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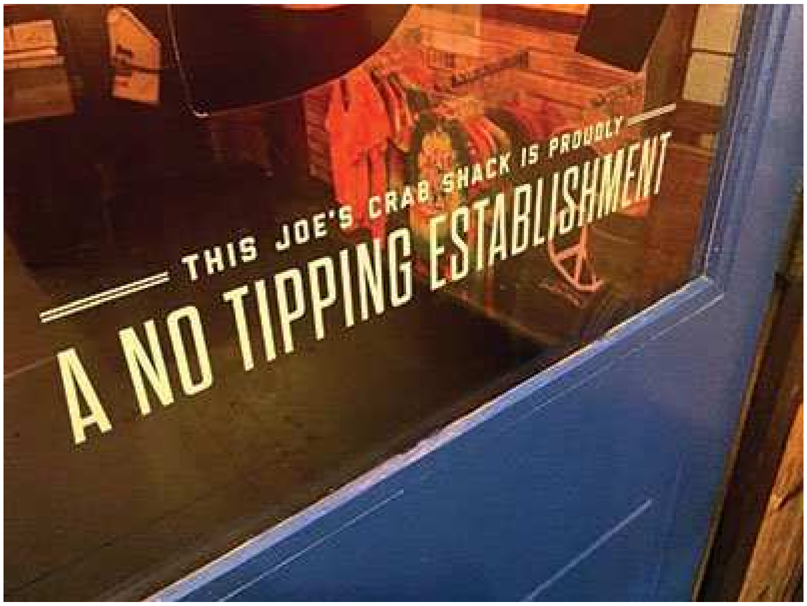
Two Risks Keep No-tipping Policies a Tricky Prospect

NICHOLAS UPTON



When he first made big news by abolishing tips at his flagship restaurant, NYC restaurateur Danny Meyer said, “The American system of tipping is awkward for all parties involved.”

The man behind the popular Modern restaurant, among others, described the awkwardness well. Servers working for tips aren’t really working for the restaurant, they’re working in a liminal space between the customer and restaurant in hopes their service is rewarded.

So with a complex payment and bonus structure, Meyer promised like wages under a “hospitality-included” model and raised prices to make it work. The proceeding month, he reported the most profitable month in the restaurant’s history. He admitted the switch at Modern benefited from unprecedented global PR, but plenty of others followed suit.

The largest test came when Ignite Restaurant Group switched to a no-tipping model at 18 Joe’s Crab Shack restaurants, raising prices 12 percent to 15 percent across the menu in order to bump wages up. It didn’t work well.

“We polled 14 of the 18, almost 60 percent of our customers said they hated it, and a lot of them voted with their feet,” said CEO Bob Merritt, noting the restaurants saw an 8 percent to 10 percent drop in traffic. System operating margins also sank 600 basis points.

Those four remaining no-tip restaurants were based in and around Indianapolis, and one has already closed.

Whether its demise was accelerated by the policy is unknown, but the entire test demonstrates one of two big risks of moving to a no-tipping policy: consumers' price sensitivity.

When diners can walk down the street to a competitor and spend around $10 for a comparable meal, why would they pay $14? This is especially risky in highly competitive areas or value-conscious regions.

“You can’t do it at an Applebee’s; the average ticket is just so low, the customers are just more price sensitive. Something over probably a $50 ticket average check would be essential,” said John Gordon, founder of restaurant consulting firm, Pacific

Management Consulting Group.

Even then there's no way around a price increase to maintain the wages for front of house and boost wages for kitchen staff.

Thad Volger, owner of Bar Agricole and Trou Normand in tourist-heavy areas of San Francisco, went the no-tipping route to remove the "gray market aspect" of tipped servers.

"The desire for things to be more normal, that's always been a tension in restaurants, that and getting the kitchen staff to share in that tip economy," said Volger. "So turning that tip economy into revenue was a way to have more access to it."

He raised prices in line with tip history, about 20 percent, paid salaries and then paid the service staff a commission of profits that remained, up to a 42 percent payroll cap.

"They were benefiting with increasing sales; it's a similar incentive, but it's not as much money as they were making," said Volger. Servers went from making $35 to $45 an hour to making $20 to $35, but raising prices more would have been too much.

"At a 20 percent increase in price, I was nervous the paying public would think of us as too expensive, but I think the public was ready for it," said Volger. "But at 40 percent you really look crazy. And that's always a complaint in San Francisco—value. There's a real disconnect between what it costs and what people want to pay."

It didn't get as much press as the original move, but Meyer raised prices at Modern again, coming in line with Volger's estimate of about 40 percent, but with a wildly different customer.

"I think the predominant enabler of potential success is the customer and their tolerance for a perceived 'marginal' price increase," said Gordon, who noted that consumers willing to pay understand that wages can't be too low.

An informal survey by economist Richard McKinsey at the National Center for Policy Analysis showed the average wage servers required to move away from tipping was near $30, with respondents in pricey Orange County and less-pricey North Carolina.

Without the 40 percent bump, Volger couldn't match tips and servers left in droves—the second risk of a no-tipping policy.

Ideologically, servers saw the same unfairness Volger sought to address, but ideology in the face of a 30 percent wage cut is hard to swallow. Volger lost 70 percent of his tipped staff, new staffers learned service skills, and then they left for one of the 20 competing restaurants within two blocks.

"I don't think we realized how much energy we would be expending," said Volger. "It's busy work running restaurants, and that had become such a big part of our focus—both the turnover draining staff and of training new staff."

After 10 months, Volger, like many other early adopters, had to pull the plug and return to a tipping model. He lowered prices some, but maintained a slight bump to continue paying kitchen staff more.

Still, the model is working in a select few places such as the high-wage metros of New York and Seattle, where experiments are doing well. But outside of high-wage regions or in value-conscious areas, the no-tipping model is still quite a risk. It might be best to wait.

"At some point the model has to change, it's just that the American consumer is not ready for it yet," said Ignite's Merritt.