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The indirect effects of tipping policies on patronage intentions through perceived expensiveness, fairness, and quality

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ABSTRACT

Many service firms allow their employees to be directly compensated by customers via the institution of tipping despite the fact this practice exposes firms to substantial risks, such as collusion between employees and customers against the firm. This paper examines a potential reason businesses may accept these risks. Specifically, it reports on a study finding that voluntary tipping policies increase potential demand by reducing perceived expensiveness, increasing perceived tipping policy fairness, and increasing a-priori expectations of service quality.

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1. Introduction

Most companies fully control the compensation of their employees, but many service firms give up this control by allowing consumers to directly reward staff via the institution of tipping. Commonly tipped occupations include bartenders, beauticians, cab drivers, casino croupiers, concierges, delivery drivers, doormen, exotic dancers, maitre'ds, musicians, parking valets, porters, tour guides, and waiters/waitresses (Star, 1988). Although the amount given by a single customer to any one worker is usually modest, it is not negligible. Depending on the country in which the service occurs, tips to restaurant

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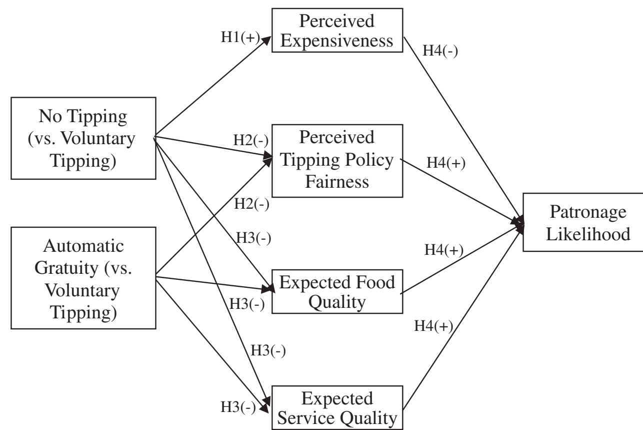

Fig. 1. Model of tipping policy effects.

workers (when given) often represent 10–16% of the bill amounts paid to the restaurant and tips to taxicab drivers (when given) represent 7–12% of the fare amounts paid to the taxicab firm (Lynn & Lynn, 2004). For a given worker in the United States, the sum of tips received from all customers often exceeds forty percent of his or her total compensation (Payscale, 2009). Furthermore, across all service workers, the total amount tipped annually in the United States and Canada alone has been estimated at over $40 billion (Azar, 2009).

The prevalence of tipping is puzzling from an economics and business perspective, because having customers directly compensate employees exposes the firm to substantial risks. First, tipping makes employees agents of the customer as well as of the firm. This can create role conflict as employees struggle to meet the competing demands of customers and managers (Eddleston, Kidder, & Litzky, 2002) and can lead to collusion between customers and employees against the interest of the firm. As an example of the latter possibility, waitresses may refill drinks at no extra charge to the customer in an effort to get larger tips. Second, compensation via tips motivates employees to deliver poor service to customers perceived to be poor tippers, which can result in lawsuits and the loss of business from those customers discriminated against (Lynn, 2004).

In the United States, tipping exposes firms to additional risks. Specifically, it increases the firm's risk of fines and penalties from non-compliance with employment-tax obligations, because employees often under-report their tip income (Lynn & Withiam, 2008). In addition, tipping exposes firms to potential employment discrimination lawsuits, because black employees sometimes receive lower tips than white employees doing comparable work (Ayres, Vars, & Zakariya, 2005; Lynn & et al., 2008). This pay discrimination represents an adverse impact that may be unlawful under Title VII of the Civil Rights Act of 1964 and companies may be legally responsible for the resultant pay discrimination, even though it is the customers who are making the discriminatory pay decisions (Lynn & Withiam, 2008).

These business risks associated with tipping raise a question about why tipping exists. What possible benefits could tipping provide to firms that lead them to accept the risks involved? One answer to this question is that tipping motivates workers to deliver better service. The intangible and customized nature of certain services means that service customers are often in a better position than firms to know what they want in the way of service and how well a service worker performs, so customers can often monitor and reward service-employee behavior more efficiently than can firms (Azar, 2004; Ben-Zion & Karni, 1977; Jacob & Page, 1980; Kwortnik, Lynn, & Ross, 2009). As a result, service firms leave these monitoring tasks to their customers via the institution of tipping. Consistent with this idea, recent research has found that most servers perceive at least a moderately strong relationship between tips and service and that tipping does motivate servers to deliver better service (Kwortnik et al., 2009).

A second explanation advanced for the existence of tipping is that it helps firms to attract and retain better and more motivated workers (Schotter, 2000). Service managers often have inadequate information about the ability and motivation of job applicants while prospective employees often have a good idea of their own ability and motivation levels. As a performance-contingent form of compensation, tipping takes advantage of this information asymmetry by providing top performers an incentive to self-select into tipped positions and poor performers an incentive to self-select out of tipped positions. Consistent with this reasoning, a recent study found that servers with more positive service attitudes liked working for tips more, earned larger tips, and stayed in tipped occupations longer than did servers with poor service attitudes (Lynn, Kwortnik, & Sturman, 2011).

In this paper, we advance and empirically test additional explanations of why service firms may embrace tipping despite its many drawbacks from an organizational and human resources perspective. Our explanations focus not on tipping's role as a form of employee compensation, but on its role as form of pricing. Pricing affects consumer behavior through its effects on perceived cost/sacrifice (Zeithaml, 1988), perceived procedural and outcome fairness (Maxwell, 2002), and perceived product quality (Zeithaml, 1988). We draw on these effects and argue that tipping is a form of partitioned and voluntary pricing that increases demand (patronage intentions) by affecting consumers' perceptions of expensiveness, fairness, and quality. These ideas are depicted in Fig. 1 and more fully developed in the paragraphs that follow.

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