Online merchants know that e-commerce fraud poses a threat to their profits. They tend to be less aware of – and certainly less prepared for – the risk that false declines pose to profits and the customer experience their online store delivers.

As consumers increasingly use their digital devices to make online purchases, merchants find themselves struggling to find the right balance between robust fraud protection and a frictionless checkout experience.

Achieving this balance isn’t easy, but it’s critical to the success of every online store.

A new report commissioned by ClearSale and researched by the Aite Group – “The E-Commerce Conundrum: Balancing False Declines and Fraud Prevention” – provides new insights into how online merchants today are navigating this challenge.

Key takeaways from our report on false declines:

- Losses due to e-commerce fraud are projected to reach $6.4 billion by 2021. But losses due to false declines are projected to reach $443 billion by 2021 – nearly 70x more than losses from fraud itself.
- 62% of online merchants have seen false decline rates increase over the past two years.
- Automatically declining suspicious transactions may be the reason behind high false decline rates.
- Customers become unhappy when their orders are incorrectly declined, and this dissatisfaction can hurt sales over the long term.
- In competitive markets, a frictionless buyer experience can be a key differentiator for savvy merchants. The challenge is to balance customer experience with efficient fraud prevention.
- Most merchants understand the need to combine automated decisions with manual reviews. But there’s an opportunity to dramatically improve the artificial intelligence used to send orders to be manually reviewed.
- Merchants are carefully implementing fraud prevention strategies – but these strategies are not lowering their chargeback rates. Instead, they are harming the customer experience.

Our research uncovered interesting insights into how merchants are working to prevent fraud, reduce false declines, and improve their overall customer experience. Read on to learn more.
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The Rise of E-Commerce Fraud

Yes, e-commerce fraud attacks are more and more common – both domestically and internationally. In fact, almost all of the merchants we surveyed reported at least some level of attempted fraud in 2018, and 22% said these fraud attacks exceeded 0.51% of their company’s revenue.

22% of merchants experienced attempted fraud exceeding 0.51% of their company’s revenue

Q: As a % of your company’s revenue, what was the % of attempted fraud in 2018?

Q: What were your losses to fraudulent chargebacks as a % of revenue in 2018?

Fraudulent Chargebacks Contribute to Revenue Losses

Losses caused by fraudulent chargebacks are a major contributor to fraud losses, with 19% of merchants surveyed reporting losses to fraudulent chargebacks costing more than .5% of revenue in 2018.

19% of merchants experienced fraudulent chargeback losses exceeding 0.5% of their company’s revenue

CNP Fraud Contributes to Revenue Losses

Despite the expectation that fraud would decrease in the wake of the global EMV implementation, the opposite has occurred. Card-not-present (CNP) fraud has escalated rapidly and is expected to top $6.4 billion in the United States by 2021.

CNP fraud will reach $6.4 billion in the US by 2021

Projected CNP Fraud Losses (in US$ Billions):

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<tr>
<td>Value</td>
<td>$2.8</td>
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Organized crime rings are likely behind much of this fraud activity. Because the kingpins of these crime-rings are seldom caught, there is little to prevent them from continuing to escalate their coordinated attacks.

Basing fraud levels underscore the important of implementing robust fraud controls. This is especially true for merchants who have no idea how often they’ve been a target of fraud attacks.

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19% of merchants experienced fraudulent chargeback losses exceeding 0.5% of their company’s revenue

Q: What were your losses to fraudulent chargebacks as a % of revenue in 2018?

More than 100 basis points | 2% |
51 to 75 basis points | 11% |
51 to 75 basis points | 14% |
31 to 50 basis points | 11% |
11 to 20 basis points | 19% |
6 to 10 basis points | 13% |
1 to 5 basis points | 0% |
Don’t know | 1% |
21 to 30 basis points | 5% |
31 to 50 basis points | 6% |
6 to 10 basis points | 5% |
11 to 20 basis points | 6% |
1 to 5 basis points | 6% |

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In-House or Outsourced Fraud Prevention?

When developing a fraud prevention strategy, the first decision a merchant must make is whether to build an in-house fraud prevention team or leverage a third-party fraud prevention provider. Today, 25% of merchants completely outsource their fraud prevention measures, these factors alone don't explain how merchants choose their fraud prevention suppliers.

In fact, if merchants are learning anything in today's increasingly risky marketplace, it's that they need to take a flexible approach to fraud prevention. Just because they've invested in a solution doesn't mean that they should be locked into it for life.

Making Changes in Fraud Prevention Strategies

The merchants we surveyed are spending an increasingly large percentage of their revenue on fraud and protect the customer experience.

Q: What did you spend on CNP fraud prevention as a % of revenue in 2018?

Q: For which transactions will you use 3DS 2.0?

Q: Do you plan to deploy 3DS 2.0 in the next 18 months?

Q: Which automated fraud prevention solutions do you use?

The Cost of Fraud Prevention

All international transactions are subject to chargebacks, and all chargebacks are subject to a 2% chargeback fee. If a merchant doesn't have a good fraud prevention strategy, they could be spending 2% of their revenue in chargebacks.

The fraud prevention solution chosen will determine the cost savings or cost increase. For merchants who manage fraud entirely in-house, with no outsourcing and no use of external tools, our study revealed a market trend towards outsourcing. Only 7% of merchants say they manage fraud entirely in-house.
Manual Reviews and Automated Declines

Sometimes, correctly identifying fraudulent orders from good orders is like finding a needle in a haystack. The merchants we surveyed use multiple tactics to validate incoming orders, including both manually reviewing questionable orders and automatically declining highly suspicious orders.

The Prevalence of Manual Reviews

We were somewhat surprised to find that all our survey respondents review at least some of their transactions, and 15% review every transaction. Only 2% of merchants review fewer than 10% of transactions.

The Prevalence of Automated Declines

Given the inefficiencies around manual reviews, it may seem prudent to automatically decline orders that are highly suspicious. More than half of the merchants we surveyed report their fraud prevention solution automatically declines between 3.1% to 7.5% of all their transactions.

Q: What % of your sales transactions do you manually review?

<table>
<thead>
<tr>
<th>Percentage Range</th>
<th>Manual Review %</th>
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<tbody>
<tr>
<td>1% to 10%</td>
<td>15%</td>
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<tr>
<td>11% to 20%</td>
<td>16%</td>
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<tr>
<td>21% to 30%</td>
<td>9%</td>
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<tr>
<td>31% to 40%</td>
<td>7%</td>
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<tr>
<td>41% to 50%</td>
<td>2%</td>
</tr>
<tr>
<td>51% to 60%</td>
<td>0%</td>
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<tr>
<td>61% to 70%</td>
<td>0%</td>
</tr>
<tr>
<td>71% to 80%</td>
<td>0%</td>
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<tr>
<td>81% to 90%</td>
<td>0%</td>
</tr>
<tr>
<td>91% to 100%</td>
<td>0%</td>
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</tbody>
</table>

ClearSale’s approach to fraud prevention means doing three things well:

1. Approve more good orders.
2. Stop more fraud.
3. Make decisions faster.

Our team of more than 700 specialized fraud analysts is the largest manual review team in the world and has been delivering the highest order approval rates since 2001.

ClearSale’s fraud prevention solution automatically declines between 3.1% to 7.5% of all transactions.

Contact our sales team to learn more.

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False decline versus auto decline rates

In fact, there is a high correlation between auto-declines and false decline rates.
Desire to improve customer experience is keeping their eyes on when it comes to reducing fraud risk. When it comes to monitoring CNP fraud, the false decline rate is just one important metric to consider.

### Other Important Fraud Metrics

Our survey revealed that payment gateways and credit card networks are the most common sources of fraud. False declines are such a problem in the industry that 79% of merchants we surveyed measure false decline rates as a key metric. False declines are good orders that appear to be fraudulent; if the orders are indeed fraudulent, that reinforces the need for businesses to implement their current fraud prevention process.

#### Revenue Losses Due to False Declines

- **2018**: $131 billion
- **2019**: $137 billion
- **2020**: $202 billion
- **2021**: $293 billion

The potential impact unhappy customers can have on revenue underscores just how important it is to understand where false declines happen. For both merchants and consumers, false declines are frustrating. False declines are good orders that appear to be fraudulent; if the orders are indeed fraudulent, that reinforces the need for businesses to implement their current fraud prevention process.

#### Generational Differences and False Declines

Millennials – individuals who were born between 1981 and 1996 – make more than 50% of online purchases, and their spending power is growing, as demonstrated in the graph below. This is important for merchants, because Millennials have high expectations around their online shopping experiences. They are far less willing to forgive a merchant for a false decline than older generations.

#### Performance metrics per manual reviewer/fraud model’s decision-making

<table>
<thead>
<tr>
<th>Factor</th>
<th>Manual approval rates</th>
<th>Chargeback rates</th>
<th>Chargebacks</th>
<th>Manual review (n=69)</th>
<th>Detractors</th>
<th>New customers</th>
<th>Attrition</th>
</tr>
</thead>
<tbody>
<tr>
<td>High fraud losses</td>
<td>2%</td>
<td>7.5%</td>
<td>2.5%</td>
<td>15%</td>
<td>2x</td>
<td>2x</td>
<td>96%</td>
</tr>
<tr>
<td>Simplification of process</td>
<td>59%</td>
<td>7.5%</td>
<td>2.5%</td>
<td>15%</td>
<td>2x</td>
<td>2x</td>
<td>96%</td>
</tr>
<tr>
<td>Eliminate chargback liability</td>
<td>0.6% to 1%</td>
<td>2%</td>
<td>0.5%</td>
<td>0% to 5%</td>
<td>0.6%</td>
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<td>0%</td>
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<td>0.6% to 1%</td>
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And here lies the issue with false declines: if the fraud prevention process is too stringent or inflexible, the process will almost certainly result in legitimate orders being declined. This can lead to high cart abandonment rates, chargebacks, and revenue losses.
Recommendations for Moving Forward

Tips for balancing false declines, fraud prevention, and the customer experience

While e-commerce fraud continues to escalate rapidly, false declines can also wreak havoc on revenue and customer relationships.

So, how can merchants balance fraud prevention, revenue, and the customer experience?

Here are four recommendations to consider implementing today:

✔ **Review current fraud prevention solutions.**  
Evaluate your CNP fraud protection and make sure it detects and prevents fraud without generating high false positive rates that can lead to costly manual reviews and potential false declines.

✔ **Communicate with the other parties in the payment approval chain.**  
Because a transaction can be falsely declined at any point in the payment approval process, talk with the other parties in your network to discuss how to work together to increase sales without increasing fraud losses.

✔ **Perform risk assessments.**  
Determine how and where fraud losses are occurring and whether additional fraud prevention layers can help mitigate those losses.

✔ **Understand the business case behind implementing a new fraud protection layer.**  
Whether you're thinking of adding a new fraud protection layer now or including it in future plans, your business case should consider any potential gains in operational efficiency and reduction in fraud losses. Also, consider that as other merchants implement more stringent fraud prevention strategies, organized crime rings will target less-protected merchants. Don't let that be you.
Our Data and Methodology

We conducted our research in May 2019 as a collaboration between ClearSale and Aite Group. Aite conducted an online survey of executives at 100 U.S. merchants with annual revenue between $100 million to $999.9 million.

To qualify for their survey, merchants with revenue between $100 million to $499 million had to generate at least 30% of their revenue via e-commerce, while merchants with revenue of $500 million to $999.9 million had to generate at least 20% of their revenue via e-commerce. Ultimately, 75% of the participating merchants generated at least 50% of their total annual sales via digital channels.

Q: What are the primary types of goods sold by your company?

- Apparel and accessories: 62%
- Consumer electronics: 50%
- Consumer packaged goods: 50%
- Luxury goods: 34%
- Sports and fitness: 32%
- Furniture and appliances: 31%
- Toys and hobbies: 28%
- Office supplies: 28%
- Video games, consoles, and accessories: 27%
- Home and garden: 24%
- E-books or audio books: 23%
- Cosmetics: 23%
- Online gaming: 22%
- Books and magazines: 18%
- Fitness or nutrition tracking: 17%
- Alcoholic beverages: 16%
- Health and nutraceuticals: 16%
- Flowers, greetings, and miscellaneous gifts: 14%
- Streaming movie services: 14%
- Financial management tools: 14%
- Automotive, boats, airplanes: 12%
- Travel: 10%
- Event tickets: 8%
- Other - virtual digital goods: 1%