceived intentionality and controllability, procedural fairness, and the level of prior trust within the relationship (Mayer *et al.*, 1995; Cropanzano *et al.*, 2007). Fulfillment should therefore not be treated merely as the absence of breach, since repeated experiences of fulfilled obligation can reinforce trust, strengthen relational confidence, and increase tolerance for temporary ambiguity (Kiefer *et al.*, 2022).

The distinction between breach and violation is particularly important because it separates the cognitive recognition of nonfulfillment from the affective intensity that may subsequently shape behavior. Breach changes how the focal actor understands the status of the relationship by indicating that a perceived obligation has not been met, whereas violation gives that judgment emotional force through feelings such as betrayal, anger, resentment, or disappointment. Not every breach produces a strong sense of violation, especially when the obligation is peripheral, external circumstances provide a credible explanation, or timely repair reduces the perceived seriousness of the event. Preserving this distinction prevents the model from treating all discrepancies as emotionally equivalent or from assuming that every perceived breach will generate the same relational or organizational consequences.

The dynamic character of psychological contracts is equally important because these contracts evolve through processes of formation, maintenance, disruption, revision, and repair as actors interpret events and update earlier beliefs (Rousseau *et al.*, 2018). Psychological contract theory has also expanded beyond conventional employer-employee relationships to multiparty arrangements in which obligations may be attributed to several organizational actors or contract makers simultaneously (Lapalme *et al.*, 2011; Morf *et al.*, 2014). Corporate governance concentrates many of the conditions that make such dynamics salient, including repeated interaction, incomplete contractual specification, reciprocal dependence, substantial discretion, multiple principals, and signals whose meaning can change over time.

The evolving content of psychological contracts further implies that governance relationships may not return to their original form after fulfillment, disruption, or repair. Repeated fulfillment can broaden relational expectations, strengthen perceived mutual commitment, and increase interpretive tolerance, whereas repeated unresolved discrepancies may narrow the contract, encourage greater reliance on formal procedures, or transform a previously collaborative relationship into a more transactional one. Repair may therefore generate a revised psychological contract rather than restore the earlier understanding in its original form. This temporal perspective is especially relevant to governance because leadership transitions, strategic crises, changes in performance, and shifts in board composition repeatedly alter the circumstances under which prior commitments were initially formed and later interpreted.

Questions of level of analysis also require careful treatment because psychological contracts originate as individual beliefs, even when their consequences extend to boards and organizations. A board does not independently experience breach apart from the perceptions of its members. Individual appraisals become collective governance dynamics through discussion, convergence, coalition formation, influential framing, and formal enactment in board decisions. Collective constructs therefore emerge through interaction rather than through simple aggregation, while trust may develop into a higher-level phenomenon when individual perceptions converge and become embedded in shared practices, routines, and governance arrangements (Morgeson and Hofmann, 1999; Fulmer and Gelfand, 2012).

Event-based reasoning helps specify when dormant obligations become salient. Routine conduct may confirm a contract without conscious appraisal, whereas a sudden intervention, undisclosed risk, public criticism, or leadership change can trigger active comparison between expectations and conduct. The meaning of an event depends not only on its objective form but also on its novelty, centrality, and consistency with the history of the relationship (Kiefer *et al.*, 2022).

Power shapes the movement from individual perception to collective consequence. A chair's or controlling shareholder's appraisal may be enacted through formal authority even without widespread agreement, while less powerful directors or executives may experience breach without securing acknowledgment. The relevant issue is therefore not only whether interpretations converge, but also which interpretation becomes embedded in board action, public communication, and structural change. These foundations support the recursive dual-contract model developed next.

4. A recursive dual-contract process model of governance relationship maintenance and failure

The model explains the relational functioning of governance systems rather than every outcome associated with boards or executives. It asks whether governance actors can exchange credible information, exercise accountability, contest decisions, coordinate action, and revise expectations without destroying the relationships on which these activities depend. It therefore separates relational states, behavioral responses, and governance-system outcomes. Distrust is a relational condition, information withholding is a behavioral response, and strategic instability is a possible consequence. Governance-system failure occurs only when deterioration materially impairs oversight, advice, accountability, strategic coordination, or credible communication.

This outcome distinction is necessary because the same relational episode can remain contained, be successfully repaired, or spread into system impairment. A temporary loss of trust may produce cautious communication without disabling oversight. By contrast, persistent withholding, coalition conflict, or symbolic compliance can erode the information and cooperation on which formal governance depends. The model therefore treats governance failure as an emergent outcome of interacting appraisals and responses, not as a direct synonym for breach, distrust, or poor performance.

4.1 Formal contractual architecture and relational governance signals

Formal contractual architecture comprises explicit arrangements allocating authority, incentives, monitoring rights, reporting duties, accountability, and decision responsibility. Agency and incomplete-contract perspectives explain their control and coordination functions under information asymmetry and uncertainty (Williamson, 1979; Grossman and Hart, 1986; Jensen and Meckling, 1976; Eisenhardt, 1989). The model adds an interpretive function: compensation signals valued contributions, reporting rules communicate assumptions about accountability, and intervention communicates how discretion and oversight are balanced.

Formal architecture also establishes the baseline against which later conduct is interpreted. A board charter may reserve intervention rights, but appointment communications and repeated practice may imply that those rights will be used only under specified contingencies. Compensation design may communicate not only incentives but what forms of contribution, risk, and time horizon are valued. Formal structure is consequently both a control system and a meaning-generating system, although its relational meaning remains dependent on enactment.

Relational governance signals are the actions and interaction patterns through which actors interpret how formal arrangements will be enacted, including tone, consultation, feedback, consistency of support, transparency, timing, and treatment during disagreement. Identical structures can therefore acquire different meanings. Monitoring may communicate responsible accountability when routine and explained, but distrust when abrupt and inconsistent with prior assurances. Board-process research supports this distinction by showing that governance effectiveness depends on how authority is exercised and information is exchanged, not only on formal design (Roberts *et al.*, 2005; Westphal and Zajac, 2013).

The distinction between architecture and signals also clarifies why structure alone cannot determine expectations. Relational cues can reinforce formal terms, qualify them, or create ambiguity. A board that consistently consults before intervention may foster an obligation of voice even when no written rule requires consultation. Conversely, transparent reminders that discretion remains conditional can prevent autonomy from being interpreted as unconditional. Expectations arise from the joint pattern of formal design and relational conduct.

4.2 Promissory interpretation and expectation formation

Formal arrangements and relational signals do not automatically create psychological contracts. They become binding when actors interpret them as credible reciprocal commitments. Promissory force is more likely when a signal comes from an authorized source, is specific, repeated and consistent, implies reciprocity, and induces reliance. Thus, delegated authority may remain a formal permission, while repeated assurances of discretion can become a perceived obligation of autonomy. Promissory interpretation is the model's distinctive bridge between signaling and obligation formation.

Authority of the source is critical. A casual comment by one director may not bind the board, whereas assurances from the chair or a formally mandated committee are more likely to be treated as commitments. Specificity and repetition reduce ambiguity, reciprocity links the cue to an exchange, and reliance gives the cue practical consequence. These conditions explain variation in promissory force and protect the model from classifying all governance communication as contractual.

Psychological contract expectations are beliefs that another governance party owes conduct concerning autonomy, support, candor, fairness, consultation, stewardship, confidentiality, or restraint. They are actor-specific and can evolve. A board-executive relationship may begin with transactional expectations concerning targets and reporting but develop relational expectations through repeated interaction; after disappointment, it may become more explicit and transactional (Rousseau *et al.*, 2018).

Subjectivity also creates the possibility that parties form different contracts from the same interaction. An executive may treat delegated discretion as durable, while directors regard it as conditional and revocable. Neither interpretation must be strategically deceptive. The discrepancy can originate in ambiguous communication, different frames of reference, or changes in personnel. This is why the model separates expectation formation from later breach appraisal rather than assuming shared contractual content.

4.3 Expectation-conduct comparison and alignment

Later governance events, such as changes in oversight, compensation, strategic authority, leadership, disclosure, or decision procedure, are compared with perceived obligations. Event novelty, disruption, and criticality influence the attention they receive (Morgeson *et al.*, 2015). Contract alignment exists when conduct remains compatible with perceived obligations. It does not require harmony or low monitoring: strong oversight can be aligned with an accountability-centered contract, just as autonomy can be aligned with clear disclosure and escalation duties. Formal and relational governance can therefore reinforce one another (Baker *et al.*, 2002; Poppo and Zenger, 2002).

Comparison is event-sensitive rather than continuous at equal intensity. Routine conduct may confirm expectations without conscious reflection, while novel, disruptive, or critical events prompt active reconsideration of the relationship. A sudden intervention, public criticism, unexpected compensation change, or undisclosed risk can therefore carry more interpretive weight than ordinary monitoring. Event strength affects whether an existing obligation becomes salient and whether a discrepancy is treated as relationship-defining.

Contract misalignment is a perceived discrepancy between obligations and conduct. It may result from contradictory signals, changed circumstances, unsupported assurances, or incompatible interpretations. Misalignment is not breach. Some discrepancies are minor, unavoidable, or covered by understood contingencies; others invite explanation or renegotiation. Breach arises only when an actor attributes the discrepancy to failure to honor an obligation.

Alignment should not be confused with weak governance or interpersonal harmony. A demanding board and an autonomous executive may remain aligned when both understand monitoring thresholds, disclosure duties, and escalation procedures. Likewise, disagreement can coexist with fulfillment when challenge is expected and conducted appropriately. Alignment refers to coherence between perceived obligations and conduct, not the absence of control, conflict, or change.

4.4 Fulfillment appraisal, breach appraisal, and violation

Fulfillment appraisal is the judgment that an obligation has been met, appropriately revised, or exceeded. Repeated fulfillment reinforces trust, cooperation, and confidence in later signals. Misalignment activates a more complex appraisal. Actors assess salience and magnitude, attribute intentionality and responsibility, evaluate procedural and interpersonal fairness, and interpret the event through prior trust. Clear explanation and voice may convert disruption into legitimate adjustment; arbitrary or disrespectful treatment can intensify breach appraisal (Cropanzano *et al.*, 2007; Dirks *et al.*, 2022).

Four judgments are especially important in the breach pathway. Actors assess the discrepancy's magnitude; attribute responsibility, intention, and controllability; evaluate whether the process offered explanation, voice, consistency, and respect; and interpret the event through accumulated trust. A regulatory intervention outside the board's control may be accepted, while a strategically concealed withdrawal of autonomy may be viewed as deliberate reneging. Prior trust can create interpretive latitude, whereas a history of inconsistency makes suspicious attribution more likely.

Breach is the cognitive judgment that an obligation was not fulfilled. Violation is the affective response, including betrayal, anger, resentment, or disappointment (Morrison and Robinson, 1997). Not every breach produces intense violation; effects depend on the obligation's centrality, attributed intent, relational history, and repair. This distinction clarifies the mechanism linking discrepancy to behavioral escalation. Table 1 summarizes the constructs, their levels, and their roles in the model.

Fulfillment and breach can also accumulate asymmetrically. A history of fulfillment may create reserves of trust, but a single highly central violation can still reframe the relationship. Conversely, one corrective action may not repair repeated breach. The temporal weight of events depends on their centrality, strength, and consistency with the wider relational history, which is why the model includes both event characteristics and feedback.

4.5 From individual appraisal to collective dynamics

Psychological expectations and appraisals originate at the individual level. They become collectively consequential when interpretations converge, are coordinated, or are enacted by influential actors. Directors may develop a shared account through discussion; a chair or coalition may frame an event; or a formal resolution may translate a dominant appraisal into monitoring, authority restrictions, dismissal, or public communication. Divergent appraisals can instead produce board fragmentation. Power therefore affects whose interpretation shapes governance action, and system deterioration does not require unanimity (Morgeson and Hofmann, 1999; Fulmer and Gelfand, 2012).

Collective emergence can follow several routes. Directors may converge through shared discussion, comply with an influential chair's framing, or form competing coalitions. Formal resolutions may institutionalize a dominant interpretation even when private perceptions remain divided. These routes should not be treated as equivalent: genuine convergence, strategic conformity, and power-based enactment may produce similar board decisions but different prospects for repair and future conflict.

The model therefore distinguishes collective emergence from mere aggregation. A high average level of perceived breach among directors does not necessarily indicate a shared board interpretation if views remain polarized. Conversely, one powerful actor may produce board-level consequences without perceptual consensus. Empirical applications must identify whether collective outcomes arise through convergence, influence, coalition dominance, or formal authority.

Table 1. Core constructs and outcome levels in the recursive dual-contract process model

Construct	Definition	Principal level	Function and conceptual distinction
Formal contractual architecture	Explicit governance arrangements allocating authority, incentives, accountability, monitoring rights, and decision responsibilities	Organizational and governance-system	Establishes formal control and coordination while generating cues about expected conduct
Relational governance signals	Actions, communications, and interaction patterns through which actors interpret how formal governance arrangements will be enacted	Event, individual, and dyadic	Convey relational meaning but do not automatically create perceived obligations
Promissory interpretation	The judgment that a governance cue communicates a credible reciprocal commitment rather than information, preference, or aspiration alone	Individual	Converts selected governance signals into psychologically binding obligations
Psychological contract expectations	Beliefs that another governance party owes particular conduct concerning autonomy, support, candor, accountability, fairness, or stewardship	Individual	Provide the reference standard against which later conduct is evaluated
Contract alignment	Perceived correspondence between psychological contract expectations and observed governance conduct	Individual and dyadic	Creates the basis for fulfillment appraisal and relational reinforcement
Contract misalignment	Perceived discrepancy between psychological contract expectations and observed governance conduct	Individual and dyadic	Creates the possibility of renegotiation or breach appraisal but is not itself a breach
Fulfillment appraisal	Cognitive judgment that a perceived obligation has been met, appropriately revised, or exceeded	Individual	Reinforces trust, cooperation, and relationship maintenance
Breach appraisal	Cognitive judgment that another party has failed to fulfill a perceived obligation	Individual	Depends on discrepancy salience, attribution, fairness, and prior trust
Psychological contract violation	Emotional response to an appraised breach, including betrayal, anger, resentment, or disappointment	Individual	Intensifies behavioral responses and increases the likelihood of relational escalation
Governance responses	Actions arising from fulfillment, breach, or violation, including information sharing, voice, monitoring, withdrawal, symbolic compliance, renegotiation, and repair	Dyadic and board-level	Translate individual appraisals into interaction patterns and collective governance action
Relationship maintenance and repair	Continued ability to cooperate, monitor, contest, exchange information, and recalibrate expectations without relational breakdown	Dyadic and board-level	Represents a maintained or restored relational condition, not the absence of disagreement
Governance deterioration	Progressive erosion of trust, information exchange, cooperation, and perceived relational legitimacy	Dyadic and board-level	Intermediate process through which breach can spread and become collectively consequential

(*continued*)

Table 1. Continued

Construct	Definition	Principal level	Function and conceptual distinction
Governance-system failure	Material impairment of oversight, advice, accountability, strategic coordination, or credible communication	Board and organizational	Final system-level outcome, distinct from individual distrust or isolated behavioral reactions

4.6 Recursive dynamics, temporal evolution, and repair

The recursive character of the model is reflected in two contrasting feedback pathways. In a deterioration loop, perceived breach reduces trust and encourages defensiveness or information withholding; reduced transparency then prompts tighter monitoring, which communicates further distrust and may induce additional withdrawal. Each party's protective response thus becomes evidence of unreliability for the other. By contrast, a reinforcement loop develops when fulfillment strengthens trust and increases tolerance for temporary inconsistency. Trust does not eliminate accountability, but it makes explanation, adjustment, and continued cooperation more credible.

This deterioration pathway explains how governance conflict can escalate even when each individual action remains formally defensible. The board may intensify oversight to protect the organization, while the executive may restrict information to preserve discretion. Directors may then interpret withholding as evidence of agency risk, whereas the executive may interpret tighter control as confirmation that prior trust has been withdrawn. Recursive interaction thereby transforms initially protective conduct into mutually reinforcing signals of relational unreliability.

A further pathway involves repair, through which governance actors may acknowledge the discrepancy, explain changed conditions, restore voice, revise decision rights, redesign reporting procedures, or renegotiate expectations. Effective repair combines relational action with structural correction where necessary (Dirks *et al.*, 2009; Gillespie and Dietz, 2009). It does not necessarily restore the original psychological contract, since post-violation relationships may become narrower, more formal, or more transactional while still recovering sufficient coherence for governance functions to continue (Tomprou *et al.*, 2015).

The likelihood of successful repair increases when parties recognize that a discrepancy exists, acknowledge the legitimacy of the other party's interpretation, and align relational assurances with observable change. Explanation without structural correction may appear symbolic, while procedural redesign without relational acknowledgment may leave the experience of violation unresolved. Repair therefore depends on the joint operation of sensemaking, fairness, and substantive changes to the governance arrangements that generated the conflict.

4.7 Boundary conditions

Communication clarity, relational history, prior trust, power asymmetry, multiplicity of obligations, event strength, and external scrutiny condition the process. Clear communication reduces incongruence; a history of fulfillment supports charitable attribution; power determines whose appraisals are recognized and enacted. Multiple audiences create conflicts in which fulfilling one obligation may misalign another, while strong events and public scrutiny increase discrepancy salience and can transform a contained dispute into a credibility crisis (Aguilera *et al.*, 2015; Morgeson *et al.*, 2015).

These conditions operate at different stages. Communication clarity and source authority shape obligation formation; relational history, trust, justice, and event strength shape appraisal; power and coalition structure shape collective enactment; and external scrutiny shapes amplification. Treating them as stage-specific conditions provides greater precision than presenting them as undifferentiated moderators of the final outcome.

Multiplicity of obligations is especially consequential because governance actors may be unable to fulfill every perceived commitment simultaneously. A board responding to investor pressure may conflict with executive expectations; an executive protecting employees may disappoint short-term market expectations. The model does not classify these conflicts automatically as breach. It asks whether affected actors recognize the competing obligation, receive credible explanation, and view prioritization as fair.

4.8 Integrated process logic

The preceding stages specify a recursive process in which formal architecture and relational signals shape promissory interpretations, subsequent events activate comparison and appraisal, and resulting responses either sustain, renegotiate, repair, or erode the relational capacity through which governance operates. Crucially, outcomes re-enter the process as new signals and conditions. Explanation may redirect apparent misalignment toward renegotiation, failed repair may reactivate breach, fulfillment following repair may rebuild trust, and external scrutiny may amplify a contained dispute. Figure 1 integrates these temporal, multilevel, and feedback relationships.

The model's contribution is therefore not simply that governance is relational, but that formally similar actions can generate different trajectories depending on the obligations actors infer, the appraisals they make, and the feedback their responses create. These trajectories are contingent rather than deterministic: misalignment may generate learning, fulfillment may coexist with demanding challenge, and deterioration becomes governance-system failure only when it undermines the relational capacity required for effective oversight, advice, coordination, accountability, and credible communication.

5. Reinterpreting governance failures through the process model

The explanatory value of the dual-contract process model becomes particularly visible in governance episodes where formally legitimate actions generate divergent relational consequences. Board-executive breakdown, symbolic governance, competing obligations, and repair illustrate how prior signals, relational history, and perceived obligations shape the meaning assigned to governance conduct. Across these settings, the critical issue is not formal authorization alone, but whether subsequent actions are interpreted as consistent with the obligations actors believe the relationship has created and how those interpretations affect the capacity to monitor, advise, coordinate, communicate, and exercise accountability.

Board-executive relationship breakdown provides the clearest application of this process. Repeated board support may create a perceived commitment to strategic autonomy, while a history of executive openness may create an expected obligation of candor and consultation. Intensified monitoring may be accepted when it reflects an understood contingency, is explained transparently, and preserves procedural voice. The same intervention may be appraised as breach when it is abrupt, humiliating, unexplained, or inconsistent with prior assurances of discretion. Likewise, an executive decision may remain within formally delegated authority while contradicting directors' perceived expectations of consultation or timely disclosure.

Once breach is appraised, the resulting responses may become recursive. An executive who experiences intensified monitoring as a withdrawal of trust may become defensive or restrict information sharing. Directors may interpret reduced openness as evidence that stronger control is necessary. Increased monitoring then reinforces the executive's belief that the board has abandoned its prior commitment to autonomy. Perceived breach reduces trust, reduced trust changes conduct, and changed conduct generates further signals that intensify breach appraisal. The dual-contract model therefore specifies how the control-collaboration tension

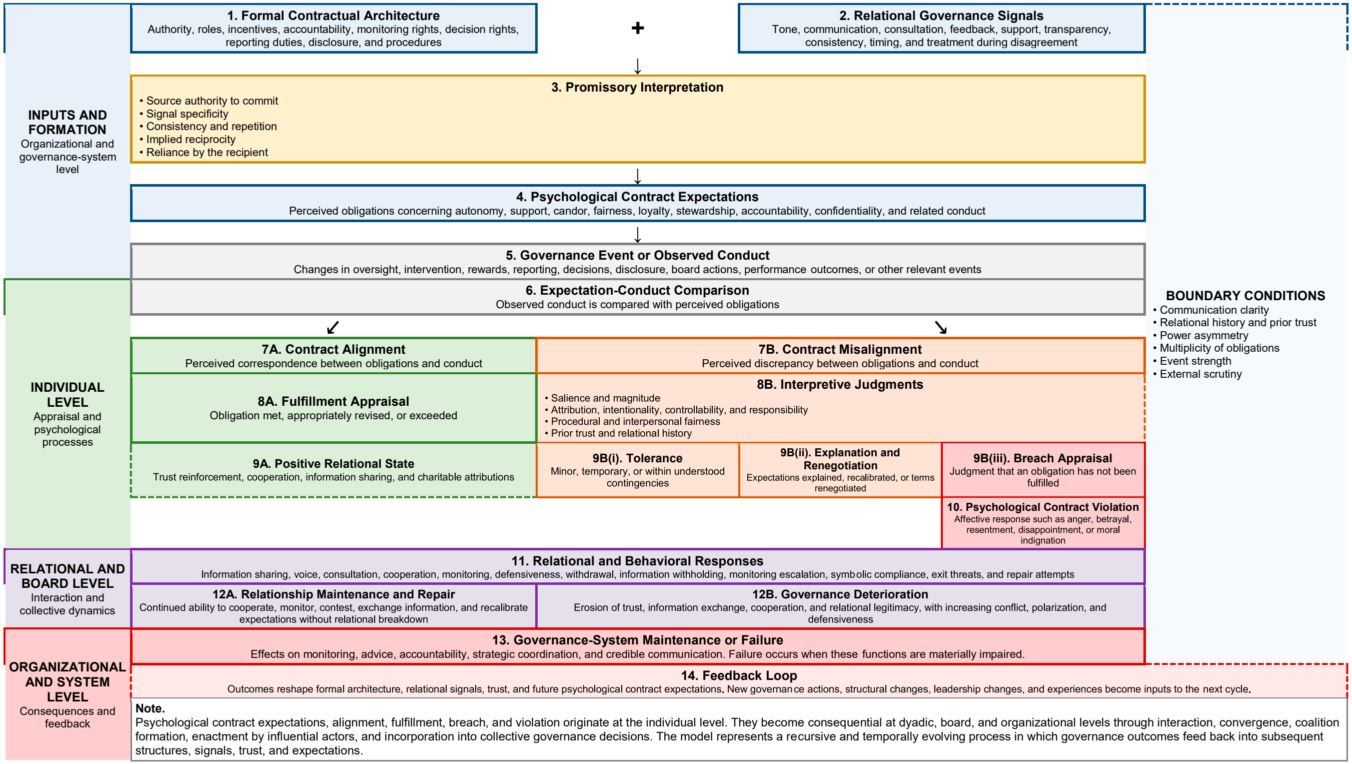

Figure 1. Recursive dual-contract process model of governance relationship maintenance and failure

identified by Sundaramurthy and Lewis (2003) can develop into a self-reinforcing cycle rather than remaining a static governance paradox.

This application also explains why formally similar board actions can produce different relational outcomes. Monitoring introduced as part of a clearly stated contingency may confirm an accountability-centered psychological contract, whereas monitoring imposed after repeated assurances of discretion may contradict it. The formal action is similar, but relational history, explanation, procedural treatment, and attributed intention differ. The model consequently explains variation that cannot be inferred from board structure or monitoring intensity alone.

Individual appraisals become collectively consequential through discussion, framing, coalition formation, and formal enactment. One director's perception that an obligation has been breached does not itself constitute board-level failure. It may, however, become consequential when a chair or influential coalition embeds that interpretation in monitoring decisions, restrictions on executive authority, leadership changes, or public communication. Divergent appraisals may instead produce board fragmentation and competing responses. This multilevel pathway prevents the model from treating individual distrust, interpersonal conflict, collective board action, and organizational failure as analytically equivalent.

A second application concerns symbolic governance and credibility breakdown. Organizations frequently adopt governance codes, committees, policies, reporting systems, and public commitments that may become decoupled from organizational practice (Meyer and Rowan, 1977; Bromley and Powell, 2012). Decoupling identifies the gap between formal structure and implementation, but it does not fully explain why audiences sometimes experience this gap as a violation. The dual-contract model adds that formal governance arrangements become psychologically consequential when audiences interpret them as credible commitments rather than as symbolic statements alone.

A committee may communicate that meaningful oversight will occur, a disclosure may imply a commitment to transparency, and a governance reform may signal that future conduct will change. A discrepancy between the signal and subsequent practice may initially be understood as an implementation delay, resource constraint, or temporary adjustment. It is more likely to be appraised as breach when the commitment was specific and repeated, fulfillment appeared feasible, and nonfulfillment is attributed to concealment, disregard, or strategic impression management. Symbolic action may therefore damage credibility more than silence because it creates the perceived obligation against which subsequent conduct is judged.

Psychological breach and legitimacy loss remain distinct even though they may interact. Psychological breach concerns the perceived nonfulfillment of an obligation attributed to an identifiable party. Legitimacy concerns broader judgments about whether organizational conduct is socially appropriate or acceptable (Suchman, 1995). A breach may remain contained within a board-executive relationship, but media, regulatory, investor, or employee attention may amplify the interpretation and transform it into public credibility loss. Research on selective environmental disclosure illustrates this possibility, although the same process can apply to executive compensation, whistleblowing systems, risk oversight, misconduct responses, and board accountability (Marquis *et al.*, 2016). The model thus connects decoupling, psychological appraisal, and legitimacy loss without collapsing them into a single theoretical process.

A third application concerns the multiplicity of governance obligations. Boards and executives rarely operate within a single psychological contract. They face expectations from shareholders, employees, regulators, activists, auditors, and other organizational audiences. Fulfilling one perceived obligation may create misalignment with another. A board may respond to investor demands for tighter control while contradicting executive expectations of discretion. A chief executive may satisfy market expectations for rapid action while violating directors' expectations of consultation. Such conflicts should not automatically be interpreted as opportunism because governance actors may face genuine obligation incompatibilities in which no available action can fully satisfy every audience.

Breach appraisal in these situations depends partly on whether affected actors recognize the competing obligation, receive a credible explanation, and regard the prioritization process as procedurally fair. Multiparty psychological contract research supports treating governance as an interconnected obligation system rather than as a single isolated dyad (Lapalme *et al.*, 2011; Morf *et al.*, 2014). System-level instability may arise not because one psychological contract was deliberately violated, but because efforts to satisfy competing obligations create a sequence of misalignments across interconnected governance relationships.

Multiplicity also raises questions of power, prioritization, and voice. Powerful audiences may have their expectations acknowledged, negotiated, and incorporated into governance decisions, while less influential actors absorb the costs of conflicting commitments. Relational deterioration may therefore reflect not only incompatible obligations, but also asymmetry in whose expectations are treated as legitimate. Governance actors can reduce this risk by identifying competing obligations explicitly, explaining why certain expectations receive priority, and creating meaningful opportunities for affected parties to express concerns before perceived nonfulfillment becomes breach.

Finally, breach does not inevitably lead to governance failure. Misalignment may be contained through explanation, acknowledgment, procedural voice, renegotiation, apology, revised authority, or governance redesign. A board may clarify why changed conditions require intensified oversight and explain whether the intervention is temporary or represents a lasting revision of executive discretion. An executive may acknowledge a failure of consultation, provide missing information, and agree to revised reporting procedures. Effective repair requires credible action that addresses both relational harm and the structural conditions that produced the discrepancy (Dirks *et al.*, 2009; Gillespie and Dietz, 2009).

Repair does not necessarily restore the original psychological contract. Following a significant breach, the relationship may become narrower, more formal, more cautious, or more transactional while regaining sufficient coherence for governance functions to continue (Tomprou *et al.*, 2015). Successful repair therefore means restoring the capacity for monitoring, advice, accountability, and credible information exchange, not erasing the history of the breach or recreating the relationship exactly as it existed before.

Repair can nevertheless fail for several reasons. Parties may deny that an obligation existed, acknowledge the event while disputing responsibility, offer an apology without changing the underlying governance arrangement, or redesign procedures without addressing relational harm. Because repair activities generate new expectations, symbolic or incomplete repair may itself become a second perceived breach. Explanation without observable implementation can appear manipulative, while structural change without acknowledgment may leave the experience of violation unresolved. Repair is therefore an uncertain pathway requiring coherence between communication, responsibility, procedural treatment, and substantive action.

Taken together, these applications show that the dual-contract model changes the diagnosis of governance episodes rather than merely adding relational variables to conventional agency explanations. Escalating monitoring, executive defensiveness, symbolic compliance, or credibility loss may arise from recursive obligation conflict as well as from opportunism or weak control. Their meaning therefore depends on the sequence through which expectations formed, discrepancies were interpreted, and responses became mutually reinforcing or were successfully repaired. This process-based diagnosis is the principal value of applying the model across different governance settings.

6. Theoretical contributions, future research agenda, and practical implications

6.1 Theoretical contributions

The first contribution lies in elaborating agency theory by showing that formal governance mechanisms have interpretive consequences alongside their established allocative and control functions. Monitoring, delegation, incentives, and accountability arrangements not only structure behavior but also contribute to beliefs about discretion, support, responsibility, and appropriate intervention. The implication is not that control is inherently destabilizing or should be replaced by trust. Rather, the relational consequences of control depend partly on whether its enactment remains coherent with obligations made credible through prior governance arrangements and conduct.

The second contribution is to corporate governance theory through the specification of promissory interpretation as an obligation-forming mechanism. Relational and behavioral governance scholarship demonstrates that trust, interaction, cognition, and informal processes matter, but the dual-contract model explains why formally similar structures can acquire different relational meanings across governance relationships. By locating this variation in the obligations actors infer and subsequently use to evaluate conduct, the model provides a mechanism-based explanation of governance relationship maintenance and deterioration that cannot be derived from formal structure alone.

The third contribution extends psychological contract theory into a governance setting characterized by concentrated authority, multiple contract makers, competing obligations, and consequential organizational decisions. The model preserves the individual-level foundation of psychological contracts while explaining how individual appraisals become collectively consequential through convergence, coalition formation, influential framing, and formal enactment. It therefore connects subjective obligation judgments to board-level and organizational consequences without treating individual perceptions and collective outcomes as equivalent.

Finally, the model contributes a temporal and recursive account of governance relationships. Fulfillment, breach, behavioral response, and repair are not isolated events because each response becomes part of the informational and relational environment in which subsequent expectations are formed and interpreted. This feedback logic allows the model to explain stability, escalation, and recovery within the same framework and shifts attention from static governance arrangements toward the evolving relational capacity through which formal governance is enacted.

6.2 Future research and empirical operationalization

Several theoretically testable expectations follow directly from the process logic developed in this paper. Governance cues should be more likely to acquire promissory force when they originate from actors with authority to commit, are sufficiently specific and consistently reinforced, imply reciprocity, and induce recipient reliance. Contract misalignment, in turn, should be more likely to generate breach appraisal when discrepancies are salient, responsibility and intentionality are attributed to the other party, procedural fairness is weak, and prior trust is limited. The consequences of breach should primarily unfold through relational and behavioral pathways, including declining information exchange, defensive conduct, monitoring escalation, and collective enactment, rather than through an immediate transition from individual appraisal to governance-system failure. Conversely, fulfillment, credible explanation, and substantive repair should interrupt recursive deterioration, whereas repeated unresolved breach, power-based enactment, and external amplification should increase the likelihood that relational deterioration becomes collectively and organizationally consequential.

Empirical research should first examine how governance expectations acquire promissory meaning. Formal contractual architecture can be captured through executive contracts, board charters, committee mandates, compensation arrangements, delegated decision rights, reporting procedures, and escalation provisions. Relational governance signals can be examined through paired surveys, interviews, board evaluations, meeting records, appointment communications, and critical incidents. Promissory interpretation should be measured separately from general expectations by assessing whether the relevant cue originated from an authoritative source, was sufficiently specific and consistent, implied reciprocity, and generated reliance.

Developing valid governance-specific measures will likely require an initial qualitative stage because psychological contract obligations at board and executive levels may not map directly onto measures developed for conventional employment relationships. Interviews with directors, chairs, and executives could identify obligations concerning strategic discretion, candor, consultation, challenge, confidentiality, support, and stakeholder accountability. Subsequent scale development should preserve the conceptual distinctions established by the model among expectation content, perceived promise, fulfillment, misalignment, breach, violation, and governance-system consequences.

Examining alignment and misalignment also requires evidence from more than one side of the governance relationship. Paired CEO-director or chair-CEO designs could compare what each party believes was promised with what each believes was subsequently delivered. Polynomial regression and response-surface analysis offer more informative approaches than simple difference scores for examining congruence and asymmetry between parties' perceptions (Edwards and Parry, 1993). Importantly, evidence of misalignment should not itself be treated as evidence of breach. Empirical measures must establish that the discrepancy was interpreted as nonfulfillment and should therefore incorporate attribution, intentionality, controllability, procedural fairness, and prior trust.

Measurement of outcomes should similarly respect the model's levels of analysis. Individual-level outcomes include fulfillment, breach, violation, and trust; dyadic and board-level outcomes include information sharing, voice, coalition conflict, monitoring escalation, withdrawal, and repair; and system-level outcomes concern impairment of advice, oversight, accountability, coordination, or credible communication. Collapsing these phenomena into a single measure of governance failure would obscure the process through which individual appraisal becomes collectively and organizationally consequential.

The recursive and temporal nature of the framework also requires research designs capable of observing governance relationships as they evolve. Repeated paired surveys could track expectations before and after board intervention, leadership transition, crisis, strategic disagreement, or performance decline. Diary and event-based methods could capture fulfilled and broken promises surrounding board meetings and consequential decisions (Conway and Briner, 2002; Kiefer *et al.*, 2022), while qualitative process studies, temporal bracketing, and process tracing could reconstruct how one party's response becomes the other party's next governance signal (Langley *et al.*, 2013). Such longitudinal approaches are particularly important because breach and violation develop through interpretation and accumulated interaction rather than appearing instantaneously (Robinson and Morrison, 2000).

Multilevel research should further examine when individual appraisals remain private, become shared, or are translated into collective action. Directors are nested within boards and organizations, yet influential actors may institutionalize a particular interpretation even in the absence of perceptual consensus. Mixed-method designs combining surveys, board-network information, interviews, meeting records, and archival outcomes could distinguish genuine convergence from coalition dominance or compliance with influential framing. Comparative research could also examine whether these processes differ across ownership structures, legal systems, board models, leadership transitions, crisis conditions, and levels of external scrutiny.

Archival evidence should nevertheless be interpreted cautiously because psychological contracts are perceived obligations rather than directly observable governance structures. Board minutes, public statements, compensation changes, leadership turnover, or intervention events can identify relevant cues and consequences, but cannot establish psychological contract breach without evidence of how those events were interpreted. Strong empirical designs should therefore combine archival indicators with surveys, interviews, or process evidence capable of establishing what actors believed was promised, how they interpreted subsequent conduct, and why they attributed responsibility for perceived nonfulfillment.

6.3 Practical implications

The dual-contract perspective suggests that boards and executives should manage not only formal authority but also the expectations generated through its communication and exercise. Executive appointment, leadership transition, strategic crisis, and major changes in performance provide particularly important moments for clarifying the scope and conditions of discretion, circumstances that justify intensified monitoring, information expected before formal reporting, and procedures through which disagreement will be addressed. Periodic expectation reviews can further identify obligations that have become unrealistic, ambiguous, or inconsistent with changed governance conditions.

Expectation calibration should complement rather than substitute for formal documentation. Appointment letters, role charters, evaluation protocols, committee mandates, and scheduled governance reviews can make the contingencies surrounding discretion, monitoring, disclosure, and intervention more explicit. The objective is not to eliminate the incompleteness inherent in governance relationships, but to reduce avoidable incongruence and create clearer opportunities for renegotiation when circumstances change.

Procedural fairness becomes particularly important when boards modify executive authority, compensation, oversight intensity, or leadership arrangements. Advance communication, credible explanation, meaningful voice, respectful treatment, and consistency can help distinguish legitimate governance adjustment from apparent reneging. Boards should also attend to early indicators of relational deterioration, including defensive communication, declining information quality, coalition formation, excessive reliance on formal procedure, repeated questioning of motives, symbolic compliance, and escalating monitoring. Such signals may indicate incompatible perceived obligations rather than opportunism alone.

Where breach has already occurred, credible repair requires more than reassurance. Boards and executives may need to acknowledge the discrepancy, clarify responsibility, revise decision rights, redesign reporting expectations, reconsider committee responsibilities, or modify evaluation procedures. Relational acknowledgment without substantive change may appear symbolic, while structural redesign without recognition of relational harm may leave the underlying violation unresolved. Effective repair therefore requires consistency between explanation and observable governance action.

Practitioners should also distinguish productive challenge from relational deterioration. Vigorous debate, close monitoring, strategic intervention, and even executive replacement may be legitimate and necessary features of effective governance. The more serious warning signs arise when actors cease exchanging credible information, interpret routine conduct through increasingly hostile attributions, engage in symbolic compliance, or use formal authority primarily as protection against the other party. Under these conditions, adding further controls without addressing the underlying obligation conflict may reinforce rather than resolve the deterioration.

When deterioration has become entrenched, an independent chair, lead director, mediator, or governance adviser may help distinguish disagreement over substantive decisions from disagreement over perceived obligations. Such intervention is most useful when it facilitates candid acknowledgment, clarifies competing interpretations, and supports concrete governance redesign rather than adding another symbolic layer of oversight.

7. Conclusion

This paper develops a recursive dual-contract process model by integrating agency theory with psychological contract theory. Its central contribution is to explain how formal arrangements and relational conduct acquire promissory force, become perceived reciprocal obligations, and subsequently serve as standards for fulfillment and breach appraisal.

The framework complements agency, relational governance, signaling, trust, justice, and legitimacy perspectives by connecting their insights through an obligation-based process. Governance cues acquire different meanings depending on their authority, consistency, relational history, and the obligations actors infer from them; subsequent conduct is evaluated against those obligations; and resulting appraisals generate responses that reshape later governance relationships. This process explains why formally similar governance actions may stabilize one relationship while initiating deterioration in another.

Formal governance mechanisms therefore have both structural and interpretive consequences. Governance relationships remain viable when perceived obligations are fulfilled, credibly recalibrated, or repaired, but become vulnerable when misalignment is appraised as breach and generates responses that recursively reinforce distrust and defensive conduct. Breach and governance failure are not synonymous. Governance-system failure emerges only when these dynamics materially impair monitoring, advice, accountability, strategic coordination, or credible communication. Effective governance consequently requires the joint management of authority and obligation. Formal legitimacy remains essential, but durable governance also depends on the capacity to clarify, align, renegotiate, and repair the psychological contracts through which formal governance operates. The dual-contract perspective therefore directs attention to the relational infrastructure that allows formal governance to function.

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