

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.

Key words: tipping; employee compensation; pricing; consumer perceptions; fairness

## The Indirect Effects of Tipping Policies on Patronage Intentions Through Perceived Expensiveness, Fairness, and Quality

### 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 workers (when given) often represent 10 to 16 percent of the bill amounts paid to the restaurant and tips to taxicab drivers (when given) represent 7 to 12 percent of the fare amounts paid to the taxicab firm (Lynn and 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, and 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 and 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, and 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 and 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 and Karni, 1977; Jacob and Page, 1980; Kwortnik, Lynn, and 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, Lynn, and Ross, 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 and 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 Figure 1 and more fully developed in the paragraphs that follow. Then, they are tested in an online experiment that examines the effects of restaurant tipping policies (voluntary tipping vs. service inclusive pricing vs. mandatory service charges) on the perceived expensiveness of the restaurant, the perceived fairness of the restaurant's policies, the expected quality of the restaurant's food and service, and the likelihood of patronizing the restaurant. Finally, the theoretical and practical implications of the findings are discussed along with directions for future research.

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Insert Figure 1 about here

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## 2. Literature Review and Hypotheses

### 2.1. Tipping as Price Partitioning

In restaurants, service inclusive pricing presents consumers with a single price for the food and service, while voluntary tipping presents them with separate or partitioned prices for the food and the service.<sup>1</sup> By charging separately for food and service, restaurants with voluntary tipping can lower their menu prices relative to restaurants with

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<sup>1</sup> Service charges that are automatically added to the bill also present consumers with partitioned prices, so restaurants with automatic service charges should also be perceived as less expensive than restaurants with service inclusive menu pricing. However, the focus of this paper is on voluntary tipping rather than service charges, so service charges are not included in our discussion and hypothesis about partitioned vs all-inclusive pricing effects on perceived restaurant expensiveness. Automatic service charges will be contrasted with voluntary tipping in other discussions and hypotheses.

service inclusive pricing (Lynn and Withiam, 2008).<sup>2</sup> If consumers evaluate restaurant expensiveness by comparing menu prices, then restaurants with voluntary tipping will enjoy a competitive edge on this dimension. This competitive advantage accrues even if consumers mentally adjust their evaluations of menu prices to take into account the presence of additional costs at restaurants with voluntary tipping because consumers tend to make insufficient adjustments so their final judgments remain biased by their initial ones (see Morwitz, Greenleaf, and Johnson, 1998; Yadav, 1994). Of course, consumers could avoid this bias by calculating the sum of all the food and service costs at restaurants with voluntary tipping and comparing that sum against the menu prices of restaurants with service inclusive pricing. However, consumers are unlikely to do this because they tend to be cognitive misers (Garbarino and Edell, 1997) with weak math skills (Lipkus, Samsa, and Rimer, 2001). Thus, consumers are likely to anchor their evaluations of restaurant expensiveness on menu prices and to subjectively adjust those evaluations either upward under voluntary tipping policies or downward under service-inclusive pricing policies. In either case, the adjustment is likely to be insufficient, so that equivalent total costs will be perceived as lower under voluntary tipping than under service-inclusive pricing (see Morwitz, Greenleaf, and Johnson, 1998; Yadav, 1994).

This reasoning suggests that:

*H1: Consumers will perceive restaurants with voluntary tipping as less expensive than restaurants with “no tipping allowed” policies combined with 15 percent higher menu prices (i.e., restaurants with service-inclusive menu pricing).*

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<sup>2</sup> This fact, together with the 15 percent restaurant tipping norm, is the reason that restaurant menus with service inclusive pricing have 15 percent higher menu prices than restaurants with voluntary tipping in the study reported below. On the other hand, restaurants with voluntary tipping and restaurants with automatic service charges have the same menu prices in the study reported below, because both policies separate the costs of food from the costs of services and, therefore, permit lower menu pricing.

Thus far, our analysis offers a potential explanation of why restaurants would partition prices via voluntary tips rather than practice service inclusive pricing. However, prices can also be partitioned using automatic service charges and the previous analysis does not help explain why restaurateurs would favor voluntary tipping over this other form of price partitioning. To explain the use of tips over service charges, we look at tipping as a form of voluntary pricing.

## 2.2. Tipping as Voluntary Pricing

Voluntary pricing (also known as Pay-What-You-Want pricing) is allowing the customer to set the price paid for a good or service. Since tips are a payment for services and tip amounts are determined by consumers themselves, tipping can be seen as a form of voluntary pricing. This voluntary nature of tipping may make it seem fairer to consumers than are either mandatory service charges or service inclusive pricing (with prohibitions on tipping).<sup>3</sup> Voice (or meaningful input) is an important component of procedural justice (Anand, 2001; Diller, 2008) and the voluntary nature of tipping gives the consumer voice in a way that mandatory service charges and service inclusive pricing do not, so tipping should enhance perceived procedural fairness relative to these other policies. In fact, tipping is a particularly powerful form of voice because it puts the consumer in complete control; allowing him or her to determine the value of the services received and to compensate the server accordingly. In this way, tipping allows consumers to maintain equity in their exchanges with servers (Adams, 1964; Walster, et. al., 1973) while mandatory service charges and service inclusive pricing do not. Thus, tipping

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<sup>3</sup> Fairness is defined here as a judgment that about the reasonableness and justness of an outcome and/or the process used to achieve it (see Bolton, Warlop and Alba, 2003, for a similar definition).

should also enhance the perceived likelihood of distributive justice. Together, these considerations suggest that:

*H2: Consumers will perceive voluntary tipping policies as fairer than mandatory service gratuity policies and service inclusive pricing policies that prohibit tipping.*

The voluntary nature of tipping may also enhance a-priori expectations about food and service quality because giving customers an opportunity to lower the price they pay for a dining experience if they find that experience unsatisfactory signals a high degree of confidence on the part of the restaurant that it can deliver a satisfactory experience. In essence, tipping acts as a guarantee of food and service quality (Lynn and Lynn, 2004) and the mere existence of that guarantee may raise consumers' a-priori confidence in the restaurant (Hogreve and Gremler, 2009). Tipping may also enhance a-priori service expectations in the United States because many U.S. consumers think of tips as a reward for service and believe that this reward system motivates servers to do a good job (Mill and Riehle, 1987). These lines of thought suggest that:

*H3: Consumers will expect the food and service at restaurants with voluntary tipping to be better than those at comparable restaurants with mandatory service gratuities or with service inclusive pricing policies that prohibit tipping.*

### 2.3. Tipping Effects on Demand

Demand generally declines with perceived expensiveness (Bijmolt, VanHeerde and Pieters, 2005) and increases with transaction fairness (Carr, 2007; Martin, Ponder and Lueg, 2009) and perceived quality (Cronin, Brady and Hult, 2000). Thus, tipping's

reduction of perceived expensiveness and its enhancement of perceived fairness and of quality expectations should, in turn, increase demand. This reasoning suggests that:

*H4: The effects of voluntary tipping on consumers' perceptions of a restaurant's expensiveness, food and service quality, and tipping policy fairness will in turn increase consumers' likelihood of patronizing the restaurant.*

### 3. Method

#### 3.1. Overview

Study participants, who came from the United States, were given information (an exterior photo, interior photo, and menu) about two hypothetical restaurants and were asked to rate each in turn on a variety of dimensions. The first restaurant was identical across all participants and was used to provide a common comparison point for evaluations of the second restaurant. After reading about and evaluating the first restaurant, participants read about and evaluated the second restaurant. The second restaurant varied across participants with respect to tipping policies, which were described at the bottom of the restaurant's menu. There were three tipping policies – (i) voluntary tipping, (ii) a 15 percent automatic gratuity, and (iii) no tipping allowed (with a 15 percent surcharge built into the menu prices). Participants were asked to rate the perceived expensiveness, food and service quality, and décor of the restaurants as well as the perceived fairness of the second restaurant's tipping policies. Then they were asked how likely they would be to go to the restaurants.

#### 3.2. Participants

Four-hundred ninety-five Mechanical Turk workers from the United States completed our online experiment for a small monetary payment. Of the participants, 49%

were women and 81% were Caucasian. Their ages ranged from 18 to 82, with the average being 31. One percent of the participants had only some education, 10% were only high school graduates, 37% had some college, 41% were college graduates, and 11% had done post-graduate work. Twenty-four percent of the participants earned less than \$25,000 a year, 33% earned between \$25,001 and \$50,000, 31% earned between \$50,001 and \$100,000, and 12% earned more than \$100,000 a year. They reported dining out at full-service restaurants an average of four times per month, with a low response of zero time per month and a high response of 50 times per month. Thus, our sample, though not representative of the population, was a diverse set of restaurant patrons in the United States.

### 3.3. Stimuli

The two hypothetical restaurants in this study were mid-scale, full-service restaurants. For each restaurant, we presented an exterior photo, an interior photo, and a menu consisting of three categories: Appetizer, Entrée and Beverages. The pictures and menu items associated with a particular restaurant as well as the sequence in which the restaurants were presented remained the same across all participants and conditions.

The first restaurant's menu made no mention of a tipping policy, thus implying that the customary 15 to 20 percent tipping norm applied at that restaurant. The bottom of the second restaurant's menu contained one of the following randomly selected statements, which constituted our manipulation of different tipping policies -- (i) "Tipping 15% of the Bill is Customary," (ii) "A 15 % Gratuity (or Service Charge) will be Added to the Bill," and (iii) "No Tipping – Employees are Not Allowed to Accept Tips." In the "no tipping" condition, menu prices were 15 percent higher than in the

other conditions. These tipping policy conditions were dummy coded into two variables – no tipping (yes = 1, no = 0) and automatic gratuities (yes = 1, no = 0) -- so that each was contrasted with voluntary tipping in the regression analyses reported below.

Participants looked at the information about restaurant A and then rated the restaurant using the following scales in this order – (i) “I think restaurant A is: very inexpensive 1 2 3 4 5 6 7 very expensive,” (ii) “I expect that the food quality at restaurant A is: very low 1 2 3 4 5 6 7 very high,” (iii) “I expect that the service quality at restaurant A is: very low 1 2 3 4 5 6 7 very high,” (iv) “I think the decor of restaurant A is: very unattractive 1 2 3 4 5 6 7 very attractive,” and (v) How likely would you go to restaurant A: very unlikely 1 2 3 4 5 6 7 very likely.” After rating restaurant A, participants were shown the information about restaurant B and asked to rate it using the previously described scales plus one new scale (“I think the tipping policy used at restaurant B is: very unfair 1 2 3 4 5 6 7 very fair”) that appeared right after the expensiveness rating.

After going through the stimulus materials and rating both of the restaurants, participants were asked to answer a final, end-of-experiment set of questions designed to help describe the sample and assess boundary conditions as well as rival explanations for the observed effects.. First, participants were asked to indicate “How important were the following things in your evaluation of restaurant B’s expensiveness?” -- “Picture of the restaurant exterior,” “Picture of restaurant interior,” “Menu items/choices,” “Menu prices,” and “Tipping/service gratuity policy.” All these ratings were made on a seven point scale ranging from 1 = not at all important to 7 = extremely important.

Second, participants were asked which of three statements best described restaurant B's tipping policy (with statements describing voluntary tipping, mandatory service charges and no tipping policies). This was used as manipulation check.

Third, participants were asked to indicate "what percent you would tip for satisfactory food and service" at a full-service restaurant where tipping is voluntary. This variable was examined as a potential moderator of tipping policy effects on perceived restaurant expensiveness.

Fourth, participants were asked: "In general, how expensive do the following types of restaurants tend to be?" – "Restaurants with voluntary tipping," "Restaurants with a mandatory gratuity or service charge," and "Restaurants with service built into the menu prices and 'No Tipping'." These ratings were made using a seven point scale ranging from 1 = much less expensive than average to 7 = much more expensive than average. Every subject completed all three of these ratings, but only the rating corresponding to their experimental condition was used – to create a measure of participants' association of the tipping policy in their condition with restaurant expensiveness, which was used a control variable called "expensiveness association."

Finally, respondents were asked about their birth year, sex, race, citizenship, education, income, familiarity with U.S. tipping norms, and frequency of restaurant patronage. These variables were used to describe the sample.

#### 4. Results and Discussion

Descriptive statistics for the key variables in this study are presented in Table 1 and the means and standard deviations of the variables by experimental condition are presented in Table 2. These data are analyzed and discussed in the sections that follow.

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Insert Tables 1 and 2 about here

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#### 4.1. Manipulation Check

The overall percentage of participants correctly identifying the second restaurant's tip policy was 71%. Although less than desired, this percentage was enough to produce significant differences across conditions in perceived tipping policy such that each policy was perceived as occurring much more frequently when that policy was written on the bottom of the menu than when the other policies were at the bottom of the menu (all three  $\chi^2$ 's (1) > 95.0,  $p$ 's < .001). Thus, our manipulation, though not as strong as hoped, was successful in producing the intended differences in perceived tipping policies.

#### 4.2. Tipping Policy Effects on Perceived Expensiveness

The effects of tipping policy on perceived restaurant expensiveness were assessed in regression analyses with tipping policy dummy coded so that "no tipping" (yes = 1, no = 0) and "automatic gratuity" (yes = 1, no = 0) were contrasted with "voluntary tipping" (not explicitly coded). There was no reliable difference in the perceived expensiveness of the restaurant under the automatic gratuity and voluntary tipping policies ( $B = .01$ ,  $t(492) = .10$ , n.s.). However, consistent with hypothesis 1, the restaurant was perceived as more expensive under the no tipping policy than under the voluntary tipping policy ( $B = .56$ ,  $t(492) = 4.69$ ,  $p < .001$ ). This effect is not simply the result of a general, heuristic

association linking no tipping policies with more expensive restaurants, because it remained significant after controlling for the participant's beliefs that restaurants with a tipping policy like the one at the restaurant they evaluated tend to be more or less expensive than average ( $B = .48$ ,  $t(491) = 3.96$ ,  $p < .001$ ).

Note that although menu prices were fifteen percent higher in the no tipping condition than in the voluntary tipping condition, thirty-one percent of the participants reported that they typically tipped 15 percent of the bill and another fifty-seven percent said they typically tipped 16 to 35 percent of the bill, so the no tipping policy saved these people at least as much and often more than the 15 percent added to menu prices in that condition. Thus, it appears that U.S. consumers do not generally consider tips (or their absence) as part of the costs when assessing the expensiveness of restaurants. Consistent with this conclusion, participants in both the voluntary tipping and the no tipping conditions reported that the "tipping/service gratuity policy" was less important to their evaluation of the restaurant's expensiveness than did those in the automatic gratuity condition (voluntary tipping vs. automatic gratuity:  $B = -.53$ ,  $t(492) = 2.53$ ,  $p < .02$ ; no tipping vs. automatic gratuity:  $B = -.40$ ,  $t(492) = -1.89$ ,  $p < .06$ ).

To further explore this tendency to ignore tips when assessing restaurant expensiveness, we added typical tip size and its interaction with tipping policies to the regression model predicting perceived restaurant expensiveness and found a significant automatic gratuity by typical tip size interaction ( $B = .07$ ,  $t(489) = 2.27$ ,  $p < .03$ ) and a marginally significant no tipping by typical tip size interaction ( $B = .04$ ,  $t(489) = 1.61$ ,  $p < .11$ ). Perceived restaurant expensiveness was unrelated to typical tip size under the no tipping condition ( $B = .01$ ,  $t(161) = 0.35$ , n.s.) and the automatic gratuity condition ( $B$

= .03,  $t(164) = 1.34$ , n.s.), but decreased as typical tip size increased under the voluntary tipping condition ( $B = -.04$ ,  $t(164) = -2.04$ ,  $p < .05$ ) (see Figure 2). These findings further support the conclusion that U.S. consumers do not generally consider tips as part of the costs when assessing restaurant expensiveness. In particular, the negative effect of typical tip size on perceived restaurant expensiveness under the voluntary tipping condition is the opposite of what you would expect if people considered tips as a component of restaurant expensiveness.

This negative effect cannot be attributed to individual differences in price sensitivity driving both typical tip sizes and perceptions of restaurant expensiveness because price sensitivity should have affected perceptions of restaurant expensiveness under the other tipping policies as well and a similar negative relationship between typical tip size and perceived restaurant expensiveness was not observed under those other policies. One plausible explanation for this effect is that big tippers are less likely than small tippers to regard tips as a component of restaurant expensiveness because big tippers perceive tipping as more voluntary than do small tippers. There are two possible reasons for such an effect. First, big tippers may perceive a larger range of tip sizes as affordable options than do small tippers and this greater perceived breadth of options may make tipping seem more voluntary. Second, research has found that U.S. consumers who tip because of social pressure generally leave smaller amounts than do those who tip for more intrinsic reasons (Lynn, 2009), so differences in the perceived voluntariness of tipping may drive the behavioral differences that define big and small tippers. Both of these possibilities deserve further investigation in future research.

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Insert Figure 2 about here

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### 4.3. Tipping Policy Effects on Perceived Fairness

The effects of tipping policy on the perceived fairness of the policy were assessed in regression analyses like those above. Consistent with hypothesis 2, participants perceived voluntary tipping as more fair than either the no tipping policy ( $B = -1.38$ ,  $t(492) = -6.86$ ,  $p < .001$ ) or the automatic gratuity policy ( $B = -1.04$ ,  $t(492) = -5.20$ ,  $p < .001$ ).

To further explore this effect, we added typical tip size and its interaction with tipping policies to the regression model and found significant effects of typical tip percent ( $B = .09$ ,  $t(489) = 2.74$ ,  $p < .007$ ) and its interaction with no tipping ( $B = -.18$ ,  $t(489) = -4.23$ ,  $p < .001$ ), but not its interaction with automatic gratuity ( $B = .01$ ,  $t(489) = -0.18$ , n.s.). Perceived policy fairness increased with typical tip size under the voluntary tipping condition ( $B = .09$ ,  $t(164) = 3.14$ ,  $p < .003$ ) and the automatic gratuity condition ( $B = .08$ ,  $t(164) = 2.03$ ,  $p < .05$ ), but decreased with typical tip size under the no tipping condition ( $B = -.09$ ,  $t(161) = -3.01$ ,  $p < .004$ ) (see Figure 3). Our ideas about consumer voice and control underlying perceptions of tipping policy fairness are inadequate to fully explain these findings because the effects of loss of voice and control should be independent of typical tip size. Our original explanation for the greater perceived fairness of voluntary tipping policies than of automatic gratuity policies remains plausible and is

supported by the tipping policy main effects, but another explanation is needed for the observed interaction of tipping policies with typical tip size.

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Insert Figure 3 about here

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We speculate that no tipping policies may be perceived as less fair than voluntary tipping policies in the United States not only because the former take away consumer voice and control, but also because they do not as clearly reward the server for his or her efforts. This effect may be more pronounced for big tippers than for small tippers because, as previous research has found, big tippers are more concerned about the servers' welfare and treatment than are small tippers (Lynn, 2009). It is possible that greater empathy for the server increases the perceived fairness of direct payments for service (whether automatic gratuities or voluntary tips) and decreases the perceived fairness of their absence. Although this possibility is grounded in prior research and can fully explain the interaction effect of typical tip size and tipping policy on perceived tipping policy fairness, it does go beyond the current data and should be tested in future research.

#### 4.4. Tipping Policy Effects on Food and Service Quality

The effects of tipping policy on expected food and service quality were assessed in separate regression analyses. The analysis of expected food quality produced non-significant effects for no tipping ( $B = .13$ ,  $t(492) = 1.13$ , n.s.) and for automatic gratuities ( $B = .04$ ,  $t(492) = 0.37$ , n.s.). The analysis of expected service quality also produced a non-significant effect of automatic gratuity ( $B = .06$ ,  $t(492) = 0.44$ , n.s.), but did produce a significant effect for no tipping ( $B = -.48$ ,  $t(492) = -3.49$ ,  $p < .002$ ). These results

provide only partial support for hypothesis 3. Expected service quality was higher under the voluntary tipping policy than under the no tipping policy, but automatic gratuities did not lower expected service quality and none of the tipping policies affected expected food quality.

In the introduction, we argued that voluntary tipping would increase expected food and service quality because it served as a type of guarantee that signaled a restaurant's confidence in its service and because U.S. consumers believe that tips motivate servers to deliver good service. Although we did find that expected service quality was higher under voluntary tipping than under no tipping policies, the failure to find a similar effect of voluntary tipping vs. automatic gratuities along with the failure to find any effects on expected food quality calls our explanatory processes into question. One potential explanation that can account for the observed pattern of findings is that, as payments for service, both voluntary tipping and automatic gratuities call attention to service and that this greater salience enhances expectations of service quality. Consistent with this possibility, researchers have argued and found that price partitioning draws attention to the benefits provided by the secondary price component (Bertini and Wathieu, 2008; Hamilton and Srivastava, 2008). This increased attention to the service component of restaurant dining experiences could enhance a-priori expected service quality through thought polarization (Tesser, 1978) or processing fluency (Reber, Schwartz and Winkielman, 2004) effects. Testing this and other possible explanations for the observed tipping policy effect on a-priori expectations of service quality is another potentially interesting direction for future research.

#### 4.5. Tipping Policy Effects on Likelihood of Patronage

The indirect effects of tipping policy on likelihood of patronage were assessed with Hayes (2012) PROCESS macro for SPSS, which uses bootstrapping to calculate the standard errors of indirect effects. The analyses involved (i) likelihood of patronage as the dependent variable, (ii) no tipping and automatic gratuity policies as the principle independent variables, and (iii) perceived restaurant expensiveness, perceived tipping policy fairness, expected food quality, and expected service quality as mediators. The regression model predicting patronage likelihood produced significant effects for perceived expensiveness ( $B = -.21, t(488) = -4.01, p < .001$ ), perceived tipping policy fairness ( $B = .17, t(488) = 5.28, p < .001$ ), expected food quality ( $B = .62, t(488) = 9.14, p < .001$ ), and expected service quality ( $B = .20, t(488) = 3.60, p < .001$ ). The effects of a no tipping policy ( $B = .18, t(488) = 1.18, n.s.$ ) and of an automatic gratuity policy ( $B = .08, t(488) = 0.57, n.s.$ ) were not significant.

Although tipping policies had no direct effects on likelihood of patronage, the no tipping policy did have indirect effects through perceived expensiveness ( $B = -.12, CI_{95\%} = -.22 \text{ to } -.05$ ), perceived tipping policy fairness ( $B = -.24, CI_{95\%} = -.37 \text{ to } -.14$ ), and expected service quality ( $B = -.10, CI_{95\%} = -.21 \text{ to } -.04$ ).<sup>4</sup> Consistent with Hypothesis 4, the effects of voluntary tipping (relative to no tipping) on perceived expensiveness, perceived tipping policy fairness and expected service quality did increase the likelihood of patronage.

The indirect effect of an automatic gratuity policy through perceived policy fairness was significant ( $B = -.18, CI_{95\%} = -.30 \text{ to } -.10$ ), but the indirect effects through perceived expensiveness ( $B = -.00, CI_{95\%} = -.06 \text{ to } .05$ ), expected food quality ( $B = .03,$

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<sup>4</sup> The indirect effect through expected food quality was not significant ( $B = .08, CI_{95\%} = -.05 \text{ to } .23$ ).

CI<sub>95%</sub> = -.12 to .17), and expected service quality ( $B = .01$ , CI<sub>95%</sub> = -.04 to .07) were not significant. These results provide partial support for Hypothesis 4 -- the effect of voluntary tipping (relative to automatic gratuities) on perceived tipping policy fairness did increase the likelihood of patronage.

## 5. Conclusions

The results of this study indicate that, relative to no tipping policies with higher base prices, voluntary tipping policies increase potential demand among U.S. consumers by reducing perceived expensiveness, increasing perceived tipping policy fairness, and increasing perceived service quality. Relative to automatic gratuities, voluntary tipping increases potential demand by increasing the perceived fairness of tipping policies. These findings help to partially explain the otherwise puzzling prevalence of tipping. Specifically, they suggest that, despite the many drawbacks of this employee compensation method, U.S. businesses may allow customer tipping of employees as a way to manage consumers' perceptions of the firm and, thereby, increase demand.

Although the current results identify several potential benefits of tipping to businesses and thereby inform our understanding of why U.S. businesses may permit customers to tip their employees, they leave three related issues unanswered. First, it is not clear to what extent these results generalize beyond the borders of the United States. There is little reason to expect the effect of voluntary tipping on perceptions of restaurant expensiveness to vary across nations, but its effect on perceived fairness is a different story. The perceived fairness of business practices increases as consumers become more familiar with those practices

(Wirtz and Kimes, 2007), so consumers in nations where service charges or service inclusive pricing are common may find those practices as equally or more fair than voluntary tipping. Second, it is not clear what extent the effects observed in this study actually drive businesses' decisions regarding tipping policies.

While it seems obvious that businesses would be concerned about tipping policy effects on demand, it is not obvious that businessmen are aware of these effects.

Third, it is not clear why businesses in countries where tipping is rare do not try to capitalize on the benefits of voluntary tipping documented here. It is possible that national differences in consumer response to tipping policies (as previously discussed) affect the benefits businesses derive from voluntary tipping and that these national differences in business benefits help drive national differences in tipping customs. For example, national differences in the perceived fairness of tipping vs. service charges may underlie some national differences in tipping. Of course, tipping also depends on consumers' willingness to give tips, so perhaps it is consumer dispositions rather than business preferences that drive national differences in tipping (see Lynn, 2006). The current data do not speak to these issues, which are left to future research.

In addition to identifying several economic benefits of voluntary tipping to businesses that may help to explain why they embrace this risky practice, the current paper contributes to the existing literature by examining tipping as a form of pricing. In particular, it ties the tipping literature to the voluntary pricing, price partitioning, and pricing fairness literatures and, thus, expands the theoretical domain of all these literatures. Additional connections between tipping and

pricing remain to be explored in future research. For example, Lynn and Withiam (2008) argue that tipping may enhance business revenues by acting as a form of price discrimination, but provide no direct evidence to support this possibility. This would be one interesting direction to take empirical research on tipping as a form of pricing.

The current study is but a small foray into a pervasive, multi-billion dollar part of the economy that deserves more research attention from behavioral economics scholars (see Lynn and Withiam, 2008). Tipping is a complex phenomenon that combines issues of employee compensation and human resources management with issues of pricing and marketing. Hopefully, this paper goes beyond answering questions about the effects of tipping on perceptions of expensiveness, fairness, and service quality to also convince more behavioral economists that tipping is an important and rich topic for interdisciplinary research.

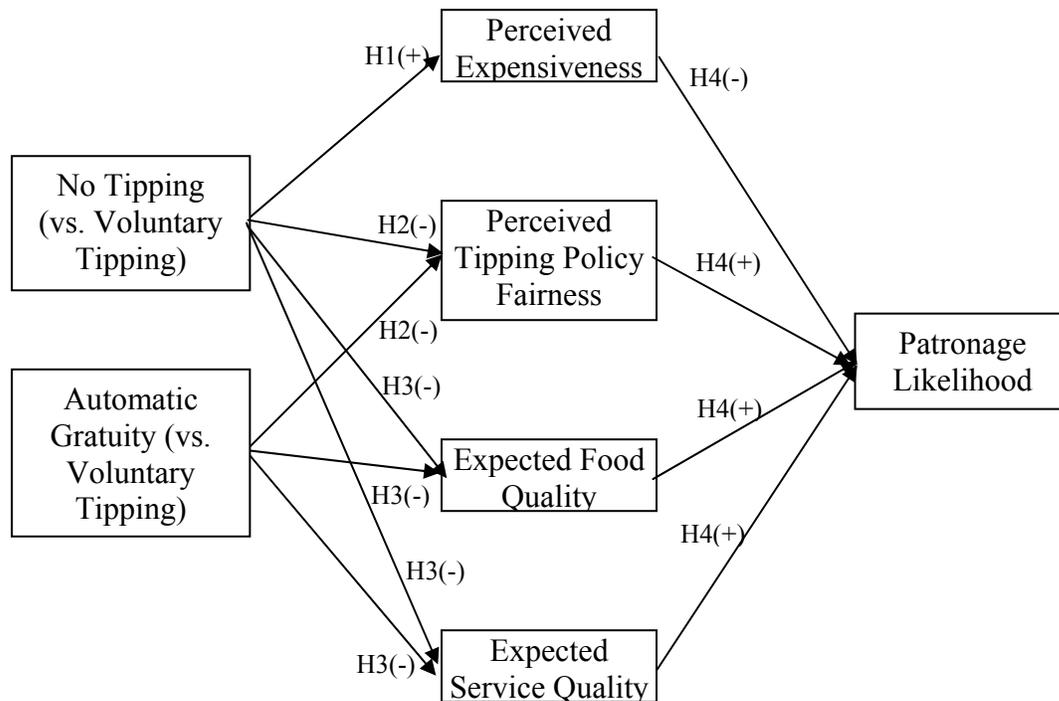


Figure 1. Model of tipping policy effects.

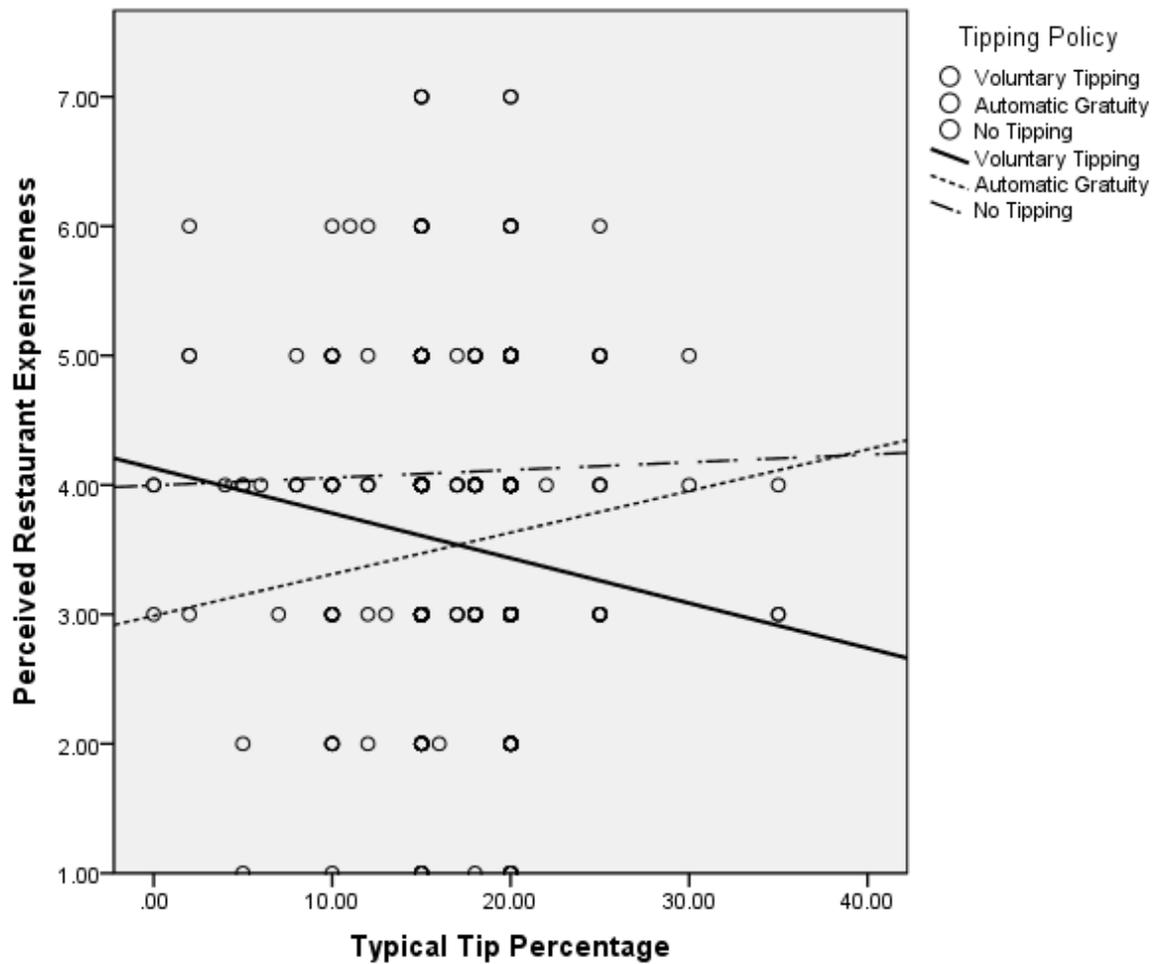


Figure 2. Interaction of tipping policy with customer's typical tip percentage as it affects perceived restaurant expensiveness.

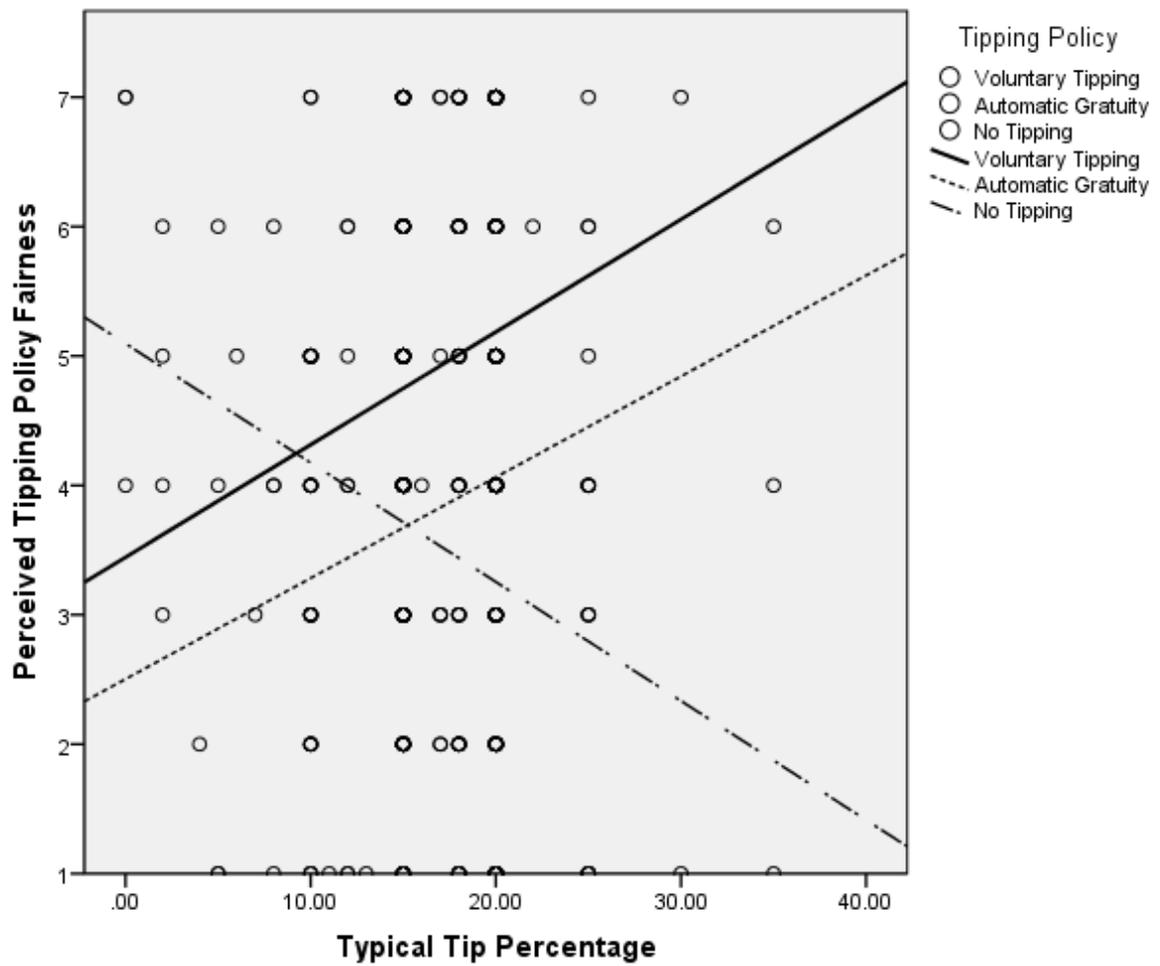


Figure 3. Interaction of tipping policy with customer's typical tip percentage as it affects perceived tipping policy fairness.

Table 1. Descriptive statistics for the key measured variables in this study.

	N	Minimum	Maximum	Mean	Std. Deviation
Expensiveness	495	1	7	3.73	1.104
Policy Fairness	495	1	7	4.11	1.917
Food Quality	495	1	7	4.49	1.053
Service Quality	495	1	7	4.36	1.274
Patronage Likelihood	495	1	7	4.42	1.560
Typical Tip Percent	495	.00	35.00	17.1455	4.41141
Expensiveness Association	495	1.00	7.00	4.5515	1.31361
Valid N (listwise)	495				

Table 2. Means (and standard deviations) by experimental condition.

	Voluntary Tipping N = 166	Automatic Gratuity N = 166	No Tipping (Service Built into Menu Prices) N = 163
Expensiveness	3.54 <sup>a</sup> (.97)	3.55 <sup>a</sup> (1.15)	4.10 <sup>b</sup> (1.10)
Policy Fairness	4.92 <sup>a</sup> (1.61)	3.87 <sup>b</sup> (1.85)	3.53 <sup>b</sup> (2.01)
Food Quality	4.43 (1.06)	4.48 (1.09)	4.56 (1.01)
Service Quality	4.49 <sup>a</sup> (1.17)	4.55 <sup>a</sup> (1.26)	4.01 <sup>b</sup> (1.32)
Patronage Likelihood	4.51 (1.48)	4.44 (1.55)	4.30 (1.64)
Patronage Likelihood (controlling for food quality)	.13 <sup>a</sup> (1.27)	.04 <sup>ab</sup> (1.35)	-.17 <sup>b</sup> (1.37)
Expensiveness Association	3.96 <sup>a</sup> (.92)	5.03 <sup>b</sup> (1.25)	4.67 <sup>c</sup> (1.48)

Note: Means within each row with different superscripts differ significantly at the .05 level.

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