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Tipping, Technology and Lessons in Compensation Design

Tipped occupations are particularly interesting because the customer has a big and direct impact on the level of pay for an employee.



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New technologies seem to be popping up everywhere to make it easier for customers to exercise their power to pay. From personal phone apps to iPad kiosks in restaurants to video screens in taxis, a tip amount is instantly calculated for you — just choose the percent or level you wish to tip. All this technological assistance on tipping

is also creating exciting, new data sources. Increasingly, labor economists and other social scientists are using such data sources to better understand how people respond to incentives and the resulting workplace implications.

Taxis and Technology: An Experiment

In a previous column, I identified tipping as an area where there is significant opportunity for designed experimental research (“Why Do We Tip?” *workspan*, April 2012, 12-13). Two Ph.D. students have recently done such a study. Kareem Haggag (University of Chicago) and Giovanni Paci (Columbia University) present their results in “Default Tips,” forthcoming in *American Economic Journal: Applied Economics*, which is filled with interesting ideas.

Their paper uses 2009 data on 38 million New York City taxicab rides where credit cards were used to pay. At the end of a ride, customers were asked to type in a tip amount

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or were offered three suggested tip amounts. One cab company changed its suggested tip amounts depending on whether the ride cost more or less than \$15. For rides just below \$15, tip amounts of \$2, \$3 and \$4 were suggested. For rides just above \$15, riders were given suggested tips of 20 percent, 25 percent and 30 percent and the corresponding dollar amounts. A cab ride right at \$15 is what economists call a “discontinuity” — in this case, the point where the suggested tip amounts jump (from \$2, \$3 and \$4 to \$3 (20 percent), \$3.75 (25 percent) and \$4.50 (30 percent)). Using modern statistical methods, including what economists call a “regression discontinuity design,” the authors confirmed that the default (suggested) tip amounts shown at the end of the ride have significant impacts on the size of the tip given. One surprising result is that there is risk in setting the default tip too high: a larger fraction of customers give no tip at all in the presence of very high suggested tips.

Ice Cream Transparent Tipping

In an NPR story on Haggag’s and Paci’s work, journalist Dan Bobkoff reported a little-change big-impact-on-tipping story from Molly Moon Homemade Ice Cream in Seattle (“Technology May Turn You Into a Bigger Tipper,” Morning Edition, March 5, 2014). Molly Moon adopted an iPad-style cash register that offers four tip suggestions. Before customers could complete the purchase of their cones and move on to the signature page for a credit card sale, they had to click to choose between the first three tip suggestions of \$1, \$2 or \$3,

or the fourth option: “No tip.” The “No tip” option essentially forces the customer to affirm publicly what some might consider being, well, stingy... and over an ice cream cone after all. The ice cream shop employees saw tip income increase by up to 50 percent with the new registers. When the company that makes the register updated its software so that the tip options appeared on the same screen as the credit card signature line, tips declined substantially. (The software revision was reversed within a matter of a few days.)

Implications for Employers and Organizations

The tipping examples described here offer some interesting lessons to employers and those designing compensation systems. Seemingly, tiny changes in how compensation systems are designed and communicated can have extraordinary consequences. In my June 2011 *workspan* column “Does That Pay Practice Really Have Any Impact?” I wrote about the challenge of trying to find the true causal impact of HR policies. Doing so well can sometimes be invasive, but doesn’t have to be. If designed correctly, simple experiments in HR systems can save organizations a significant amount in unintended costs and problems when introducing system-wide change. [WS](#)



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