LAW AND ECONOMIC ANALYSIS OF SERVICE CHARGE IN RESTAURANTS

Niharika Agarwal and Diya Parikh[1]

ABSTRACT

The levy of service charge in India is at present highly contented, which has led to a war of words among various authorities of the country. This paper investigates three scenarios through an economical lens and within the boundaries of the consumer rights. The pros of the three scenarios are then weighed against its cons to reach a final recommendation of the study which in turn also proves all the three scenarios which are contended in the country at present as economically inefficient. The findings of the study show that the first scenario of tipping is proved inefficient as India does not have a strong tipping culture leading to undertipping, along with that tips are only realised to the front-end workers and not the back-end workers or the cleaning staff. Secondly, the next scenario contemplates on mandatory service charge being added by default to the bill itself which is proved inefficient as it takes away the discretion of the consumers and also leads to deception of consumers resulting in the violation of consumer rights and reducing consumer surplus as a high cost. Finally, the paper looks into the aspect ofthe service charge being added within the price of the food itself, being inefficient because a part of the producer surplus is lost as rent paid due to revenue sharing clauses in lease agreements and the consumer being worse off due to lack of discretion in price paid for service.

Keywords: *service charge, economic efficiency, tipping, consumer rights*

[1] Students, Gujarat National Law University, Email: niharika21bal045@gnlu.ac.in; diya21bal093@gnlu.ac.in.

ISSN 2582-2667

1. INTRODUCTION

'Service Charge,' these two unholy words have recently sparked a heated debate in India surrounding the levying of service charge by hotels and restaurants on food services provided to customers. The academic discourse has included propositions on three broad scenarios: whether remuneration for good service should be encouraged through tipping, mandated through the levy of service charge through the bill itself, or included in the prices of food items as presented on the menu. The crux of the debate lies in the ambiguity regarding the legality of levying a service charge and its implications for the two primary stakeholders: restaurants, i.e. the producers, and consumers. Various authorities in the country, including the Central Consumer Protection Authority, the Delhi High Court, and the Union Food and Consumer Affairs Department of the Government, have given their individual and conflicting inputs on the topic creating further uncertainty. This unresolved legal grey area provides an opportunity to delve into the law and economic analysis of the three scenarios, taking into account concepts such as maximisation of market surplus, true price disclosure, and incentivisation of service providers, to achieve clarity on the topic and provide recommendations for an efficient outcome.

Contextual Background

On the 4th of July, 2022 the Central Consumer Protection Authority (herein after CCPA) had issued guidelines on grounds of section 18(2)(1) of the Consumer Protection Act, 2019 barring hotels and restaurants from levying a service charge by default, upon receiving several complaints from consumers for the same, in the interest of the protection of consumer rights.[2]

The Federation of Hotel and Restaurant Associations of India (hereinafter FRAI) and The National Restaurant Association of India (herein after NRAI) challenged these guidelines through a petition filed in the Delhi Hight Court. On 20th July, 2022 the Delhi High court in response to the petition ordered a stay to be imposed on CCPA's guidelines arguing that service charge did not violate consumer choice and upholding the legal validity of the practice. Justice Yashwant Varma, directed the CCPA to file its reply and listed the issue for further deliberation

[2] Central Consumer Protection Authority, Guidelines to prevent unfair trade practices and protection of consumer interest with regard to levy of service charge in hotels and restaurants, 2022, F.No. J-25/57/2022-CCPA (Issued on July 4,2022), https://consumeraffairs.nic.in/sites/default/files/file-uploads/latestnews/Guidelines%20to%20prevent%20unfair%20trade%20practices%20and%20protection%20of%20Consumer%20Interest%20with%20regard%20to%20levy%20of%20service%20charge%20in%20hotels%20and%20restaurants.pdf.

ISSN 2582-2667

on 25th November, 2022. The Delhi High Court also sent a notice to the Ministry of Consumer Affairs awaiting their input on the matter at hand[3].

Piyush Goyal on behalf of the Ministry of Food and Consumer Affairs asserted that restaurants may increase the rates on their food menus as an alternative to service charge which cannot be imposed[4].

In the contemporary context of the conflicting and unsettled views of the various authorities, this study becomes significant to analyse the arguments made by said authorities of the country and through the application of relevant economic tools study the costs and benefits of every scenario thereby determining a solution that is most efficient for all stake holders involved. The purpose of the study is to strike a balance between the protection of consumer rights, and also upholding the objective of service charge or tipping which is to incentivise the service providers to work better and reap the benefits of the same.

Statement of the Problem

The problem at hand lies in the absence of a solution which protects the interests and rights of all stakeholders impacted by the levying of service charge which also falls within the ambit of the law. Each of the scenarios proposed by the various authorities has been strongly opposed by a particular stakeholder resulting in ambiguity and dissatisfaction.

This paper thus aims to take into consideration all arguments put forth to arrive at a conclusion which will help in clarifying what the legal position ought to be so as to solve this problem in an economically efficient way which can satisfy all the involved stakeholders.

Structure of the Study

The paper will first review existing literature on the topic of contention, identifying and emphasising on the glaring gap in the literature. Further, the paper will establish the hypothesis, scope and objective of the current study for clarity.

The paper then establishes the importance of a remuneration for workers through tips or a

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[3] National Restaurant Assn. of India v. Union of India, 2022 SCC OnLine Del 2172 [hereinafter "National"].

[4] PTI, *Restaurants can't impose 'service charge' to food bills: Piyush Goyal*, THE HINDU (June 03, 2022, 18:19 IST), https://www.thehindu.com/news/national/restaurants-cant-impose-service-charge-to-food-bills-piyush-goyal/article65491118.ece [hereinafter "PTI"].

ISSN 2582-2667

service charge and their primary objective thereby establishing the foundation of the entire study.

After establishing preliminary points, the paper analyses each of the following scenarios correlating to the legal stance of each authority using relevant economic tools:

1. If discretionary tipping was the law.
2. If including service charge in the prices of the food items was the law.
3. If service charge added mandatorily to the bill by default was the law.

After having established all the pros and cons of each scenario, the paper intends to weigh them for an economically efficient outcome. Lastly the paper arrives at a conclusion on the basis of which it makes various recommendations.

2. RESEARCH QUESTION

From a law and economics perspective what should the law pertaining to the levy of service charge in alternative to tipping be, for an economically efficient outcome for all involved stakeholders?

Scope

- The scope of the study is limited to the consumer behaviour trends existing in India.
- The assumptions made and models established in the proposed study cannot be appliedto any other socio-economic model other than India.
- The paper is constrained by the limited secondary data available on consumer trends,since this paper is purely doctrinal in nature.
- The scope is limited to the Indian legal framework.
- The paper assumes the primary objective of service charge to be the incentivisation ofworkers to provide better quality services.
- The paper does not account for other legal aspects, but purely aim to reach aneconomically efficient conclusion.

Objective

- The paper primarily aims at determining the most economically efficient means of incentivising workers to provide better quality services.

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- The paper intends to fit this economic analysis within the ambit of the Indian Legal framework and cultural context for it to be possible to implement.
- This paper aims to determine whether or not the levy of mandatory service charge is economically deceptive or not as contended by the CCPA
- This paper aims to analyse which scenario helps fulfil the primary intent ofincentivisation of workers
- This paper therefore aims to compare the pros and cons of the various proposedscenarios and make recommendations on the same.

3. LITERATURE REVIEW

1. Published by American Economic Association, the paper talks about the existence of awide spread market that exists because of tipping. The paper attributes tipping not justto its economic implications but also establishes the psychological and behavioural aspects of consumers that come into the picture. The paper then establishes economic behaviour upon these consumer aspects. The paper proposes tipping to be a welfare increasing and sustainable social norm [5]. This paper limits itself to the scenarios wherethere already exists a strong tipping culture which is not present in India.
2. Published on behalf of the Canadian Economics Association this paper engages into the consumer behavioural aspect with respect to tipping. The paper revolves around the question, whether people tip strategically, to improve future services or only because tipping is a social norm. To which the paper attributes that if future service was the reason for tipping the sensitivity of tips to service quality should be higher for repeatingcustomers than for non-repeating customers., thus suggesting future service is not a reason for tipping [6]. The study proves contrary to the basic objective of tipping for whichit was introduced as a social norm.
3. This paper studies which pricing alternative to tipping is most suitable to adopt if and when restaurants decide to abandon voluntary tipping. The participants of the study rated menus with service charge being added to the bill by default over service charge included prices when the service charge component was below the 15% tipping rate. However, the reverse was true when the service charge component was above 15%. The study explored how these practices impeded

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[5] Ofer H.Azar, *The Economics of Tipping*, 34 THE JOURNAL OF ECONOMIC PERSPECTIVES, 215-236 (2020), https://www.jstor.org/stable/26913191.
[6] *Id.*

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participants' menu price judgement.[7] The study establishes the consumer behaviour with respect to service charge added bydefault to the bill and service charge being added in the price of the food.

4. A study conducted on a model based in Kenya explores the interrelation between customer tipping behaviour and its inspiration on foodservice empathy. The findings ofthe study reveal a substantial association between rewards for perceived service and food service empathy, but they were unable to detect a meaningful relationship betweenincentives for better future service or social norms[8] This paper is again in contrary tothe objective of the introduction of tipping to be used as a social norm.

Gap in literature

There exists ample literature investigating upon the consumer behavioural trends when it comes to tipping or service charge of international clientele market however there exists little to no literature which analyses the same behavioural trends in the Indian socio legal atmosphere. Moreover, there is shortage of literature of any kind on the specific topic of this paper which engages in an economic analysis of Indian laws with respect to the levy of service charge. This paper aims to address this glaring literature gap by conducting a law and economics analysis limited to the Indian consumer behaviour trends.

METHODOLOGY

This research paper employs a law and economics interface to address the research question.

Economic Tools

This paper employs various economic models, theories, and tools to analyse the three proposed scenarios of levy of service charge. Economic concepts of demand-supply, cardinal utility approach, consumer behaviour, market economics and cost benefit analysis have been employed to adequately answer the research question.

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[7] Shuo Wang, *The Effects of Service Charges Versus Service-Included Pricing on Deal Perception,* 20 JOURNAL OF HOSPITALITY & TOURISM RESEARCH, 1-9 (March 5, 2014), https://www.researchgate.net/publication/261721146_The_Effects_of_Service_Charges_Versus_Service-Included_Pricing_on_Deal_Perception [hereinafter "Shuo"].

[8] Simon Were, *Restaurant tipping behavior and its inspiration on food service empathy: a focus on two- and three-star hotels in Kenya,* 35 INTERNATIONAL HOSPITALITY REVIEW, 57-69 (2021), https://doi.org/10.1108/IHR-07-2020-0026.

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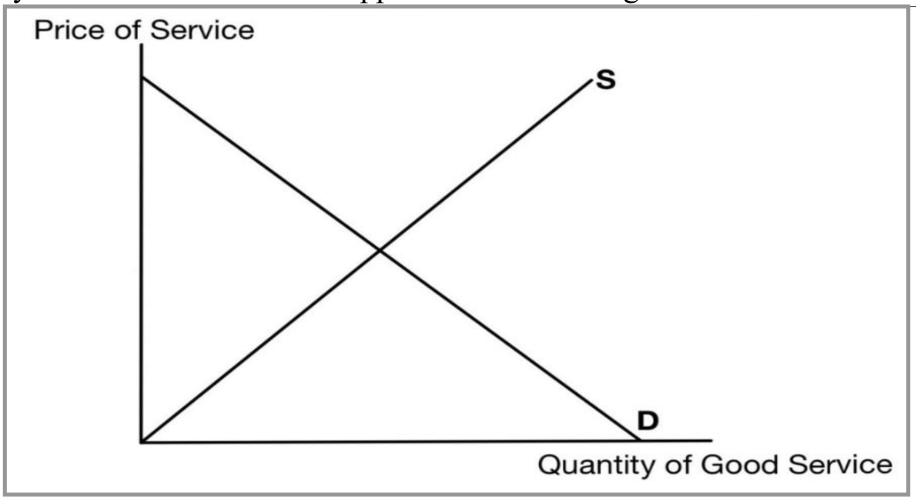
Doctrinal

This paper uses secondary data and information from various credible sources including published research papers, articles, government resources to corroborate the theories presented and apply them to the relevant context, in an attempt to answer the research question.

5. STATUS QUO

Tipping as a concept evolved in the 17th Century, in the form of giving staff a small amount of money to incentivise and show appreciation for their good service. The word 'tip' itself



evolved in the 18th Century, from the phrase 'To Insure Promptitude'[9] Tipping provides an incentive to workers to produce good quality services which ensuring better service to be enjoyed by the consumers. This in turn ensures growth of consumer welfare along with a fair remuneration for the staff who usually come the lower rungs of society.

However, it is an established fact that Indians are culturally not very generous tippers. Hence this induced restaurants to start adding service charge to the bills as an alternative to relying on tips solving the problem of stingy tipping. Therefore service charge was introduced keeping in mind the same objective of incentivization[10].

In the status quo, it is known that various restaurants in the country based on their discretion either levy a mandatory service charge or rely on the voluntary tips of their consumers.

These can be analysed graphically through the basic model shown above, which has been used throughout the paper for economic analysis. The figure above depicts this concept's demand

[9] Shephali Bhatt, *A look at the evolution of tipping culture*, THE ECONOMIC TIMES (Dec 01, 2018, 11:15 PM IST), https://economictimes.indiatimes.com/industry/miscellaneous/a-look-at-the-evolution-of-tipping-culture/articleshow/66900516.cms?from=mdr.

[10] *Id.*

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and supply curves and establishes the foundation of all economics models graphically depicted ahead. In the figure given above, the X axis denotes the Quantity of GoodService provided the staff who are the producers. In essence, a higher quantity of good servicerelates to a better quality service, while a lower quantity of good service relates to a poor qualityof service. The Y axis establishes the price paid at the end of the meal for the service received.

The diagram portrays the demand curve as downward sloping because the consumers demand higher quantity of Good Services at lowers prices of tipping or service charge so as to ensure utility maximisation i.e. the inverse relationship between quantity demanded and price.

Further if at any point of mandatory service charge the price of service charge falls it will increase a demand for the restaurant thereby increasing the demand for quantity for Good Services. Lower prices of service charge increase the affordability of the restaurants therefore increases the demand for quantity of Good Services.

Further it can be seen that the supply curve is upward sloping indicating a direct relationship between price and quantity supplied. With increasing price of service charge or tipping the supply for quantity of Good Services increases as a result of incentivisation. With a gain in prices of Good Services, it leads to an increased desire among the producers to produce more of the same so as to ensure profit maximisation.

6. SCENARIO 1: TIPPING

Position of the authorities on tipping

The CCPA highly recommends the conventional system of tipping which ensures maximum consumer benefit by allowing the consumers to tip on their own discretion in direct correlation to the satisfaction that they obtain based on the quality of service provided. In this scenario the CCPA argues that the consumers are not deceived in any manner and can chose to spend only that much for tipping that they seem fit to the quality of service they have received. In this context, the CCPA has issued guidelines which stops hotels and restaurants from adding service charge automatically or by default in the food bills to prevent any 'unfair trade practice' and ensure protection of consumer rights as laid down by the Consumer Protection Act, 2019.[11] The arguments advanced by the NRAI and the FRAI against tipping state that the tips are onlygiven to the front-end workers however the final output of good quality of service is a combinedeffort of the back-end workers and the cleaning staff. Thus, the distribution of the tips is unequitable

[11] National, *supra* note 2.

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and unfair to a particular set of stakeholders all together[12]

Tipping Culture in India

One may observe in common practice that not many of us are good tippers. In most situations we either undertip or we end up not tipping all together. The Indian tipping culture lacks the societal backing, that exists in most of the other international countries. This is indicated both by empirical data and various restaurant owners who have commented on the tipping trends in India:

"People usually leave 6-7% of the bill amount as tips," says one such Mumbai based restaurant owner Tanu Narang. This is far below international standards which calls for 15 – 20% of the bill. "*Tip for restaurant staff must be 10-15% of the bill in India"* says Pria Warrick a Delhi based corporate etiquettes trainer. Liji Thomas, Director, Nouvo Image Consultancy, says, *"Indian customers tip better when they pay through their corporate credit cards. But otherwise, theamount is too little.*[13][12] Another survey on tipping culture in India was conducted among 1400 respondents by TripAdvisor India. The survey indicated that Indians were the least generous tippers in comparison to other international countries, with only around 35% of Indian customersactually tipping. Nikhil Ganju, country manager, TripAdvisor India commented, *"It is strange tonote that our perception of Indians as a community of generous tippers is very low, with only 15%respondents indicating Indians are generous tippers."*[13]

Further 47% respondents said they tip if the staff have met basic expectations, 40% said they only tip if they have gone that extra mile in their service. "It also seems that people feel obliged to tip as a social norm or courtesy as 35% respondents agreed they tipped simply because they think it's expected,".[14] Taking into consideration the comments provided by stakeholders of the industry and the secondary data that has been provided, one can come to the conclusion that the tipping culture in India has definite scope for improvement. It can be noted that the Indian tipping culture does not realise the objective of tipping in the first place as it is not adopted by most Indians.

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[12] Arnab Dutta, *India's restaurant body calls service charge guidelines illegal*, BUSINESS TODAY (Jul 06, 2022, 12:40 PM IST), https://www.businesstoday.in/latest/economy/story/indias-restaurant-body-calls-service-charge-guidelines-illegal-340493-2022-07-06.

[13] Bindisha Sarang, *The complete guide to tipping*, THE TIMES OF INDIA (Jan 5, 2015, 05:15 IST), http://timesofindia.indiatimes.com/articleshow/45755289.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst.

[14] *Indians fear 'cheap' tag, tip liberally abroad,* THE ECONOMIC TIMES (Jul 27, 2013, 06:37 AM IST), https://economictimes.indiatimes.com/indians-fear-cheap-tag-tip-liberally-abroad/articleshow/21387177.cms?from=mdr.

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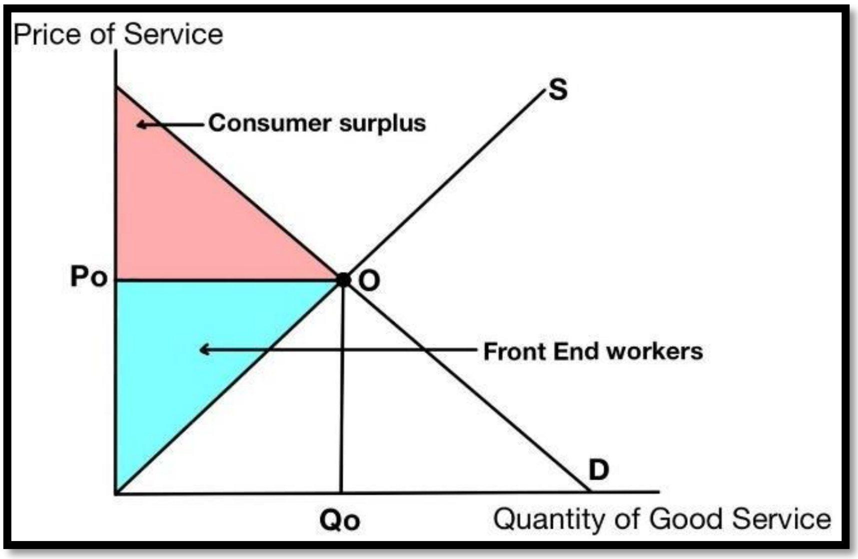
Analysis of Tipping

One of the biggest benefits of tipping compared to the other two scenarios that willbe discussed below is that the consumer gets to retain its discretion. This allows the consumer topay in direct proportion to the utility that he/she feels has been obtained based on the quality of theservices provided. In an optimum scenario where we ignore the bleak tipping culture in India thisscenario would be the most ideal situation for both the parties which are the consumers as well asthe producers as they are in part delicto indicated by an equal consumer surplus and producer surplus *(explained economically through Fig 1)*. However, there are few cons of this scenario which make it an economically less efficient option to opt for. The cons include:

1. The lack of a strong tipping culture in India there by leading to undertipping. As consequenceof this, the incentive to work with which the staff members provide their services to the customers are not rewarded with an equitable tip. Thus, the staff members end up workingmore in expectation of a higher tip however they are given a significantly lower tip. This leads to dissatisfaction among the service providers which debunks the main objective of tippingwhich is the incentive to provide better services. This also leads to a significant loss in theproducer surplus. *(Explained economically through Fig 2)*
2. The tips are only directed towards the front-end workers thus the earnings are not realised tothe back-end workers and cleaning staff which too contribute to the overall quality of services. Due to this an entire stakeholder is not engaged in the profit sharing, which makes it unfairand against the rights of the staff.

Economic Analysis of Tipping

The above provided rationale can be economically analysed for its impact on all involved stakeholders.



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The impact of tipping, in an ideal scenario can be graphically represented as shownbelow:

Fig 1 Market of Tipping when culture of undertipping is ignored

In the diagram above, the Y axis in this scenario denotes the price of tips. The X axis denotes the quantity of Good Service that would ideally be provided at the specific price of tip that is given by the customer. Point 'O' represent the equilibrium point of the demand and the supply curve which also denotes the point at which the current market is operating. 'Po' is the point which denotes the optimum tip from a consumer for the optimum quantity of Good Services provided by staff members which is denoted as 'Qo'. Here the utility derived by the customer for optimum quantity of Good Service provided is equivalent to the optimum price, and the consumers are willing to pay this price. In this scenario there is pareto optimality between consumers and the producers, depicted by the equal consumer surplus and producer surplus, the consumers are paying as per their utility and the producers are being incentivised for their efforts resulting in economic optimality. However, it is imperative to note that even in this case the producer surplus is realised only to the front-end workers. Thus, even though the scenario seems economically optimum it is limited to particular stakeholders and the benefit of all is not protected.

However, one should consider that this scenario denotes an ideal scenario and in reality due to the lack of tipping culture in India the probability of this scenario itself is very low, making this option not viable to be opted for. The actual outcome given the socio-cultural behaviour trends of consumers in India, results in undertipping as shown below:

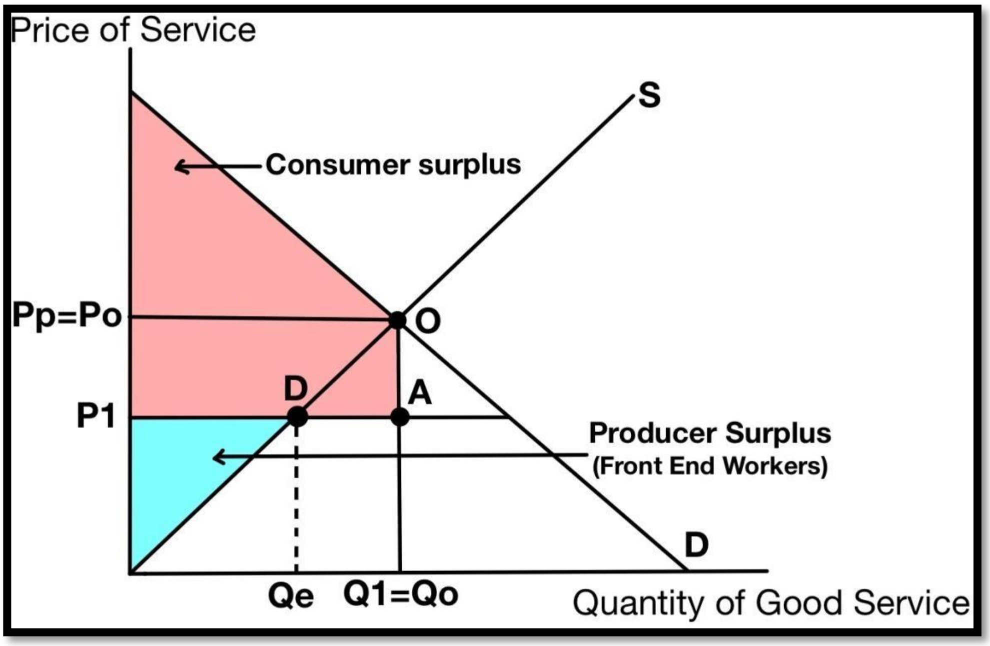

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Fig 2 Market of Tipping when culture of undertipping is included

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Point 'A' on the diagram denotes the point at which this particular market operates which is at price 'P1' and quantity 'Q1'. It is imperative to note that P1 is significantly below Po denoting the optimum price indicating that customers in this market undertip significantly in comparison to the expected price in an ideal situation. Since tipping is done after the services have already been provided, the staff provides optimum quantity of services (hence Q1 = Qo) in expectation of the optimum tipping price (Po = Pp). However the staff ends up receiving a tip which is much lower at P1 instead of the perceived Pp. This situation then observes an increased consumer surplus denoted by the red shaded triangle on the figure along with an decreased producer surplus shown as the blue shaded portion which is only realised by front end workers. The rectangle Po-P1-A-O represents the loss caused to the producer. The loss occurs due to the decrease in tipping price from the optimum price that the producer would have perceived or expected to have received thus (Pp=Po) for the quantity of good service provided. Hence even at a lower tipping price the consumers are obtaining optimum quality of services (Q1=Qo). Whereas, had the producers had full information about the tip they would receive they would only have been willing to provide Qe quantity of services, but are not able to regulate that since tips are received only after the service is provided. The triangle DOA in fact represents those portion of workers who would not be willing to provide any service at all at that price P1 as it lies below the supply curve. The foundation of this loss exists in the fact that the producers provide optimum quantity of Good Services after which the consumers at their discretion pay for the services and due to the lack of tipping culture the consumers end up under tipping.

7. SCENARIO 2 : INCLUSION OF SERVICE CHARGE IN THE PRICE OF FOOD

Position of Food and Consumer Affairs Minister

Food and Consumer Affairs Minister Piyush Goyal made a statement on the controversy of Service Charge denouncing the practice of levying a mandatory service charge by restaurants on consumers.[15] An argument often put forward by Restaurants as also claimed by NRAI is that the service charge helps ensure proper wages and payment to workers and thus must not be done away with.[16] In response to the same, Piyush Goyal argued that restaurants may increase the prices of their food since there exist no price controls in India, so as to increase the pay of their staff

[15] PTI, *supra* note 3.
[16] Thomas Fenn, *Barring restaurants from levying service charge is unfair, reeks of discrimination,* NRAI (July 7, 2022), https://nrai.org/barring-restaurants-from-levying-service-charge-is-unfair-reeks-of-discrimination/ [hereinafter "Thomas"].

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but cannot pass on this cost arbitrarily to consumers through mandatory service charge.[17]

In light of this proposition by the Government, in this section we analyse the economic implications of increasing the price of goods on the menu itself to incorporate the service charge amount.

Economic Analysis of Higher Prices

When the service charge is incorporated into the price of the goods provided, this defeats the entire purpose for which service charge as a concept was created, i.e. to incentivise workers to provide better service and remunerate them for the same. With higher prices on the menu, the discretion of the consumer is entirely snatched such that regardless of the nature of service received, the consumer is forced to pay that component of service charge reflected in the higher prices.

Additionally, there is a lack of transparency in such a circumstance pertaining the distribution of the revenue from the price of the goods between the restaurant as profits and the workers' remunerations. As a result, it is also possible that the extra amount paid through the higher

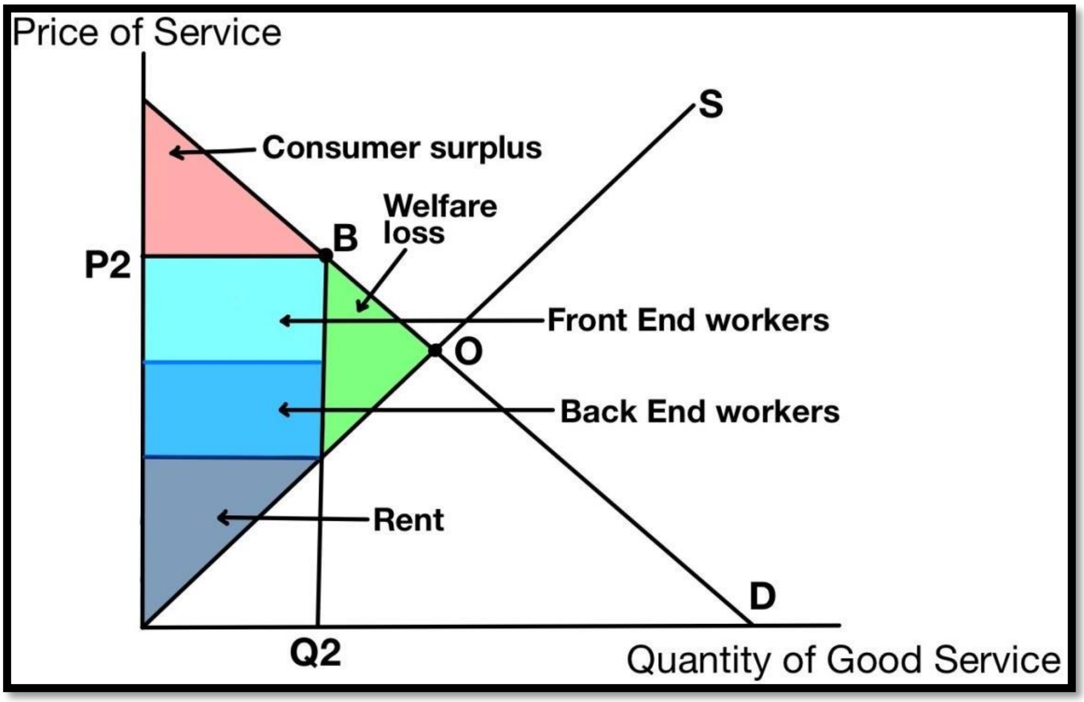

Fig 2.0 Market of Service Charge when it is included in the Price of the Food

prices is not actually realised to the workers and is siphoned by the owners themselves.

However, it has been contended by the NRAI as a representative of restaurant owners that often restaurants enter into lease agreements having revenue sharing clauses. When they earn the

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[17] PTI, *supra* note 3

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additional revenue through higher prices a portion of the same would have to be paid as rent under the agreement defeating the purpose of increasing the prices. However, when servic charge is collected, this is acknowledged by landlords as a charge to be paid to workers directly and outside the ambit of restaurant revenue. They thus do not include it within the calculation of revenue for the payment of rent.[18]

The above mentioned arguments can be graphically presented as follows:

In the above diagram, Market Equilibrium 'O' represents the optimum point of functioning where the marginal cost for good service i.e. the price paid equal the marginal demand for the service i.e. the utility or satisfaction derived by the consumer as a result of good service.

However, when the price of the service is included in the price of the food, the consumer can longer reduce the amount paid for the service in accordance with the quality of service received i.e. the quantity of good service. As a result, often consumers end up paying more for the service than the quantity of good service received. This is represented by point 'B' where the market operates when the service charge is included in the price of the food. At this point, theprice paid, 'P2' is higher than it would have been at equilibrium, and the quantity (representingthe amount of good service provided) is lower at 'Q2'.

At point 'B', the consumer is worse off due to the reduced utility derived from the poor quality service received as compared to the price paid for that service as marked by the red shaded region. The producer is able to benefit from the higher producer surplus due to the assured income even when the service provided is sub-par. The producer surplus is distributed into 3 segments marked on the diagram as the blue shaded region. Part of the producer surplus is paid as rent due to the revenue sharing clause under lease agreements resulting in a smaller portion of the revenue benefitting the workers. However, unlike the problem faced in the first scenario of tipping, in this case the service charge can be evenly distributed among both front end and back end workers ensuring equitable distribution of the surplus.

Yet, it is important to note that as a result of the higher price paid for the service as compared to the utility derived, in this scenario the market is not functioning at the equilibrium resulting in market inefficiencies. Not only is this resulting in a smaller quantity traded seen as Q2 but also in a welfare loss to society marked on the diagram as the green shaded region.

We can therefore see from the diagram, that in such a circumstance the primary objective of service charge which was to incentivise workers and improve the quality of service is not

[18] Thomas, *supra* note 15

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achieved as reflected by the reduced quantity Q2 and neither the consumers nor producers are better off due to the reduced consumer surplus, and loss in surplus to rent, respectively.

8. SCENARIO 3 : MANDATORY SERVICE CHARGE

Delhi High Court Ruling

On the grounds of a plea challenging the Guidelines issued by the Central Consumer Protection Authority, the Delhi High Court in its order, the Delhi High Court upheld the charging of service charge by Restaurants which if included in the bill would be mandatory for the consumer to pay. The court argued that those unwilling to pay the service charge may choose not to eat at that restaurant at all. The Court however also instructed eateries charging service charge to prominently display a notice of the same on their menus and other places.[19]

Analysis of Mandatory Service Charge

One of the benefits of a mandatory service charge as compared to the first scenario of tipping is that the revenue generated can be equitably distributed among all the workers (both front end and back end workers) as was also seen in the case of service charge included prices.

But the same glaring cons as were also present in the second scenario of service charge included prices remain even in the circumstance of mandatory levying of service charge. This includes the lack of incentive to provide good quality service by restaurant workers and a lack of discretion on the part of consumers to be able to pay in proportion to the utility derived from the service received. Besides the benefit of labelling it as a service charge- in that no portion of it is needed to be paid as rent - the singular glaring difference between the second and third scenario is the deception created when service charge is added to the bill by default. As a result of this deception levying of service charge on the bill has been termed as an "unfair trade practice" by the CCPA which lead to its guidelines as explained earlier in this paper.

Mandatory Service Charge as Deceptive

It is important to note that although the Delhi High Court has instructed for service charge to be displayed, as per a report by LiveLaw the CCPA had received numerous complaints by consumers on the National Consumer Helpline saying that restaurants were levying service charge without informing the customer and by default.[20] Therefore, there is an information asymmetry which is created, because the producers, i.e. the Restaurant is aware of the service

[19] National, *supra* note 2

[20] Business Desk, *Service Charge Row: Delhi HC Stays Guidelines Banning Levy of Service Charge by Restaurants*, NEWS 18 (July 20, 2022, 13:16 IST), https://www.news18.com/news/business/service-charge-row-delhi-hc-stays-ccpa-order-banning-levy-of-service-charge-by-restaurants-5589553.html.

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charge being added mandatorily at the end of the bill, but the consumer being unaware of the same makes decisions without proper knowledge of the pricing. As a result, relative to Scenario 2, where the prices are increased to include service charge, there is an element of deception in this scenario.

Due to lack of information pertaining to the levy of service charge, consumers are unable to properly evaluate their demand for the goods being provided as the price of the goods seem deceptively lower than they actually are upon payment of the bill. As a result, consumers are unfairly forced into purchasing goods that they otherwise may not have had they had complete information about the service charge and its impact on the final price of the good.

A study published in the Journal of Hospitality and Tourism Research collected empirical data on the effects of service charges versus service-included pricing on deal perception of consumers. When the service charge was 12%, it was found that menus stating the percentage of service charge to be added later lead to a better deal perception by consumers (M = 4.57) as compared to equivalent service included prices on menus (M=3.92)[21].[21] This indicates that even when the menu explicitly states that a given percentage of service charge would be added to the bill at the end of the meal, it still hinders the ability of consumers from making informed choices about their demand for that good, and is hence deceptive. The matter is worsened significantly when such a notice of service charge is either not provided before the customer orders, or if provided, it is placed in a small font in a not easily visible location on the menu.

In fact, the impact of the service charge on the ability of the consumer to determine their demand based on the price is increased due to the taxes that become applicable on that service charge. If for example, a restaurant were to levy a 10% service charge, and fall within the 10% GST bracket, then in effect the consumer would end up paying 11% more in the final bill (10% + 10% of 10%) as compared to when the consumer is allowed to leave a voluntary tip. What this means is that such factors are often not considered by consumers when demanding goods and made that much harder for them to properly assess the price on the basis of which to demand goods.

Economic Analysis of Mandatory Service Charge

The above provided rationale can be economically analysed for its impact on all involved stakeholders. The impact of levying a mandatory service charge can be graphically represented as shown below:

[21] Shuo, *supra* note 7.

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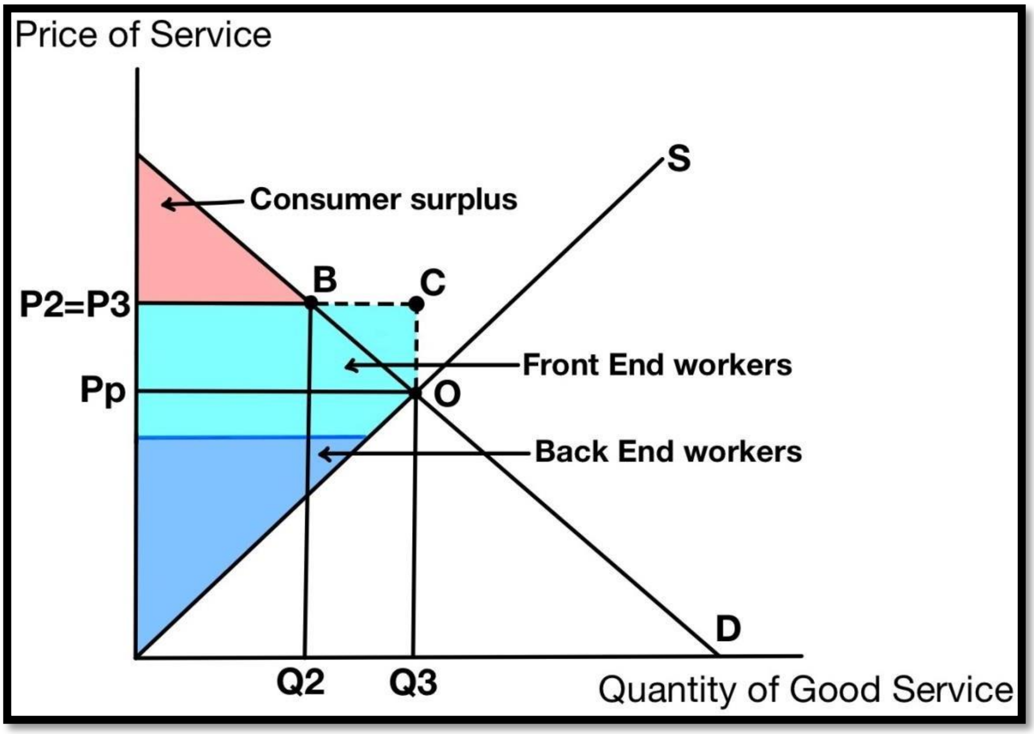

Fig 3.0 Market of Service Charge when it is Levied Mandatorily

In the diagram above, the point 'C' represents the point at which the market operates when Service Charge is levied mandatorily. In the diagram it is assumed that there is a complete lack of information about the levy of service charge to the consumer, as result of which the consumer demands goods i.e. places their order in the restaurant without accounting for its impact on the final price at all. However, it is possible that in certain circumstances notice is provided but the consumer underestimates its impact on the resultant price, in which case the impact of the deception would exist but be reduced than as shown in the diagram.

In this situation, where there is a complete lack of information pertaining to the mandatory levy of service charge, the consumer expects the price of service to be at the equilibrium price 'Pp' i.e. the perceived price, which lies at point 'O'. This is because they assume that the price that they would pay for the service received would be discretionary and in the form of an additional tip which would be proportional to the utility that they derived from the service. At this perceived price, the quantity of service demanded by the consumer is Q3.

However, after having purchased the goods, they are forced to pay the mandatory service charge added by default to their bill, thereby increasing the price of the service from the expected Pp to price 'P3' which is the same price as charged when the service charge was included in the price of the food 'P2' in the second scenario. However, in this scenario, since

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the consumer was not given adequate notice of the real price, they demand a far greater quantity than they would have had they known the true price, reflected by the difference between Q2 and Q3. This in effect artificially increases the demand by deceiving the consumer about the real price. On the graph, this is represented by the triangle 'OCB' which shows those consumers who would not have demanded the goods had they known the true price, as it now lies beyond the demand curve 'D'. Although the ultimate consumer surplus, marked by the red shaded region remains the same in scenarios 2 and 3, there is a feeling of deception on the part of the consumer, making them worse off in this scenario. The area enclosed between 'Pp-P3-O-C' represents the loss in consumer surplus suffered by the consumers due to this deception wherein they are made to pay a higher price of P3 as compared to the expected price of Pp. Therefore, the rectangle enclosed within 'Pp-O-C-P3' represents graphically the impact of the deception caused by a service charge when there is improper information provided to the customer about its levy which has been termed an "unfair trade practice" by the CCPA.

However, the producers are better off in this scenario as a result of the increase producer surplus in this context. Not only is a higher quantity traded, but they also benefit from the higher price charged for the service charge. The producer surplus is graphically represented by the blue shaded region, which is equitably distributed between both front-end and back-end workers. From the graph it is clear why this scenario is most beneficial for producers and therefore why NRAI and other restaurant owners are in this debate defending and promoting the levy of mandatory service charge.

Although at a first glance, the scenario appears economically efficient due to the absence of a welfare loss, it is imperative to note that the loss caused to the consumer as a result of the deception as marked by rectangle 'Pp-O-C-P3' can be considered economically inefficient as it prevents utility maximisation for the consumer and rational decision making. It would also mean, that after having been deceived once a consumer is unlikely to return to the same restaurant reducing the market size in the long run rather than promoting market efficiency.

Impact on Consumer Welfare

The contentions established conceptually above can be corroborated by empirical data. A survey conducted across India with over 21,000 respondents from consumers in 291 different districts ranging across Tier 1, 2 and 3 cities found that over 70% consumers were unwilling to pay the service charge. Out of this, 20% planned to put up a fight at restaurants so as to not pay, 37% intended on avoiding restaurants that levy a service charge and only 20% expressed

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willingness to pay the service charge is included in the bill.[22]

We can infer from these statistics that due to the poor quality of service and feeling of deception faced by consumers when forced to pay such a mandatory service charge, a portion of the consumers would be willing to put up a fight or even stop consuming those goods i.e. frequenting those restaurants in an attempt to ensure that their utility is maximised and they are able to benefit from their payments.

Parameter	**Scenario 1: Tipping**	**Scenario 2: Increased pricing**	**Scenario 3: Mandatory Service Charge**
Is the primary objective of incentivizing the workers achieved?	Yes to some extent (tipping is not adequate for proper incentivization)	No	No
Are the workers adequately remunerated for their service?	No	Yes to some extent (part of the remuneration is lost to rent)	Yes
Are the back-end workers able to benefit from the remuneration?	No	Yes to some extent (part of the remuneration is lost to rent)	Yes
Do the consumers get discretion to pay as per the utility deriver?	Yes	No	No
Do the consumers have proper information for decision making? i.e. they are not deceived	Yes	Yes	No

This data shows a largely adverse response from consumers towards service charge. The rationale for the same becomes apparent based on the admission of 71% respondents that they had had one or more experiences in the past 5 years where service charge was levied by an air-conditioned restaurant but their service was below expectations. In fact, as per the survey 23% stated it had twice, 18% said it happened on 3-5 occasions, 24% revealed that it had occured up to 10 times, while 6% admitted to having suffered such a bad experience in spite of service charge being levied in the bill, more than 10 times[23]

[22] FE Bureau, *Majority of consumers unhappy with High Court allowing service charge: Survey*, THE FINANCIAL EXPRESS (July 26, 2022 4:20:00 am), https://www.financialexpress.com/industry/majority-of-consumers-unhappy-with-high-court-allowing-service-charge-survey/2605931/.

[23] *Id.*

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This points to the fact that although the mandatory levying of service charge does not necessitate poor service in all cases, but the lack of incentive for workers coupled with lack of discretion provided to consumers means that there can often be cases where consumers pay for service charge and still receive sub-par quality service as demonstrated in the diagram above.

9. CONCLUSION

In order to objectively compare each of the three scenarios analysed above, it is necessary to compare the result that they produce for each stakeholder to determine the economic efficiencies and what the position of law should be. The table below attempts to summarise the findings of the study so as to draw this final conclusion.

Therefore, it is apparent from the table above, that none of the three scenarios are economically efficient as they do not achieve pareto optimality. In each scenario one of the stakeholders is better off at the cost of the other, resulting in inefficiencies. It therefore explains the grey area in the law receiving competing arguments from the consumers and the NRAI (i.e. the producers) and the academic debates surrounding.

10. RECOMMENDATIONS

Given that each of the existing scenarios discussed in the paper have significant cons and limitations which either prevent them from attaining the essential objective of incentivisation or cause unfair loss to one of the stakeholders, it is recommended that a different model from the ones discussed above is implemented so as to achieve the basic objective and reach closer to the economically efficient point of pareto optimality.

Keeping the above in mind, it is recommended that:

1) *A service charge of 10% be levied on the bill.*

This would ensure that despite the lack of a cultural or social environment to tip, the levy of the same would promote individuals to remunerate workers for their service and help fulfil the objective of incentivising workers to provide good service. The only downside to the same would be the inability to decide the amount of service charge to be paid in proportion to the quality of service, which although economically efficient has been practically found to be flawed. This is because the amount left when entirely discretionary is often arbitrary, and subject more to cultural and social factors than proportionate to the type of service. Therefore, by placing the 10% on the bill it would indicate to the consumer the amount to be left **if** they

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are satisfied with the service and in a way prevent undertipping.

2) *However, a very clear notice be also provided alongside that service charge stating clearly that the payment of the same is not mandatory and upon the discretion of the consumer depending upon satisfaction achieved by the quality of service provided.*

By making the payment of such a service charge voluntary rather than mandatory, it will ensure that the consumer still retains discretion so that they only pay when they are satisfied with the service received ensuring that their utility is maximised in proportion the amount paid.

3) *An option be provided to the consumer to remove aforementioned service charge fromthe bill upon request.*

Culturally it is seen that consumers do not voluntarily leave adequate tips. But through the survey discussed earlier, it was seen that when dissatisfied with the quality of service respondents had stated that they would be willing to fight for removing the service chargeindicating the cultural norm to have the incentive to do so. As a result it would allow consumersto retain discretion while also increasing the likelihood of workers being adequately remunerated when good service is provided. Further, by allowing the consumer to remove the service charge from the bill as compared to it being mandatory, the element of deception is entirely removed, and the workers remain incentivised to provide good service under the fear that their income may be reduced if not.

4) *A clear notice be provided to both consumers at the start of the meal prior to placing their order about such a voluntary service charge as well as the workers that their receipt of income through service charge would be dependent upon the quality of service provided by them.*

By providing clear notice to both stakeholders, it would remove the information asymmetry and allow both parties to make better, informed decisions and as a result increase the efficiency of the market as a whole.

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ISSN 2582-2667