

Tips are Welcome! Integrating Tips into Contractor Compensation

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Abstract

In many two-sided markets, platforms allow a customer to leave a tip for the contractor who provided a service (e.g., food delivery). Since tips can constitute a significant part of the contractors' earnings, some platforms have tried to integrate tips into overall contractor compensation. For example, DoorDash, a popular food delivery platform, has been using a minimum guaranteed payoff scheme, which allows DoorDash to pay the contractor a lower wage if the contractor receives a large tip. Interestingly, before switching to the guaranteed minimum payoff scheme in 2017, DoorDash used to pay contractors a fixed wage, which did not depend on the tips that the contractors received. In this paper, we build an analytical framework to analyze when and whether a platform should use the minimum guaranteed payoff scheme, and how it affects the contractors' service quality and monetary payoff. We find that if the contractors are not very likely to be rewarded for high-quality service with a large tip, the platform is better off by paying fixed wages. However, if receiving a large tip is very likely, then the platform should use the minimum guaranteed payoff scheme. Under the guaranteed minimum payoff scheme, the contractors tend to earn a lower expected monetary payoff than when they are paid a fixed wage. Surprisingly, when the contractor's likelihood of receiving a large tip increases, her expected monetary payoff may decrease.

Keywords: *tipping; two-sided markets; contract design*

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