THE ECONOMICS & ETIQUETTE OF TIPPING

Tipping is common in the US. **Steen Videbeck** has looked at economic research on tipping to see whether it has benefits.

To the uninitiated, the act of tipping can be a somewhat confusing experience. There are entire books offering advice on when to tip (it is polite to tip at restaurants but not required at fast food outlets); on how much to tip (usually between 15-20% depending on the quality of service); and even, believe it or not, on the mechanics of giving the tip (including single or double handshakes and various oddly named techniques like the peel, agent, and signal methods).[1] Yet, however complicated the etiquette, many believe that tipping is actually an important way to reduce what economists refer to as the principal-agent problem.

To illustrate this, consider a restaurant owner (the principal) who hires waiters and waitresses (the agents) to serve customers food in a timely and pleasant manner—that is, to take actions on the owner's behalf.[2] Direct monitoring of the employee's effort may be difficult and/or costly (think of following an employee around all day). But without this monitoring the employee may take advantage of the information asymmetry and shirk. So in order to motivate the employee to work hard, the owner may tie their pay to some easily observed output. Such compensation contracts are commonly used in many professions, from executives to salespeople. For example, a CEO's salary may be related to the share price of the firm they manage, so that they have an incentive to work hard and raise the share price.

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Tipping follows a similar rationale. While the owner of the restaurant finds it difficult to observe the effort of the waiting staff, customers are in an excellent position to do so. Thus the owner provides a lower base wage (presumably offering the meal at a lower price) and relies on the customer to choose their own service charge based on the quality of the service they believe they've received. This reduces monitoring costs, creating savings that in a competitive market will be passed on to consumers and provides the employee with a monetary incentive to provide a high-quality service, something that both the owner and the customer desire. Furthermore, as most customers tip a percentage of the bill size rather than a fixed amount (so-called 'flat tippers' are estimated to account for only 20% of the population)[3] the server also has incentive not only to provide high quality service, in order to maximise the tip percentage, but also to increase the bill size—which owners also desire.

Employees who are naturally talented servers may also have much to gain from tipping. In theory, tipping can lead to an efficient match between workers' attitudes to service and the jobs they perform. To see how, suppose that potential waiters can be classified into two types: naturally friendly ones (who enjoy helping customers, or who at least don't find doing so too taxing) and naturally grumpy ones. In a world without tipping, both groups of waiters are pooled together and (if their employers are to break even) paid a wage that reflects their 'average' service levels. This gives the friendly waiters no incentive to provide good service—and it might even be impossible to tell the friendly waiters from the grumpy ones. Overall, the quality of service falls. With tipping, a separating equilibrium may result which sees the two types of waiters classified into different camps. Friendly waiters will go the extra mile, earn their tip, and receive a relatively high income; grumpy waiters will assess the money they can earn by tipping and decide it is not worth it—they will forgo potential tips in return for an easier day at work. If 'tipless' wages are sufficiently low, then grumpy waiters might actually choose to exit the industry and take jobs that would better suit their personalities.

Contrast this with New Zealand and Australia, where service employees generally receive a set wage and thereby have little incentive to 'go the extra mile' especially if the additional effort will not be noticed (and rewarded) by their employer. So should Australia and New Zealand follow the United States example and embrace the custom of tipping? And if so, are many establishments in Europe, the traditional home of tipping, making a mistake by replacing tips with incentiveless fixed gratuities? To help answer these questions, it is useful to examine the reasoning behind why people tip.

In a consumer world of specials, sales, bargains, and markdowns, the act of tipping is something of an anomaly. Consumers actually choose to pay more than the contract they entered into requires—behaviour seemingly at odds with the traditional economic assumption of a rational consumer who cares only about their own consumption of goods and services. One popular theory that could reconcile the two is repeat custom—where the tip is paid to help ensure good service (or to avoid retaliation such as food tampering) in the future. Unfortunately, this theory doesn't explain why many customers tip even when they never intend to visit the establishment again (or why, for that matter, people tip bus boys when they leave the hotel).

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An alternative possibility is that consumers derive satisfaction from sources in addition to their own consumption. For example, customers may tip in order to experience the positive feelings that come from showing compassion for the low-income worker. Yet the reason for tipping need not be entirely altruistic. The most widely supported theory states that people tip simply to avoid the considerable stigma that accompanies 'stiffing' (not leaving a tip)—a kind of selfish economic agent with feelings.

Unfortunately this strong reluctance to violate the social norm of tipping could actually negate, or even eliminate tipping's capacity to help reduce the principal-agent problem. If customers, in their desire not to appear cheap (or because of an overwhelming desire to leave a tip in order to feel compassion), choose to leave the same tip irrespective of the level of service, then the monetary incentive to provide a higher level of service is removed and the principal-agent problem is again present.

In order to ascertain whether tipping does provide an incentive for employees to provide a better service, a number of empirical studies have examined whether there is a positive relationship between the quality of service and the amount the customer tips. These studies typically consist of either: exit interviews, where the customer is asked about the quality of service they received; or use manipulated waiters/waitresses, who are instructed to display certain types of behaviour while serving. This qualitative data is then compared with collected quantitative data (tip size, number of diners, total bill size, etc) in order to see if statistically significant relationships emerge. Another approach is to use questionnaires, which ask people how much they would tip in different hypothetical situations.

Other peculiar tip-inducing behaviour includes squatting at the table, drawing a smiley face on the bill, forecasting good weather, telling a joke, and wearing a flower in your hair.

It's important to note that the approaches used to investigate tipping are not immune from criticism. Hypothetical questionnaires are perhaps the least reliable, as people are likely to 'talk tough' but act weak i.e. say they would withhold the tip if they receive bad service and then back out when confronted with the real situation. Exit interviews, while probably more reliable, have to contend with the stigma of not tipping. For example, consumers who didn't tip because they are cheap are inclined to say they did so because of bad service in order to avoid to stigma of being stingy. Server manipulation, while being a very useful way to look at whether specific behaviours influence the size of the tip, are less effective in accessing the overall impact of service quality.

Unfortunately for tipping, a number of studies point toward a positive but weak relationship between service quality and the amount tipped. For example, a study by Cornell University Professor Michael Lynn and Ithaca College Professor Michael McCall, combined the results of 13 studies using exit interviews of 2,547 dining parties at 20 different restaurants and found that the correlation between tip percentage and service ratings was only 0.11—that is service quality explained, on average, only a very small proportion of the variation in tip percentages.[4] Also worrying, was that they found that tips were not related to servers' or third parties' evaluations of service. Another study by Professor Michael Lynn, this time with fellow Cornell University Professor Ted O'Donoghue and Professor Michael Conlin from Syracuse University, looked at the tipping behaviour of 1,393 dining parties in 39 restaurants in Houston, Texas, and found that one point increase in service quality increased the tip by only 1.5% of the total bill—not very encouraging considering that the study used only a five point scale. The correlation between tip percentage and service ratings was even lower in this study, only 0.07.[5] These results are important as they call into question whether tipping provides strong enough incentives to improve service quality.

Furthermore, some studies find factors that affect the size of a tip which seem to have little to do with the principal-agent problem. For example, one study reports that lightly touching customers when returning change increases the tip size.[6] Beware too the innocent piece of candy that arrives with your bill as it may be a strategy to elicit a higher tip—one study found that customers who received a small piece of candy give larger tips that those who did not; and that the tip size was related to the size of candy.[7] Other peculiar tip-inducing behaviour[8] includes squatting at the table, drawing a smiley face on the bill, forecasting good weather,[9] telling a joke, and wearing a flower in your hair.

So, while tipping in theory seems to offer a clever solution to the principal-agent problem, in practice it is not clear whether it offers much of a solution at all— ironically, for the very reason that many believe the custom continues. In any case maybe it's a good thing that we haven't embraced the tipping custom in Australia and New Zealand. One study found that tipping is more likely to be a custom in more 'neurotic' countries![10]

Endnotes

1 Mark L. Brenner, *Tipping for Success: Secrets for How to Get In and Get Great Service* (Sherman Oaks, California: Brenmark House, 2001).

2 Other tip-receiving professions include hairdressers, supermarket baggers, taxi drivers, delivery people, and doormen.

3 Tibbett Speer, 'The Give and Take of Tipping', *American Demographics*, February (1997), pp. 51-54.

4 Michael Lynn and Michael McCall, 'Gratitude and gratuity: a meta-analysis of the research on the service tipping relationship' *Journal of Socio-Economics*, 29 (2000), pp. 203-214.

5 Michael Conlin, Ted O'Donohue and Michael Lynn, 'The Norm of Restaurant Tipping', *Journal of Economic Behavior and Organization* 52 (2003), pp. 297-321.

6 April H Crusco and Christopher G Wetzel, 'The Midas Touch: The Effects of Interpersonal Touch on Restaurant Tipping', *Personality and Social Psychology Bulletin* 10(4) (1984), pp. 512-517.

7 David Strohmetz, Bruce Rind, Reed Fisher and Michael Lynn, 'Sweetening the Till: The Use of Candy to Increase Restaurant Tipping', *Journal of Applied Social Psychology*, 32(2) (2002), pp. 300-309.

8 For more on tip-inducting behavior see Michael Lynn, 'Seven Ways to Increase Your Servers Tips.' *Cornell HRA Quarterly*, 37 (June 1996), pp. 24-29.

9 Bruce Rind and David Strohmetz, 'Effects of Beliefs about Future Weather Conditions on Tipping', *Journal of Applied Social Psychology* 31 (2001), pp. 2160-2164.

10 Michael Lynn 'National Personality and Tipping Customs', *Personality and Individual Differences* 28(2) (2000), pp. 395-404.