

**ACQUISITIONS TO OVERCOME ENTITLEMENT CONSTRAINTS:
EVIDENCE FROM FRANCHISE SYSTEMS**

Nicholas Argyres
Olin School of Business
Washington University in St. Louis
argyres@wustl.edu

Janet Bercovitz
Leeds School of Business
University of Colorado, Boulder
janet.bercovitz@colorado.edu

Hugo Leenders
Leeds School of Business
University of Colorado, Boulder
hugo.leenders@colorado.edu

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Abstract

The strategy and finance literatures have extensively studied behavioral and social attributes of acquirers that drive acquisition behavior. Less studied are the behavioral and social attributes of targets that invite their acquisition. We maintain that "entitlement constraints" are an important such attribute in franchising systems because they limit a current franchisor's ability to capture additional value from the system by changing written contract terms. These constraints arise because many franchisees perceive that such changes undermine their entitlements, motivating them to retaliate against the franchisor. New owners of franchise systems, however, are less subject to such retaliation, because they did not make such prior commitments. We provide empirical evidence consistent with the importance of entitlement constraints from a matched sample of acquired and non-acquired systems.

keywords: entitlement; acquisitions; franchising; contracting; behavioral economics

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The last 25 years have seen a significant increase in strategy and finance research on the behavioral and social drivers of acquisitions (Devers, Wuroinen, McNamara, Haleblan, Gee & Kim 2020). Scholars have examined a wide variety of acquirer characteristics that drive acquirer behavior, especially CEO attributes and acquisition experience (e.g., Chatterjee & Hambrick 2007; Malmendier & Tate 2008; Gamache, McNamara, Mannor & Johnson 2015; Iyer & Miller 2008; Kim, Haleblan & Finkelstein 2011; Kim, Finkelstein & Haleblan 2015). Research has also studied the influence of outside firms on acquirers' acquisition behavior (Stuart & Yim 2010; Rogan & Sorenson 2014; Ozmel, Reuer & Wu 2017; McCann, Reuer & Lahiri 2016).

There has been much less study, however, of how the behavioral and social characteristics of *target firms* influence acquisition behavior. Clearly, understanding the factors that make firms attractive acquisition targets is important for strategic management because such targets can present valuable business opportunities. The small literature on target characteristics that encourage their acquisition has focused on social factors such as a target's market popularity (Massa & Zhang 2009), the target's ties to prominent investors or investment banks (Reuer & Ragozzino 2012; Vasudeva, Nachum & Say 2018), and target owners' personal motivations (Graebner & Eisenhardt 2004). In this paper, we explore an understudied behavioral characteristic of some target firms that may lead to their acquisition, and determine important post-acquisition choices by acquirers; namely what we term "entitlement constraints". Our focus on entitlement constraints was motivated by a desire to understand a long-standing puzzle in the franchising literature: the pervasive stability of franchisor-franchisee contracts. The terms of these contracts are rarely adjusted even in the face of significant changes in exchange conditions (LaFontaine & Shaw 1999).

A widely-cited notion is that acquisitions sometimes occur when a target's leaders are unwilling to take actions that violate prior commitments made to employees, even if these actions are efficiency enhancing, because employees see these commitments as entitlements (Shleifer & Summers 1988). Acquirers are better placed to take such actions post-acquisition because they have not made such commitments to a target's employees. When this difference exists, an acquirer's willingness to pay for a target will exceed the target owner's reservation price.¹ We extend this idea by examining whether entitlement constraint considerations are present when leaders' prior commitments are to franchisees rather than to employees. As observers of franchising have emphasized, franchisors often make unwritten promises to franchisees not to undermine their financial interests (Chanut & Pache 2011; El-Sayed 2011). We argue that over time, franchisees begin to see such commitments as entitlements, and are therefore liable to retaliate against franchisors who are seen as violating these unwritten promises.² Franchising has a long history of contentious franchisor-franchisee relations (Argyres & Bercovitz 2015). New owners of a franchise system, because they have not yet made specific promises to the franchisees, will be able to make changes to contractual agreements with franchisees at lower expected retaliation cost than can incumbent owners. We thus contend that entitlement constraints encourage acquisitions. While earlier research on acquisitions and entitlement constraints concerned hostile takeovers of publicly-owned firms, we provide evidence that they are also present in friendly acquisitions of privately-owned firms.

¹ The evidence is mixed regarding whether hostile takeovers make employees worse off (Pontiff, Shleifer & Weisbach 1990; Rosett 1990).

² By "entitlement" here we mean "the state of having a title, right or claim to something" (Dictionary.com). The literature on "entitlement mentality" in contrast, uses a definition closer to: "the unjustified assumption that one has a right to certain advantages, preferential treatment, etc." (Dictionary.com). Our theory makes no assumption regarding whether franchisees' feelings of entitlement are justified or not.

Our evidence is derived from a sample of 79 franchise system acquisitions matched with 98 non-acquired systems. Over the past 25 years, private investors, especially private equity firms, have been actively acquiring (and selling) entire franchise systems. Why franchising is so attractive to private equity investors is an interesting strategy question. Our evidence suggests that overcoming entitlement constraints may be one important motivation for these acquisitions. First, we find that, on average, acquirers raise franchise, royalty and marketing fees that franchisees pay to franchisors soon after acquiring a franchise system. Because target owners could previously have raised such fees with a few strokes of a computer keyboard (i.e., at zero cost to themselves), the fact that they did not do so suggests that target owners were constrained. We argue that these constraints are created by franchisees' feelings of entitlement to the fee levels that prevailed in the initial franchise contracts they signed; that is, initial contract terms serve as reference points by which franchisees judge whether or not to retaliate against franchisors for perceived violations of unwritten promises (Hart & Moore 2008).

Second, we test for two contingencies to help identify our hypothesized entitlement constraints mechanism, and to rule out alternative explanations for the post-acquisition fee increases we observe. In particular, we find that post-acquisition increases in royalty fees are more likely for target franchise systems in which entitlement constraints bind more tightly: systems that emphasize multi-unit franchising, and systems with older units. First, owners of target franchise systems that emphasize multi-unit franchising are particularly reluctant to raise fees for fear of alienating highly productive existing franchisees interested in owning future units. Second, many owners of newer units are less concerned about fee increases because they will only incur them if they choose to renew their agreement years in the future. These two contingency findings, along with the logic and robustness tests we use to cast doubt on

alternative explanations, together provide strong circumstantial evidence for the entitlement constraints mechanism as a driver of franchising acquisitions.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Acquisitions occur when a buyer's willingness-to-pay for a firm exceeds the firm's value to its current owner. The difference between these two values reflects differences in acquirer versus seller expectations about the future value of the firm (Barney 1986). In some cases, these differences arise because the acquirer possesses superior business intelligence (Makadok & Barney 2001; Nary & Kaul 2021), while in other cases the acquirer sees opportunities to capture unique synergies involving its current businesses and the target -- opportunities that the target's owner lacks (Barney 1988; Mackey, Barney & Dotson 2017). In still other cases, however, the acquirer perceives that the target's owner is unable to generate as much value from the business as can the acquirer, even if such synergies are absent. The acquirer believes that it can create and extract greater value by imposing stricter financial controls over the acquired firm's operations, introducing stronger incentives into executive compensation plans, allocating capital to or from the acquired firm in a more efficient way, or increasing leverage to prevent target managers from wasting corporate resources (e.g., Williamson 1975; Jensen 1989; Wruck 2008; Gompers, Kaplan & Mukharlyamov 2016).

Shleifer and Summers (1988) famously offered a different kind of argument, contending that hostile takeovers in particular often occur because a target's managers are reluctant to cut costs to improve short-run efficiency. This reluctance stems from a concern that doing so will undermine the interests of the target's employees or other stakeholders and thereby erode employees' trust in management. Target managers, they argued, typically make implicit (or

explicit but unwritten) promises to employees to safeguard their interests in order to elicit employees' commitment to high levels of effort and/or relationship-specific investments that benefit the firm. Cutting costs through layoffs, for example, might improve efficiency in the short-term, but would be seen by employees as violating the implicit promises made to them, thereby undermining their motivation and performance over the longer term. Shleifer and Summer (1988) argued that acquirers, never having made such commitments to the target's employees, are freer to take actions aimed at improving short-run efficiency.

The organizational behavior literature speaks of these unwritten -- indeed, perhaps even unspoken -- expectations and beliefs about employees' and employer's obligations in their relationship as "psychological contracts" (e.g., Rousseau 1995). When psychological contracts are perceived as having been violated, employees may engage in various kinds of undesirable behaviors (Robinson & Morrison 1995; Turnley & Feldman 2000).³ Consistent with this, individuals who feel wronged in a relationship with another individual are more likely to behave selfishly in the relationship (Zitek, Jordan, Monin & Leach 2010).

We contend that these theories of unwritten commitments and expectations apply with particular force to acquisitions of business format franchise systems. Such franchising is based on long-term, highly detailed, government-regulated agreements that allow a franchisee to use the franchisor's brand name in exchange for royalties and other payments. The agreements formalize many additional obligations for the franchisee and franchisor, such as training to be provided by the franchisor, and various quality standards to be upheld by the franchisee.

³ Strategy scholars have argued that "governance inseparability" occurs when prior commitments by a firm to a stakeholder group make it difficult to alter governance arrangements with those stakeholders in order to accommodate changes in the firm's environment (Argyres & Liebeskind 1999). While the emphasis is on contractual rather than unwritten commitments, the basic mechanism is similar.

Franchise agreements are generally offered on a take-it-or-leave it basis to all prospective franchisees. Business format franchise systems are widespread in the economy because of their ability to create value in numerous industries (Blair & Lafontaine 2005).

Observers of franchising relationships have emphasized that, in addition to signing written agreements, the parties develop "tacit expectations of their partners that they actually consider as obligations" (Chanut & Pache 2011, p. 75). Such obligations on the part of franchisors include making efforts to protect franchisees' financial interests as partners in the larger franchise enterprise (El Sayed 2011). Expectations that all franchisees within a system will be treated in a similar manner reinforce perceptions of obligations that further constrain the franchisor's ability to alter existing arrangements (Lafontaine & Shaw 1999).

When franchisees perceive that their franchisor has violated prior commitments or unwritten expectations, they may take a variety of retaliatory actions, similar to the ways in which employees have been found to retaliate against employers who they believe mistreated them (e.g., Lord & Hohenfeld 1979; Greenberg 1990; Restubog et al. 2015). Prominent among these retaliatory actions is what Hart and Moore (1990) term "shading": i.e., performing to the letter rather than the spirit of the franchise agreement. Williamson (1975) similarly distinguished between "perfunctory" and "consummate" performance. For example, aggrieved franchisees may reduce their efforts to produce quality service in ways that are difficult for the franchisor to observe and punish informally (e.g., by reverting to perfunctory performance themselves). Franchisees might shade by reducing the speed and/or friendliness of their customer service, skimping on cleanliness of their service locations, or underperforming their service in ways that customers cannot immediately detect. The focal franchisee bears only a portion of the costs of such shading because the effects of any consumer dissatisfaction are shared with the franchisor

and other outlet managers in the system. Such actions hurt franchisors by reducing franchisees' sales, thereby reducing their royalty payments to the franchisor, and by damaging the value of the franchisor's brand (e.g., Klein 1980; Brickley & Dark 1987).

While it may be argued that franchisee retaliation is unlikely because it reduces franchisee profits, experimental studies have shown that people are often willing to absorb financial losses in order to retaliate against those whom they believe have mistreated them (e.g., Guth, Schmittberger & Schwarze 1982). Moreover, there are other actions that franchisees take that harm their franchisor's business, but involve relatively low costs to themselves. These actions include withholding royalty payments, suing the franchisor for breach of the written contract, and making public complaints against a franchisor to damage the franchisor's reputation with potential franchisees. Lawsuits and complaints are often supported by the American Association of Franchisees and Dealers, an organization that represents franchisee interests (Argyres & Bercovitz 2015). As an example, in 2021 over 100 Massage Envy franchisees publicized their complaints about fee increases by the franchisor, filed arbitration actions, and called for the franchisor's top managers to step down (Ewen 2021). Fee increases by McDonald's caused an "open revolt" by its franchisees in 2000, who boycotted meetings with franchisor management (Zetlin 2000). Over 200 UPS Store franchisees sued their franchisor in 2007 for requiring them to undertake low-margin services (accepting pre-paid packages and offering printing and document services: Post & Parcel 2007). Because conflict between franchisees and franchisors occurs frequently, often resulting in litigation, franchisors will have every expectation that retaliation of some kind will likely follow any major perceived violation of franchisee entitlements.

What determines whether franchisees will feel that their unwritten expectations of franchisor behavior were violated? Hart and Moore (2008)'s theory of contracts as reference points suggests that formal written agreements are a major basis for such expectations. In their theory, written agreements set the terms of understanding between the parties, and over time each party begins to feel entitled to the treatment that is stipulated in the agreement (whether those feelings are justified or not). Therefore, if a franchisor makes changes to contract terms in its standard written agreement that franchisees believe will negatively affect their profits, franchisees will see this as an abrogation of their entitlements as agreed to in their original written contract, and are likely to retaliate.⁴ By law, franchisors have the opportunity to change the terms of their standard franchise agreements every year. Any such changes therefore affect new franchisees, franchisees who are renewing in that year, as well as those who wish to be granted additional units of the franchise in that year. Furthermore, such contract changes will be perceived as highly salient by those franchisees who are nearing the expiration of their current franchise agreement as they will be required to sign the then-current franchise contract in order to renew.

The key implication of Hart and Moore's (2008) theory is that rigid written agreements, by setting clear expectations, lead to less shading than flexible contracts, which have the benefit of better adaptation to new conditions. Experimental evidence for this implication was found by Fehr, Hart and Zehnder (2011). However, rigid contracts that, for example, specify numerical sales targets for franchisees, are difficult to implement in franchising contexts. The reason is that franchisee sales are affected by many factors over which franchisees have no control, and are

⁴ The founder of a fast-food franchise system that was acquired in 2014 stated that, as a general rule, “franchisees hate change, even changes that arguably have long-run benefits for the franchisees.” The founder further noted that franchisees tend to resist change, and often do so via an independent franchisee association (Interview, 10/24/2023).

difficult to predict. Local entry by competing brands, changes in customer tastes, changes in traffic and crime patterns, etc. make it difficult to rely solely on rigid contracts to avoid shading. Ownership changes, we suggest, are an alternative mechanism by which inefficiencies caused by incumbent owners being bound to prior commitments and psychological contracts are eliminated.

Thus, we maintain that new owners of franchise systems, because they were not party to the original franchise agreements signed by franchisees, are less constrained by the same set of franchisee expectations -- "entitlement constraints" -- as compared to current system owners. As a consequence, new owners have greater scope to change the terms of franchise agreements offered for new units in ways that are perceived as benefitting the franchisor at franchisees' expense. Franchisees are less likely to retaliate against such actions by new owners, or at least to retaliate less severely, because their psychological contract or prior commitment involved the current owner, not the new owner.⁵

This logic was corroborated by an experienced executive who was on the founding team of a franchisee firm that went on to own and operate more than 50 units in the same franchise system. When asked to explain the surprising stability of franchisee agreements over time, and typical franchisee reactions to changes in agreements, he responded as follows:

“The original (often inexperienced) franchisor has lots of loyalty to the franchisees. With the agreement, they set an expectation for their franchisees... [the franchisor doesn't] want to make changes and upset the apple cart and deal with backlash. [This is] never a good thing. . . [If you make changes,] you [can] piss the franchisees off enough so they don't perform. Franchisors use change of control in ownership to change terms. The reaction of the franchisees is different. It's less personal, the founders are gone, or less

⁵ Another possibility is that franchisees are less likely to retaliate against new owners because franchisees perceive that fee increases by new owners are fair given their recent investments in acquiring the franchise system in question. On the other hand, some franchisees may not perceive this justification as sufficient. While there is a literature on how explanations for adverse changes can cause them to be perceived as fair or just, we are not aware of a strong theory that would make clear predictions regarding franchisee responses to fee increases by new vs. current owners (Colquitt, Conlon, Wesson, Porter & Ng 2001).

active. You are dealing with a more professional management team (interview, January 17, 2023).”

Following this logic, we postulate that when new owners acquire franchise systems, they will quickly take actions that many franchisees oppose, even if the current owner is not the founding owner. The reason is that an important motive for acquiring the system in the first place is to take advantage of the fact that new owners do not face the same set of entitlement constraints as do current owners. This difference in constraints also implies that current owners will value their systems less than do acquirers, leading to gains from trade. Indeed, if acquisition of a franchise system is quickly followed by actions that capture value for the franchisor, this begs the question as to why the current owner did not capture this value earlier. The reason, we submit, is entitlement constraints.

What kinds of actions would we expect new owners of franchise systems to take? We propose that acquiring franchisors will prioritize changes that involve low implementation costs, and provide immediate and certain financial returns that target owners were not able to make due to entitlement constraints; namely, they will raise franchise, royalty, and marketing fees charged to franchisees. Franchise fees are one-time, fixed fees charged upon signing a new franchise agreement. The royalty fee is usually the fraction of franchisee sales paid to the franchisor for the rights to the franchise. Marketing fees are charges to the franchisees for advertising and marketing of the franchise system, and are also usually calculated as a percentage of franchisee sales. We contend that a current owner seeking to raise these fees beyond the levels specified in a franchisee's original agreement risks retaliation by franchisees, while for a new owner those risks are significantly lower.

Franchisees typically oppose fee increases for two reasons. First, most franchise systems feature multi-unit franchising, in which new franchises are disproportionately awarded to existing franchisees, rather than new franchisees (Kaufman & Dant 1996; Kalnins & Lafontaine 2004; Garg, Rasheed & Priem 2005). Many franchisees aspire to own additional units in the same system because there are economies of scale in managing multiple units. Increases in fees for new units reduce the attractiveness of those units. Second, franchise agreements have a limited duration, typically 10-20 years. To renew for an additional term, franchisees must sign the then current franchise agreement. When fees for renewal or for new units are increased, franchisees' investments in learning how to operate their franchise lose value. Such increases are thus a mild form of "hold-up" (Williamson 1985).⁶

Another possibility, however, is that raising fees creates value for the entire franchise system, benefitting franchisees as well as the franchisor. This would be the case, for example, if franchisors use increased franchisee payments to invest in advertising, new products and services, and the like, such that increased system sales compensates franchisees for the higher royalties and fees.⁷ However, even if some franchisees welcome an acquisition and the associated fee increases, many others will not. Loss aversion (Kahneman & Tversky 1979)

⁶ New owners might consider taking other actions that capture value, such as shortening the duration of the franchise agreement (facilitating earlier termination of poorly performing franchisees), lengthening the period in which franchisees are prevented from opening competing outlets, or reducing the sizes of exclusive territories assigned to franchisees. However, these actions only improve franchisor profits in the longer term, and to an uncertain extent. Acquirers with shorter-term investment horizons, such as private equity firms (Gompers et al. 2016), will therefore emphasize immediate fee and input price increases. As noted above, in recent decades private equity owners have been active in acquiring franchise systems.

⁷ Of course, if this were the case, we would expect incumbent owners to make these changes themselves rather than sell the system to others, because franchisees would not be expected to retaliate against value-creating changes by any owner. Still, some franchisees may not have confidence in the motives of the incumbent owner and/or they may be too short-sighted to see the value-creating potential of increases in fees, thus effectively tying the owner's hands.

implies that those who feel threatened will be more vociferous in their opposition than supporters will be in endorsing the acquisition and associated fee increases.

Therefore, even if some franchisees welcome an acquisition of the franchisor, and possibly even welcome fee increases, many others will be opposed, and will potentially retaliate. To be clear, our theory of entitlement constraints carries no particular implication regarding whether franchisees will actually be better or worse off following an ownership change. It merely implies that new owners will quickly take virtually effortless actions that, due to entitlement constraints, previous owners could not. Therefore, we hypothesize that:

H1: Acquirers raise franchise, royalty and marketing fees soon after acquiring franchise systems.

As we elaborate in the Discussion section below, taking advantage of entitlement constraints may not be the only reason why acquirers of franchise system raise fees post-acquisition. For example, acquirers who rely heavily on debt to finance an acquisition often seek immediate revenue gains from the target in order to meet large debt obligations (Murphy 2003). Therefore, in order to more precisely test whether the entitlement constraint mechanism in particular is operating rather than some alternative, we examine conditions under which the mechanism would be expected to operate more strongly or weakly. In particular, we contend that entitlement constraints are more important when franchisors rely more heavily on current franchisees to fuel system growth by opening new units of the franchise. Current franchisees feel a greater sense of entitlement than new franchisees who have not yet contributed to the franchise. Such franchisees therefore feel especially aggrieved by fee increases, and are therefore less willing to sign new contracts with the franchisor for new units. On the other hand, franchisors who rely more on new franchisees for growth will be less constrained by franchisee entitlements.

The tradeoff is that current franchisees may outperform new franchisees in terms of generating revenue from a given location because they have more experience with the franchise, and because they have less incentive to free-ride. They are less likely to free-ride because negative reputation effects spill over to other units that they own (Brickley 1999; Kalnins & Lafontaine 2004). On the downside, current franchisees may impose greater entitlement constraints.

While most franchise systems employ multiunit franchising, some rely on it more heavily than others. One measure of a franchise system's emphasis on multiunit franchising is whether it offers so-called “area development agreements” (Brickley 1999; Garg et al. 2005). Franchisees who sign these agreements commit to opening multiple new units of the same franchise system in a given geographic region over time, signing the then current franchise agreement for each new unit in the year the new unit is established. When signing an area development agreement, franchisees typically pay a franchisee fee equal to the sum of the franchisee fees for the number of units they commit to open. However, royalty and marketing fees are not specified in area development agreements. Therefore, franchisors may choose to increase royalty and marketing fees for future units. Because such increases will often be perceived as a violation of the franchisee’s entitlements, they will likely be opposed not only by those franchisees that signed area development agreements, but also by any franchisee that was expecting to be a candidate to own additional future units. Franchisors that rely less heavily on current franchisees for growth do not offer area development agreements. Therefore, we hypothesize that:

H2: Acquirers are more likely to raise franchise, royalty and marketing fees if the target offers area development agreements.

As noted above, the term of a U.S. franchise agreement usually ranges between 10 and 20 years. Therefore, if a franchisor raises fees in a particular year, some owners of newer units will not face these increases until their agreement comes up for renewal many years in the future. The owners who are in this situation are those who are not currently seeking additional units, or who eventually will seek them but are years away from qualifying to become multiunit owners. (Franchisors usually award additional units to experienced franchisees.) Less experienced new unit owners, we contend, are less likely to retaliate against fee increases by the current franchisor because they rationally discount them given that they will only incur them if they decide to renew years in the future. Therefore, entitlement constraints will be less binding in franchise systems with a greater fraction of recently added units. We hypothesize that:

H3: Acquirers are less likely to raise franchise, royalty, and marketing fees for systems with a greater fraction of recently added units.

Of the three types of fees listed in Hypotheses 1-3, we expect the strongest effects of entitlement constraints to be on royalty fee increases. The reason is that franchise fees are one-time payments only, and are often discounted with a franchisee's purchase of additional units. Royalty fees, on the other hand, continue to be paid throughout the 10-20-year contract term. Total royalty payments are therefore much larger than franchise fee payments for larger franchisees, making franchisees more likely to oppose increases in them.⁸ In addition, while marketing fees are also continuing fees and are similar in size to royalty fees, franchisors are contractually required to spend these fees on advertising, which benefits franchisees. Some

⁸ In the data we describe below, the average franchisee paid 17.2 times as much in royalty as in franchise fees per unit owned. Typical 1-2% increases in royalty fees cost a franchisee that was one standard deviation above the mean in terms of system size between \$36,000-\$73,000 over the life of a contract, whereas a typical franchisee fee increase would be \$7000, and often less for multiunit franchisees due to discounts offered by the franchisor.

franchisees might oppose increases in marketing fees if they feel that marketing spending is excessive or ineffective, or if they think that the franchisor is violating the contract by not spending all of the proceeds on advertising. Because these are likely to be atypical cases, however, we expect the strongest franchisee opposition to be against royalty fee increases.

METHODS

Sample and data

Our data are recorded from franchise disclosure documents (FDDs): highly detailed reports designed in compliance with the U.S. Federal Trade Commission to inform aspiring franchisees regarding 20 features of a franchise system, including its ownership structure and required fees, operating standards, historical performance indicators, and the like. FDDs also include the franchise agreement to be offered in that year. Four states not only require franchisors to register and file their FDDs, but also to make them publicly available on their Departments of Commerce websites: California, Indiana, Minnesota, and Wisconsin. We built our sample by selecting those franchise systems that were acquired in the period between 2012 and 2019, and which filed disclosure documents in at least one of the four states above. We used Item 1 -- The Franchisor and any Parents, Predecessors and Affiliates -- of the FDD to identify systems that had been acquired within the time window of interest. (When a franchise system is acquired, the existing franchisee agreements are assigned to the new franchisor.) We also use Item 1 to identify whether the acquirer owned more than one system. We use Item 17 – Renewal, Termination, Transfer and Dispute Resolution – as well as the franchisee agreement to confirm the presence of a change of control provision that gives the franchisor unrestricted rights to assign

or transfer franchisee agreements upon the sale of the system.⁹ We used the other items in the FDD to construct our variables of theoretical interest as well as control variables: Item 2 (Business Experience), Item 5 (Initial Fees), Item 6 (Other Fees), Item 11 (Franchisor's Advertising), and Item 20 (Outlets and Franchisee Information).

We chose to focus on those five industries in which the most franchise system acquisitions took place during our sample period. We wished to avoid discriminating based on industry while finding a sufficient number of matching non-acquired franchise systems for our analysis. Franchise system acquisitions were most prevalent in the food and restaurant industry, which accounts for roughly 35 percent of our sample. Additional industries in which franchise system acquisitions took place and that were included in our sample are Home & Maintenance (29%), Healthcare (12%), Business Services (12%), and Fitness (12%). We also aimed to achieve a size distribution of franchise systems in our sample that approximates the size distribution in the population, as reported by the World Franchising Network (2016).

For each acquired franchise system, we collected 5 years of data – from the two years prior to acquisition, the acquisition year, and the two post-acquisition years. Our final sample consists of 79 acquired systems, which we supplemented and matched with a group of 98 non-acquired systems with a similar industry representation. For each non-acquired system, we collected 12 years of data – from 2010 to 2021 – to facilitate our multivariate matching analyses described below. Additional information regarding the sample also appears below.

⁹ A typical change of control provision reads as follows: “We [the franchisor] have the right to transfer or assign all or any part of our rights or obligations under this Agreement to any person or legal entity. If the assignee expressly assumes and agrees to perform all of our obligations under this Agreement accruing after the date of assignment, then the assignee will become solely responsible for all of our obligations under this Agreement from and after one (1) year after the effective date of assignment. In addition, and without limiting the foregoing, we may sell our assets; may sell our securities in a public offering or in a private placement; may merge with or acquire other corporations, or be acquired by another corporation; and may undertake any refinancing, recapitalization, leveraged buy-out, or other economic or financial restructuring.” (Meineke 2014 Franchise Agreement).

Measures and analysis

Dependent variables. Our first hypothesis concerns increases in three dependent variables: franchise fees, royalty fees, and marketing fees. *Franchise Fee Increase* is a dummy variable that equals 1 if the initial franchise fee, or the franchise fee for any subsequent franchises in the case of multi-unit franchising, was higher than the franchise fees specified in the previous year's contract, and zero if it decreased or stayed the same. We specified a dummy variable here because in some systems, franchise fees are not absolute amounts, but instead depend on the population of the franchise territory. Moreover, in some cases franchisors keep base franchise fees unchanged while changing fees for subsequent franchises (for multiunit franchisees). *Royalty Fee Increase* is also a binary variable, coded as 1 if the annual royalty fee increased from one year to the next, and coded as zero if it decreased or remained unchanged. Again, this is specified as a dummy variable to account for differences in royalty fee estimation methods across systems: royalty fees can be calculated as a percentage of net or gross sales, or as an absolute amount to be paid either weekly or monthly. The third dependent variable, *Marketing Fee Increase*, is another binary variable that is coded in the same manner as royalty fee increase. Our rationale for using a dummy variable here is the same as for the royalty fee.

Independent variables. We are interested in possible increases in our dependent variables in the initial years after acquisition compared to the years before acquisition. Our main independent variable, *Post-Acquisition*, is a dummy variable that equals 1 in the first and second year after acquisition, and zero otherwise. Our second independent variable of interest is *Area Development*. This variable is also a dummy, taking the value of 1 if the system offers area

development agreements in a given year, and zero if it does not.¹⁰ The variable is thus a proxy for a franchise system's strategic intent regarding multiunit franchising.

Our third independent variable measures the fraction of recently-added franchise units. *Newness Rate* is the number of franchise outlets opened in the previous 3 years plus the number of transfers in the previous 3 years divided by the total number of franchised units in the focal year. We combined new outlets opened with transferred outlets because in both cases the franchisee signs a new contract with the franchisor.

Control variables. We incorporate a series of controls for franchise system characteristics that might be related to our dependent variables. *Size* measures the end-of-year number of franchised outlets, which could matter for many reasons. For example, a given fee increase in a larger system is more lucrative to the franchisor. Conversely, smaller franchise systems could be in their growth stage, or be in a growing industry, providing an incentive to raise fees as well. Another factor that may have an effect on post-acquisition fee increases is the time since the franchise system last changed ownership. Franchise systems that were the subject of one or more prior acquisitions might be less likely to undergo fee increases if increases were imposed after the prior acquisitions. This is especially the case when the time between a prior acquisition and our focal acquisition was short. We therefore include a variable, *Time*, which measures the time in years since the most recent prior acquisition. For franchise systems that were never acquired before, we code *Time* as the number of years since the system first began offering franchises.

We also control for the presence of the original founder on the executive team. In the first several years after founding, founders may be especially likely to make commitments to franchisees in order to attract them to what is an unknown brand. Commitments to early

¹⁰ Unfortunately, data on the number or sizes of area development agreements offered or signed by franchise systems is not available in FDD's.

franchisees may deter founders from raising fees in any particular year. This is consistent with the quote from our interviewee above. We therefore include the dummy *Founder*, which is coded as one if the founder was part of the executive team during a given year, and zero otherwise. We also control for the presence of a Franchise Advisory Council. These councils consist of franchisees selected by the franchisor, other franchisees, or both, and have an advisory role regarding mostly marketing and advertising, but in some cases operations and management of the franchise system as well. *Council* equals 1 if a Franchise Advisory Council was present during a given year, and zero otherwise. The presence of such a council may indicate stronger commitments to franchisees, and therefore a lower likelihood of fee increases post-acquisition (Argyres & Bercovitz 2015). In addition, we include industry and year dummies in our regressions to control for industry differences in likelihood of fee increases, as well as for possible macroeconomic or other impacts associated with particular years in our data. Table 1 displays the descriptive statistics and Pearson correlation coefficients for each variable in our study, for the pooled sample of both acquired franchise systems and non-acquired franchise systems.

One alternative explanation for the fee increases following acquisition is that they help to finance knowledge transfer activities or other kinds of efficiencies available from joining related businesses in the acquirer's portfolio. We control for this explanation as follows. Some acquirers are “umbrella firms”: companies that own more than one franchise system. Umbrella firms are thought to capture economies of scale in procuring standardized inputs, and revenue gains and/or cost savings from transferring knowledge about franchising best practices across systems by, for example, rotating managers across systems (Cohen & Kaufman 2021). Cross-selling services to customers, or units in different systems to franchisees, are additional rationales. In a subsample

analysis of the acquired franchises systems only, we therefore added a control variable that takes the value of one if the acquirer was an umbrella firm, and zero if not. Table 2 displays descriptive statistics and Pearson correlation coefficients for each variable included in our study, for the subsample of acquired franchise systems only. Thus, the "umbrella" variable is meant to control for efficiencies and/or potential synergies other than overcoming entitlement constraints.

Because our analysis focuses on changes over time, we apply a panel data approach, with the franchise system as the unit of observation (grouping by acquirer in our subsample analysis). We use probit estimation methods for our binary dependent variables (franchise fee increase, royalty fee increase, and marketing fee increase).

Entropy Balancing. Studying a sample of acquired systems only could bias findings if acquired franchise systems were systematically different from non-acquired systems, or if there was an upward trend in fees across all systems during the period of our study.¹¹ Indeed, these kinds of problems may have been present in earlier tests of the Shleifer and Summers (1988) hypothesis. Biases could arise, for example, if there were stronger upward trends in fees in acquired systems relative to non-acquired systems. To control for these possibilities, we matched our 79 acquired franchise systems to 98 franchise systems that were not acquired during our sample period, while ensuring that the industry representation rates within the sample of non-acquired franchise systems were the same as those within the sample of acquired systems. Subsequently, we used entropy balancing to ensure that the acquired and the non-acquired franchise systems in our analyses were otherwise comparable on their observable characteristics.

¹¹ Whether a franchise system is acquired or not is obviously not exogenous. Therefore, an alternative approach would be to specify a two stage model that includes an instrumental variable in the first stage that is correlated with the acquisition choice, but is not expected to affect fee increases post-acquisition. This approach is difficult to implement in our case, however, because our theory claims that the same unobserved variable – entitlement constraints – is driving both likelihood of acquisition and fee changes post-acquisition. We therefore implement a ITCV test (see below) to examine the robustness of our results to exclusion of this confounding variable.

Entropy balancing is a relatively novel multivariate matching approach that has recently been applied in the strategy literature (e.g., Distelhorst & McGahan 2021; Shi & DesJardine 2022) and is argued to be more efficient and less biased than more traditional multivariate matching approaches such as propensity score matching and coarsened and exact matching (Hainmueller 2012; Hendricks, Howell & Bingham 2019). Entropy balancing in its strictest form reweights observations in the control group in such a way that the means, variance, and skewness of the treatment and control sample become virtually equal. We apply this strict form here in order to reduce covariate imbalance between the treatment and control groups; in our case, the acquired and non-acquired franchise systems, respectively. Entropy balancing decreases model dependence, and, in turn, results in greater efficiency and less bias (e.g., Ho, Imai, King & Stuart 2007; Iacus, King & Porro 2012). While it is impossible to match observations on all observed and unobserved characteristics, entropy balancing achieves matching across numerous characteristics in order to create strong pseudo-control and pseudo-treatment groups. An important additional advantage of entropy balancing is that, unlike propensity score matching, no observations are lost in the matching process (Shi & DesJardine 2022). Finally, researcher discretion in choice of matching variables is minimized (Hendricks et al. 2019).

Table 3 displays descriptive statistics for the 1,090 system-year observations in our study, distinguishing between acquired and non-acquired franchise systems. We compared the two groups on all independent and control variables that we use in our pooled-sample analysis, except for *Post-Acquisition* and *Newness Rate*. We did not match on *Newness Rate* because our t-test showed no differences between our treatment and control group in terms of this variable ($p = 0.765$). *Post-Acquisition* is always zero for non-acquired franchise systems because no acquisition takes place. On average, acquired systems are larger (*Size*) than non-acquired

systems. They are also more likely to offer area development agreements (*Area Development*) and to contain a franchise advisory council (*Council*). Finally, for acquired franchise systems, it is less likely that the founder (*Founder*) is still part of the executive team. *T*-tests on these variables (and *Time*) indicate that acquired franchise systems are systematically different from non-acquired franchise systems (i.e., *p*-values are all < 0.05 , except *Newness Rate* and *Time*). The right hand side of Table 3 shows that after reweighting the observations within the group of non-acquired franchise systems (i.e., the pseudo-control group), the group of non-acquired franchise systems indeed becomes virtually equal to the group of acquired franchise systems in terms of the means, standard deviations, and skewness of the variables.

Additional comparisons. We also compared the sample of acquired systems with the sample of non-acquired systems in terms of the absolute level of their fees. Given that franchisors require fees to be paid in different ways (e.g., absolute amounts vs. percentages, scaled vs. non-scaled, etc.) and that there are differences across industries, we could not include absolute fees in our models or entropy balancing procedure. However, to rule out the possibility that fees are raised post-acquisition because they were unusually low pre-acquisition, we compared the subsamples of acquired and non-acquired systems that charge franchise fees in “standard” ways. For franchise fees, the most standard procedure is for the franchisor to charge an absolute, non-scaled dollar amount, whereas for royalty and marketing fees, the most standard procedure is to charge a percentage of gross sales. We compared franchise, royalty, and marketing fees between acquired (only the pre-acquisition years) and non-acquired systems for each of the five industries in our sample, by conducting *t*-tests. Of our 15 *t*-tests, nine showed no differences, three showed higher fees for the acquired systems, and three showed higher fees for the non-acquired systems. Overall, this seems to rule out the alternative explanation that fees are

raised post-acquisition simply because they were unusually low to begin with. That is, post-acquisition fee adjustments appear to be driven by within-system organizational dynamics rather than between system competitive dynamics.

RESULTS

Table 1, 2, and 3 display correlations and descriptive statistics for the variables used in our study. Table 1 applies to our pooled sample of acquired and non-acquired franchise systems together, whereas Table 2 applies to a subsample of only acquired franchise systems. In Table 3, descriptive statistics on both acquired and non-acquired franchise systems (both pre- and post-entropy balancing) are provided. On average, the acquired franchise systems in our sample consist of approximately 241 franchise outlets, and have not changed ownership in about 12 years. In an average year, a franchise advisory council is present in 44% of the acquired systems, 41% offer area development agreements, and in 14% the founder is still part of the executive team. Regarding the parties to the acquisition, 44% of acquirers are umbrella firms, and 7% of sellers are publicly owned companies.

With respect to our variables of theoretical importance, the correlation matrices reveal that *Franchise Fee Increase*, *Royalty Fee Increase*, and *Marketing Fee Increase* are all positively correlated ($p < .05$), indicating that if one of the fees is increased, the others are also likely to be increased. We also observe positive correlation coefficients between *Post-Acquisition* and *Franchise Fee Increase* ($p < .05$ in both Tables 1 and 2) and between *Post-Acquisition* and *Marketing Fee Increase* ($p < .05$ in both Tables 1 and 2), indicating that these fees are generally more likely to be increased after acquisition than before acquisition of the franchise system. Overall, correlations among the variables are small, with a maximum variance inflation factor of

1.41, suggesting that there are no multicollinearity concerns in our sample. On average across our sample of acquired systems, franchisors increase franchise fees in 17%, royalty fees in 8%, and marketing fees in 8% of pre-acquisition system-year observations. Post-acquisition, these percentages are much higher: on average, franchise fees are increased in 27%, royalty fees in 10%, and marketing fees in 15% of system-year observations.

[Insert Tables 1-3 here]

Table 4 displays probit estimation results from the entropy balancing matched full sample for our payment-related dependent variables. The coefficient estimates on *Post-Acquisition* are positive in all of the models, providing support for H1, with the strongest overall effects being for royalty fees. The average marginal effects of *Post-Acquisition* on the probability of franchise fee increase, royalty fee increase, and marketing fee increase are 0.15, 0.05, and 0.07, respectively. Thus, on average, the probability that the franchise fee will be increased post-acquisition is 15% higher than the probability that the franchise fee will be increased pre-acquisition. For royalty and marketing fees, the probabilities of an increase are respectively 5% and 7% higher post-acquisition vs. pre-acquisition.

[Insert Table 4 here]

Table 4 also shows a positive coefficient estimate for the interaction between *Post-Acquisition* and *Area Development* on royalty fees ($p = 0.037$), with weak results for franchise and marketing fees. These results thus provide partial support for H2, although recall that we expected the strongest effects of emphasis on multiunit franchising to be on royalty fees because these are the largest franchisee payments, and franchisors are not contractually obligated to spend them in ways that benefit franchisees. The positive effect of *Area Development* on the likelihood of an increase in royalty fees post-acquisition is also economically meaningful (see

Figure 1). In franchise systems that offer area development agreements, the likelihood of an increase in royalty fees is 14% greater post-acquisition than pre-acquisition (18% vs. 4%). In franchise systems that do not offer area development agreements, the likelihood of an increase in royalty fees is only 2% greater post-acquisition than pre-acquisition (7% vs. 6%).

[Insert Figure 1 Here]

The coefficient estimates on *Post-Acquisition * Newness Rate* are negative for royalty fees ($p = 0.003$), and again the results for franchise and marketing fees are weak. The findings with respect to royalty fees thus lend partial support for H3, though again, this was expected given that royalty fees are much larger. Figure 2 shows the economic significance of the negative effect of *Newness Rate* on the likelihood of an increase in royalty fees post-acquisition: while the probability of a post-acquisition royalty fee increase is 17% when *Newness Rate* is zero, it gradually decreases to only 1% when *Newness Rate* is 2.25 (the highest value for *Newness Rate* in our sample).

[Insert Figure 2 Here]

Other results from Table 4 suggest that founders are more likely to raise franchise fees during our time period, perhaps because they were less likely to do so in earlier time periods. In addition, marketing fees are more likely to be raised in systems in which a council is present, perhaps because franchisees are less likely to oppose such increases if they have a voice in setting them. Finally, the greater the size of the franchise system, the more likely that marketing fees are raised.

Table 5 shows regressions on the unmatched subsample consisting of acquired systems only. The purpose of these regressions is to introduce a control for umbrella acquirers: firms that owned one or more franchise systems prior to acquisition. Recall that these firms may have

efficiency-related motives for raising fees post-acquisition rather than (or in addition to) avoiding entitlement constraints. The sample here is unmatched because umbrella status is undefined for non-acquired systems, making matching impossible. However, note that the concern about unobserved heterogeneity in these regressions is limited by the fact that the results in Table 5 are similar to the matched results in Table 4. The positive coefficients on *Post-Acquisition* in the Table 5 regressions indicate that our main results continue to hold after controlling for the alternative explanation that post-acquisition fee increases are based on efficiencies other than overcoming entitlement constraints.

The positive coefficient estimates on the *Umbrella* variable in Table 5's Models 1-4 indicate that umbrella firms were more likely to raise franchise fees in any year (regardless of acquisition). A reason may be because these firms were seeking to invest in capturing synergies between systems. On the other hand, the coefficient estimates on *Umbrella* in Models 9-12 are negative, perhaps because such firms are able to realize economies of scope in marketing by virtue of owning multiple franchise systems.

[Insert Table 5 here]

Robustness tests

Propensity Score Matching. To aid in the interpretation of the findings and confirm the robustness of our results, we repeated our full sample analyses using propensity score matching as an alternative multivariate matching approach. Although propensity score matching has limitations compared to entropy balancing, including the risk of increasing imbalance (instead of decreasing it) by approximating random matching, (e.g, King & Nielsen 2019) as well as dropping observations (Shi & DesJardine 2022), it is probably the most frequently used

multivariate matching approach among management scholars.¹² We therefore replicated our analyses using nearest-neighbor propensity score matching, matching acquired and non-acquired franchise systems based on their propensity scores. We calculated propensity scores using the same set of variables that we used in our entropy balancing procedure: all independent and control variables, except for *Post-Acquisition* (and *Umbrella*, given that this variable only applies to the subsample of acquired franchise systems). The results are qualitatively consistent with those in Table 4, and are shown in Table A2 in the Appendix.¹³

Impact threshold for a confounding variable (ITCV). Our theory holds that entitlement constraints are a major reason for both franchise system acquisitions and subsequent fee increases, making entitlement constraints an confounding omitted variable. Therefore, we conducted an ITCV (impact threshold for a confounding variable) test to determine the potential impact of any omitted variables on our results (Frank 2000). Because our models are nonlinear, we calculated the percentage bias that would be needed to invalidate our inferences, based on the average marginal effects (Xu, Frank, Maroulis, & Rosenberg 2019). To invalidate the inferences ($\alpha = .05$) with respect to franchise fees, royalty fees, and marketing fees, respectively 51.25% (559), 7.25% (79), and 21.79% (238) cases would have to be replaced with cases for which there is an effect of zero, which seems unlikely. Given that our Hypothesis 1 includes all three of these fees, it seems especially unlikely that the support we find is invalid. We were unable to conduct

¹² Propensity score matching caused us to lose most of our observations, and therefore should be discounted due to potential bias. We also estimated models using coarsened exact matching (CEM), but lost even more observations. We therefore do not report the CEM results here.

¹³ Decisions to raise franchise fees, royalty fees, and marketing fees may be made in conjunction with one another, which would cause the error terms in our models to be correlated. To control for this, we conducted an additional robustness check: multivariate probit regression using simulated maximum likelihood (Capellari & Jenkins 2003). Our multivariate probit model, in which we estimated the likelihood of franchise fee, royalty fee, and marketing fee increases simultaneously, provided qualitatively similar results (see Table A1 in the Appendix).

the ITCV test to validate the support we found for Hypotheses 2 and 3 because they are based on interaction terms.

Finally, we note that the fee increases following acquisition were quite large in our data, suggesting that raising them may have been an important motive for the acquisitions. On average following acquisition, franchise fees were raised from \$37,000 to \$44,500 (19%), royalty payments from .059 to .077 (30%), and marketing fees from .023 to .042 (87%).

DISCUSSION & CONCLUSION

Our analysis lends support to the idea that new owners have greater scope to change the terms of a franchise agreement than incumbent owners. The reason, we suggest, is that incumbent owners are more constrained than are new owners by their franchisees' expectations that such owners will not renege on implicit or explicit promises not to expropriate value from franchisees after franchisees have committed to a long-term written agreement. These promises are not necessarily written down, but are understood by franchisees to be bundled with the written agreement. Entitlement constraints of this kind are binding because franchisees can punish a franchisor in a variety of ways if franchisees believe that a violation has occurred. These ways include withholding effort or otherwise shading performance, and hurting the franchisor's reputation with potential future franchisees by publicizing complaints about the franchisor. Changes in contract terms are particularly salient in our context because written franchise agreements are central to franchising relations, making terms in them important reference points for franchisees' judgements about franchisor opportunism.

There are several alternative explanations for why acquirers raise fees post-acquisition, but none of them also explain why they do so more in systems that emphasize multiunit

franchising, and in systems with older franchisees. The explanation that raising fees is solely for debt financing, for example, doesn't explain these moderating effects. Another set of possibilities is that current owners fail to raise fees because they are: (i) insufficiently motivated to do so (Jensen 1989), (ii) incompetent (Foss et al. 2021), (ii) complacent (Samuelson & Zeckhauser 1988), or are (iv) retiring from the business. These explanations are implausible, however, because franchise systems are overwhelmingly privately owned and therefore motivated, and raising fees involves nothing more than changing a few numbers in the standard franchise agreement that is offered to all franchisees in a given year. Moreover, outside of a few small franchise systems, bargaining over franchise terms rarely occurs (Blair & LaFontaine 2005).¹⁴ Even complacent, incompetent, or retiring owners face zero costs of raising fees, and large gains from doing so. Unless they were constrained by entitlements, why wouldn't they do it? In any case, however, none of these possibilities can also explain the moderating effects of multiunit franchising and franchisee age that we find in our data. Explanations that account for more of the facts are of course preferred over those that explain fewer.

A third category of potential alternative explanations involves relational contracting, defined as a repeated exchange between the same two partners based on norms of reciprocity, trust, or implicit economic incentives (e.g., Macneil 1980; Zaheer & Harris 1995; Baker, Gibbons & Murphy 2002). Franchising relationships may well involve relational contracting, and such contracting may include a norm against taking actions (such as raising fees) that harm one's partner(s). Selling a franchise system may be a way of ending a relational contract that is no longer efficient, so that a new relational contract can be established with a new owner based on new terms, such as higher fees. We are not aware, however, of any relational contracting theories

¹⁴ According to a franchise attorney we interviewed, "franchisees have no say in how the contract is drafted; they can either take it or leave it (Interview, March 2, 2023)."

that make predictions regarding the outcomes of a change in the ownership of one of the partners. Moreover, this explanation begs the question of why the current owner needs to sell a system in order to end a relational contract. Unless entitlement constraints are binding, why can't a current owner establish a new relational contract based on higher fees? Thus, while relational contracts may well be operating in franchising, we suggest that an entitlement constraint component is necessary to explain our trio of empirical findings.

Future research should examine the implications of entitlement constraints in other contexts, such as those involving publicly-owned acquirers and/or targets. Another area for future research regards how the value created by acquisitions is split between franchisors and franchisees. Our finding that all major fees paid by franchisees increase following acquisition might suggest that value is simply redistributed from franchisees to acquirers. However, if franchisors invest some of the higher fees they receive back into the franchise system, some franchisees could benefit too, either in the short or long term. If the latter effect is strong enough, then overcoming entitlement constraints would be a type of "relational synergy" that franchise system acquisitions unlock. Relational synergies are defined as synergies that stem from better management of suppliers, buyers or alliance partners following a merger or acquisition (Feldman & Hernandez 2021: 556). Future research should investigate whether such synergies actually do result from acquisitions of franchise systems, and from acquisitions more generally.

Yet another area of future research suggested by this study involves acquirer heterogeneity. Different kinds of acquirers might have different approaches to splitting the value associated with overcoming entitlement constraints. Our setting is one in which all acquirers are privately owned, but some are private equity firms that raise funds from institutional investors while others are smaller private investment groups. Still others are umbrella firms that are more

or less diversified. While the larger private equity firms have been found to have investment time horizons of five years (Gompers et al. 2016), this information may be out of date, and little is known about the time horizons of smaller investment groups, larger umbrella firms, etc. Each might have a different approach to creating and capturing value from acquisitions that would be important for strategy scholars to understand.

Our study contributes to the literatures on strategy and interorganizational relationships by highlighting entitlement constraints as a behavioral factor that motivates acquisitions. This suggests a different rationale than that offered by traditional theories of acquisitions based on relatedness/complementarity and agency costs. We believe it opens up new avenues for understanding why acquisitions occur, and when they are successful.

Table 1. Descriptive statistics and Pearson correlation coefficients – Full Sample

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
(1) Post-Acquisition	1.000									
(2) Franchise Fee Increase	0.086	1.000								
(3) Royalty Fee Increase	0.027	0.153	1.000							
(4) Marketing Fee Increase	0.086	0.134	0.254	1.000						
(5) Area Development	0.028	-0.037	-0.095	-0.041	1.000					
(6) Newness Rate	-0.014	0.123	0.091	0.048	0.088	1.000				
(7) Size	0.113	0.040	0.045	0.119	0.148	-0.093	1.000			
(8) Time	0.018	-0.054	-0.071	-0.022	-0.144	-0.388	-0.001	1.000		
(9) Founder	-0.353	0.079	0.084	-0.006	-0.040	0.224	-0.153	-0.137	1.000	
(10) Council	0.108	0.073	-0.001	0.116	0.087	-0.115	0.239	0.154	-0.227	1.000
Mean	0.124	0.179	0.083	0.084	0.335	0.457	167.0	12.81	0.521	0.331
SD	0.33	0.383	0.277	0.278	0.472	0.257	236.8	10.29	0.500	0.471
Min.	0	0	0	0	0	0	1	1	0	0
Max.	1	1	1	1	1	2.250	1,957	74	1	1

Note. $N = 1,090$. Table 1 displays descriptive statistics and Pearson correlation coefficients for each variable included in our study, for the pooled sample of both acquired and non-acquired franchise systems. Correlation coefficients with absolute values > 0.070 are significant at $p < 0.05$.

Table 2. Descriptive Statistics and Pearson Correlation Coefficients – Subsample

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
(1) Post-Acquisition	1.000										
(2) Franchise Fee Increase	0.132	1.000									
(3) Royalty Fee Increase	0.093	0.184	1.000								
(4) Marketing Fee Increase	0.131	0.143	0.306	1.000							
(5) Umbrella	0.003	0.107	0.032	-0.104	1.000						
(6) Area Development	-0.061	-0.086	-0.080	-0.006	0.016	1.000					
(7) Newness Rate	-0.018	0.147	0.034	-0.031	-0.003	0.041	1.000				
(8) Size	-0.008	0.114	0.191	0.177	0.037	0.077	-0.073	1.000			
(9) Time	0.145	0.094	-0.016	-0.032	0.081	-0.256	-0.154	-0.005	1.000		
(10) Founder	-0.194	0.168	0.139	0.087	-0.175	0.032	0.179	0.195	-0.055	1.000	
(11) Council	0.047	0.169	0.079	0.127	-0.057	0.060	-0.175	0.227	0.060	-0.056	1.000
Mean	0.378	0.199	0.073	0.098	0.443	0.409	0.453	241.1	11.77	0.137	0.437
SD	0.486	0.400	0.260	0.298	0.497	0.492	0.260	295.2	8.27	0.345	0.497
Min.	0	0	0	0	0	0	0	1	1	0	0
Max.	1	1	1	1	1	1	2.250	1,957	48	1	1

Note. $N = 357$. Table 2 displays descriptive statistics and Pearson correlation coefficients for each variable included in our study, for the subsample of acquired franchise systems. Correlation coefficients with absolute values > 0.103 are significant at $p < 0.05$.

Table 3. Descriptive statistics for acquired and non-acquired franchise systems, with and without entropy balanced matching

	Full Sample										Entropy Balanced Matched Sample					
	Acquired Systems				Non-acquired Systems				Diff in means		Acquired Systems			Non-acquired Systems		
	<i>n</i>	Mean	<i>SD</i>	Skew	<i>n</i>	Mean	<i>SD</i>	Skew	Value	<i>p</i> -value	Mean	<i>SD</i>	Skew	Mean	<i>SD</i>	Skew
Area Development	357	0.41	0.49	0.37	733	0.30	0.46	0.88	0.11	0.000	0.41	0.49	0.37	0.41	0.49	0.37
Size	357	241.1	295.2	3.03	733	130.9	192.6	5.01	-111.2	0.000	4.92	1.16	-0.64	241	295.2	3.03
Time	357	11.8	8.27	1.89	733	13.3	11.1	2.20	-1.5	0.010	2.37	0.61	-0.16	11.8	8.27	1.89
Founder	357	0.14	0.34	2.11	733	0.71	0.45	-0.92	-0.57	0.000	0.14	0.34	2.11	0.14	0.35	2.10
Council	357	0.44	0.50	0.25	733	0.28	0.45	0.98	0.16	0.000	0.44	0.50	0.25	0.44	0.50	0.25

Note. Table 3 displays descriptive statistics for each of the variables that we matched on, for both the treatment group (acquired franchise systems) and the control group (non-acquired franchise systems). Descriptive statistics for each group, as well as the difference between the groups, are displayed for the full sample on the left-hand side of Table 3. *p*-values from two-tailed *t* tests are displayed. Descriptive statistics are also provided on the right-hand side of Table 3 for each group after reweighting the group of non-acquired franchise system observations in accordance with the entropy balancing approach. Differences and associated *t* tests are not displayed for the entropy balancing matched sample given that entropy balancing causes the mean differences between the groups to become insignificant.

Table 4. Probit Estimation Results – Entropy Balancing

	Franchise Fee Increase			Royalty Fee Increase			Marketing Fee Increase					
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Post-Acquisition * Newness Rate			0.140 (0.802)	0.146 (0.793)			-1.851 (0.003)	-1.983 (0.002)			-0.313 (0.664)	-0.347 (0.641)
Post-Acquisition * Area Development		-0.307 (0.313)		-0.308 (0.312)		0.891 (0.037)		0.912 (0.030)		0.382 (0.273)		0.387 (0.266)
Post-Acquisition	0.641 (0.000)	0.744 (0.000)	0.576 (0.064)	0.677 (0.042)	0.403 (0.061)	0.094 (0.710)	1.246 (0.000)	0.984 (0.009)	0.429 (0.017)	0.290 (0.207)	0.561 (0.101)	0.434 (0.239)
Area Development	0.316 (0.069)	0.386 (0.045)	0.315 (0.070)	0.385 (0.045)	0.008 (0.964)	-0.241 (0.312)	0.014 (0.938)	-0.242 (0.309)	-0.083 (0.653)	-0.190 (0.374)	-0.082 (0.658)	-0.190 (0.374)
Newness Rate	0.507 (0.057)	0.520 (0.048)	0.472 (0.111)	0.484 (0.101)	0.714 (0.019)	0.721 (0.023)	1.134 (0.001)	1.129 (0.002)	-0.062 (0.866)	-0.083 (0.828)	0.026 (0.953)	0.011 (0.980)
Size	0.000 (0.480)	0.000 (0.471)	0.000 (0.485)	0.000 (0.477)	0.000 (0.115)	0.000 (0.118)	0.000 (0.096)	0.000 (0.113)	0.001 (0.003)	0.001 (0.002)	0.001 (0.003)	0.001 (0.002)
Time	0.000 (0.972)	-0.000 (0.966)	0.000 (0.975)	-0.000 (0.963)	0.005 (0.609)	0.007 (0.453)	0.005 (0.579)	0.007 (0.421)	0.006 (0.505)	0.007 (0.429)	0.006 (0.512)	0.007 (0.435)
Founder	0.455 (0.007)	0.437 (0.010)	0.459 (0.007)	0.440 (0.010)	0.101 (0.617)	0.168 (0.416)	0.053 (0.794)	0.128 (0.544)	0.237 (0.205)	0.275 (0.136)	0.230 (0.222)	0.269 (0.147)
Council	0.293 (0.047)	0.304 (0.039)	0.295 (0.047)	0.306 (0.039)	0.095 (0.563)	0.072 (0.661)	0.078 (0.637)	0.057 (0.733)	0.574 (0.001)	0.560 (0.001)	0.571 (0.001)	0.557 (0.001)
Constant	-1.776 (0.001)	-1.787 (0.001)	-1.761 (0.001)	-1.771 (0.001)	-2.868 (0.000)	-2.844 (0.000)	-3.121 (0.000)	-3.103 (0.000)	-2.019 (0.000)	-1.999 (0.000)	-2.054 (0.000)	-2.037 (0.000)
Industry Dummies	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Year Dummies	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Observations	1,090	1,090	1,090	1,090	1,090	1,090	1,090	1,090	1,090	1,090	1,090	1,090
Log Pseudolikelihood	-249.0	-248.5	-249.0	-248.5	-143.9	-141.3	-141.2	-138.6	-188.8	-188.2	-188.7	-188.1
Wald χ^2	100.2	104.7	101.2	105.3	67.26	81.94	78.18	87.87	63.78	65.06	64.22	65.50

Robust *p*-values reported in parentheses.

Table 5. Probit Estimation Results – Subsample

	Franchise Fee Increase				Royalty Fee Increase				Marketing Fee Increase			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Post-Acquisition * Newness Rate			0.065 (0.900)	0.043 (0.933)			-1.789 (0.024)	-1.922 (0.029)			-0.709 (0.332)	-0.706 (0.348)
Post-Acquisition * Area Development		-0.291 (0.320)		-0.290 (0.325)		2.699 (0.006)		2.737 (0.005)		0.325 (0.371)		0.322 (0.371)
Post-Acquisition	0.510 (0.057)	0.604 (0.048)	0.480 (0.182)	0.583 (0.145)	0.692 (0.016)	0.183 (0.611)	1.528 (0.000)	1.023 (0.020)	0.576 (0.046)	0.454 (0.185)	0.888 (0.007)	0.764 (0.045)
Area Development	0.087 (0.682)	0.194 (0.434)	0.086 (0.683)	0.193 (0.434)	-0.219 (0.425)	-2.000 (0.011)	-0.182 (0.517)	-2.001 (0.013)	0.238 (0.374)	0.086 (0.791)	0.236 (0.380)	0.086 (0.793)
Newness Rate	0.582 (0.051)	0.600 (0.048)	0.560 (0.032)	0.585 (0.032)	0.156 (0.654)	-0.022 (0.953)	0.756 (0.120)	0.470 (0.339)	-0.111 (0.835)	-0.111 (0.838)	0.176 (0.755)	0.162 (0.780)
Umbrella	0.338 (0.037)	0.327 (0.045)	0.340 (0.040)	0.328 (0.049)	0.108 (0.608)	0.277 (0.286)	0.058 (0.783)	0.243 (0.336)	-0.474 (0.041)	-0.465 (0.046)	-0.498 (0.038)	-0.488 (0.042)
Size	0.000 (0.360)	0.000 (0.380)	0.000 (0.358)	0.000 (0.379)	0.001 (0.014)	0.001 (0.024)	0.001 (0.014)	0.001 (0.026)	0.001 (0.007)	0.001 (0.007)	0.001 (0.007)	0.001 (0.007)
Time	0.012 (0.149)	0.012 (0.149)	0.012 (0.149)	0.012 (0.149)	-0.013 (0.358)	-0.015 (0.260)	-0.012 (0.402)	-0.015 (0.314)	-0.006 (0.684)	-0.005 (0.700)	-0.006 (0.691)	-0.005 (0.709)
Founder	0.667 (0.000)	0.646 (0.001)	0.670 (0.000)	0.648 (0.000)	0.379 (0.294)	0.551 (0.113)	0.323 (0.373)	0.515 (0.149)	0.014 (0.969)	0.040 (0.912)	-0.016 (0.965)	0.011 (0.976)
Council	0.524 (0.005)	0.533 (0.005)	0.525 (0.006)	0.534 (0.006)	0.150 (0.481)	0.081 (0.693)	0.127 (0.559)	0.064 (0.758)	0.330 (0.156)	0.323 (0.172)	0.322 (0.173)	0.314 (0.188)
Constant	-2.343 (0.000)	-2.355 (0.000)	-2.333 (0.000)	-2.349 (0.000)	-1.591 (0.002)	-1.399 (0.078)	-1.967 (0.000)	-1.823 (0.028)	-2.472 (0.000)	-2.431 (0.000)	-2.601 (0.000)	-2.559 (0.000)
Industry Dummies	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Year Dummies	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Observations	339	339	339	339	339	339	339	339	339	339	339	339
Log Pseudolikelihood	-131.7	-131.4	-131.7	-131.4	-70.98	-64.51	-69.46	-63.13	-94.20	-93.91	-93.89	-93.61
Wald χ^2	90.51	95.66	98.11	101.5	76.12	74.53	87.46	106.5	77.06	79.48	86.44	88.04

Robust *p*-values reported in parentheses.

Figure 1. Predictive margins of Post-Acquisition * Area Development

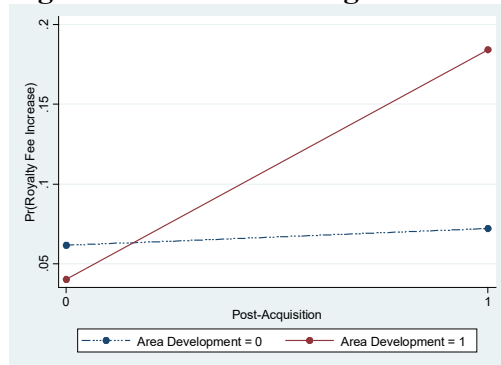
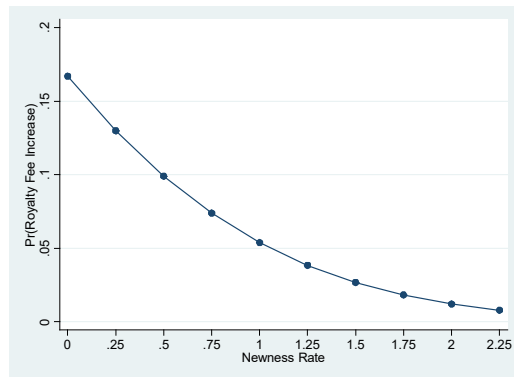


Figure 2. Predictive margins of Post-Acquisition * Newness Rate



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APPENDIX

Table A1: Multivariate Probit Estimation Results – Full Sample

	Franchise Fee Increase	Royalty Fee Increase	Marketing Fee Increase
Post-Acquisition	0.567 (0.000)	0.425 (0.036)	0.397 (0.019)
Area Development	0.154 (0.300)	-0.345 (0.024)	-0.223 (0.164)
Newness Rate	0.36 (0.079)	0.363 (0.082)	0.327 (0.217)
Size	0.060 (0.212)	0.067 (0.276)	0.173 (0.010)
Time	-0.044 (0.637)	-0.034 (0.731)	-0.085 (0.463)
Founder	0.312 (0.010)	0.285 (0.047)	0.091 (0.537)
Council	0.196 (0.098)	0.051 (0.711)	0.374 (0.010)
Constant	-1.553 (0.000)	-1.708 (0.000)	-2.685 (0.000)
Industry Dummies	YES		
Year Dummies	YES		
Log Pseudolikelihood	-1014.94		
Wald χ^2	235.9 (0.000)		
Test of $\rho = 0$	30.77 (0.000)		

Note. $N = 1,090$. p -values reported in parentheses. Standard errors clustered by target (not reported).

Table A2. Probit Estimation Results – Propensity Score Matching

	Franchise Fee Increase			Royalty Fee Increase			Marketing Fee Increase					
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Post-Acquisition * Newness Rate			-0.576 (0.340)	-0.582 (0.335)			-2.147 (0.006)	-2.316 (0.008)			-0.961 (0.192)	-0.902 (0.238)
Post-Acquisition * Area Development		-0.172 (0.616)		-0.178 (0.601)		2.092 (0.002)		2.065 (0.002)		0.873 (0.032)		0.849 (0.034)
Post-Acquisition	0.679 (0.000)	0.728 (0.001)	0.937 (0.005)	0.990 (0.006)	0.473 (0.054)	-0.007 (0.983)	1.394 (0.001)	0.968 (0.039)	0.558 (0.005)	0.273 (0.261)	0.966 (0.008)	0.661 (0.090)
Area Development	0.164 (0.447)	0.203 (0.393)	0.172 (0.426)	0.213 (0.373)	-0.307 (0.219)	-1.18 (0.022)	-0.275 (0.279)	-1.127 (0.025)	-0.047 (0.811)	-0.315 (0.221)	-0.034 (0.864)	-0.295 (0.244)
Newness Rate	0.800 (0.005)	0.802 (0.005)	0.940 (0.004)	0.943 (0.004)	0.430 (0.196)	0.324 (0.344)	0.893 (0.027)	0.751 (0.073)	0.329 (0.345)	0.299 (0.410)	0.578 (0.143)	0.518 (0.205)
Size	-0.000 (0.651)	-0.000 (0.637)	-0.000 (0.680)	-0.000 (0.667)	0.000 (0.288)	0.001 (0.108)	0.000 (0.224)	0.001 (0.095)	0.000 (0.129)	0.000 (0.082)	0.000 (0.101)	0.000 (0.068)
Time	0.011 (0.154)	0.011 (0.158)	0.012 (0.135)	0.012 (0.139)	0.002 (0.811)	0.003 (0.720)	0.004 (0.659)	0.006 (0.572)	0.010 (0.280)	0.011 (0.227)	0.011 (0.241)	0.012 (0.198)
Founder	0.449 (0.029)	0.441 (0.033)	0.433 (0.035)	0.424 (0.041)	0.128 (0.656)	0.196 (0.516)	0.072 (0.803)	0.141 (0.641)	-0.051 (0.834)	0.015 (0.950)	-0.074 (0.756)	-0.007 (0.978)
Council	0.253 (0.108)	0.254 (0.107)	0.244 (0.123)	0.245 (0.122)	0.280 (0.200)	0.333 (0.123)	0.252 (0.252)	0.312 (0.154)	0.466 (0.013)	0.469 (0.014)	0.452 (0.016)	0.455 (0.016)
Constant	-1.998 (0.000)	-1.991 (0.000)	-2.073 (0.000)	-2.067 (0.000)	-2.213 (0.000)	-2.366 (0.000)	-2.536 (0.000)	-2.704 (0.000)	-2.821 (0.000)	-2.890 (0.000)	-2.972 (0.000)	-3.022 (0.000)
Industry Dummies	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Year Dummies	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Observations	489	489	489	489	489	489	489	489	489	489	489	489
Log Pseudolikelihood	-222.6	-222.4	-222.2	-222.0	-126.9	-118.6	-124.0	-116.1	-170.2	-167.4	-169.4	-166.7
Wald χ^2	77.84	79.77	76.91	78.81	58.80	52.41	76.87	72.46	52.26	52.02	51.84	52.17

Robust *p*-values reported in parentheses.