CNP WHITE PAPERS

False Positives...

The Monster That's Really Killing You and How to Survive

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DECODING DIGITAL PAYMENTS & FRAUD

Radial

The best parts of any good horror movie are the surprising and creative ways the bad guys get their victims. Invariably, most of the teen heroes never see the chainsaw coming. In real life, however, that's never the best part. eCommerce fraud professionals battle their versions of Freddy Krueger, Norman Bates, Michael Meyers and Jason Voorhees head-on every day. And, when it comes to fraud, they often slay the monster. But, while many have their eyes focused on the threat in front of them, they can't see the real danger—the bigger danger—lurking in the shadows.

False positives—transactions attempted by legitimate customers that are flagged as suspicious by a merchant's fraud-prevention system—are a bogeyman that fraud professionals know exist. In fact, nearly 70 percent of merchants say they are concerned about their fraud prevention incorrectly targeting legitimate customers[1]. Intuitively, they understand that delaying, declining or canceling an order can result in the immediate loss of the sale in question and, more importantly, subsequent sales to a customer who, out of frustration, turns to a competitor—maybe for life.

The Price of Not Undertaking a Hard Problem

Plagued by a lack of effective ways to measure the problem, false positives often get ignored or their costs are underestimated. Despite the long-term damage to the brand caused by insulting customers—essentially calling them thieves—67 percent of merchants say a fraudulent transaction that is not detected is more costly than a legitimate transaction that is falsely declined[2].

Why? Because, it's relatively easy to measure the effect fraud has on a merchant's revenue. Subsequently, it's relatively easy to measure the ROI of technology and people devoted to fraud prevention. And, in the face of eCommerce fraud that has risen to unprecedented levels in the past year[3], companies can use that demonstrated ROI to justify spending on tools and people to fight the problem.

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Some eCommerce merchants are spending up to 23 percent of their operational budget on fraud prevention[4], so the will to invest in response to a well-defined challenge is there. On the other hand, it is very difficult to measure the most important impact of false positives—long-term revenue loss. Some aspects of the false positive conundrum have been explored. One study found one-third of all declines are false positives and that merchants, on average, are losing 2.79 percent of their revenue to false positives versus 0.52 percent to chargebacks[5]. But few, if any, offer merchants a methodology to begin to study the effect of false positives on their particular business.

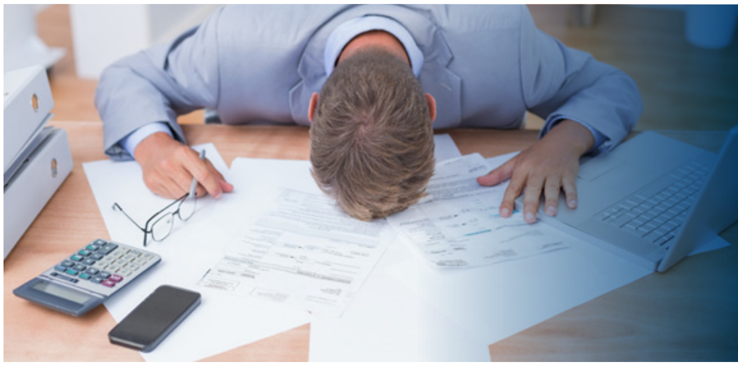
Defining the Cost of False Positives in Your Business

How can a merchant accurately capture what happens after it has declined or canceled an order placed by a legitimate customer? How do you compare the behavior of a happy customer who has never experienced any friction in the buying process to that of an insulted customer over time if the insulted customer never returns? The fraud team at payments and fraud technology and service provider Radial, devised a way to approximate the impact and achieve a definitive comparison.

How? Examine the behavior of legitimate customers who returned to your site *despite* experiencing a decline. According to Michael Graff, senior fraud manager at Radial, this is a good way to understand the magnitude of the revenue loss created by false positives, including those customers who were not lost for good.

Scary Numbers

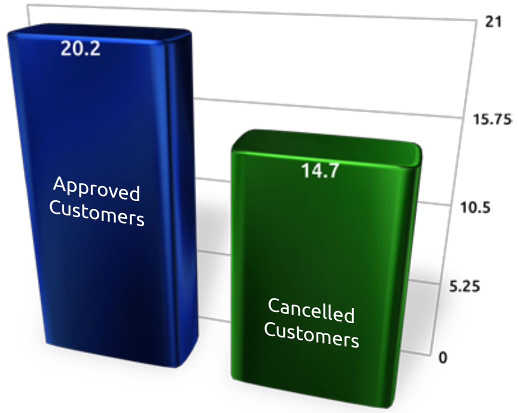
Graff's team identified customers who had an order canceled and came back to the site, ordered the same or a very similar item and this time had the transaction approved. Because these customers were replacing the original order and were approved, the team concluded it was an extremely strong, analytically based indication that the original cancel was a bad decision.



So, Radial now had a base of legitimate customers who had been wrongly identified as fraudulent, but not so insulted that they were lost to the merchant forever. How did those customers compare over time to loyal customers who had never been wrongly declined?

Throughout the period of a year, customers who had never been declined averaged 20.2 orders vs. 14.7 orders made by those who had experienced declines due to false positives. Experiencing a decline also affected how much they spent. The average order value for customers not impacted was $361.98, compared to declined customers, who spent an average of $159.30 per order. The reduction in orders and average order value after a legitimate customer was declined resulted in a 68 percent lower lifetime value per year, per impacted customer. And that, of course, is only for the portion of affected customers who still returned. The scope of the additional revenue loss attributed to customers that were permanently lost exacerbates the false positive problem to an even more significant degree.

Average Number of Orders



Average Order Amount

"The results of the analysis surprised me," Graff said. "These customers are willing to spend money on a brand. But one bad cancel destroys a lot of the equity a brand has managed to build. The effect is evident and significant.

While the customers did come back and could even come back several times during the course of a year, they simply won't spend as much as the customers who are never declined. You think you've saved the relationship when the customer orders a replacement, but you didn't recoup the original loss and the customer relationship with the brand is now tarnished. This is how consumers react and merchants need to recognize and address it for the problem it is."

Whistling Past the Graveyard

Attacking the problem of false declines begins with a willingness to face it. There are some indicators merchants are acknowledging the problem, but they still are more concerned with preventing fraud than ensuring against false positives.

> *"The effect is evident and significant. While the customers did come back that one time and could even come back several times, they simply won't spend as much as the customers who were never insulted."*

While automation has been a major net positive for companies facing eCommerce fraud, overreliance on it can throw the delicate balance necessary to control false positives out of whack. Overly restrictive rulesets, outdated blacklists or machine learning technology not tuned with proper and comprehensive data can all result in excessive false positives that may erode revenue on a far grander scale than fraud will.

Some level of automation in the fraud detection process is essential to perform at scale, but merchants abandon a balanced response to fraud that includes manual review at their peril. Approval rate, false positive rate, manual review rate, and speed are metrics that need equal consideration in any fraud prevention operation.

This layered approach as part of a fully managed fraud solution enabled one Radial client to approve 85 percent of the orders that previously would have been declined.

Conclusion

Fraudsters are acting in ways we have never seen before. They are attacking from more vectors, in more concentrated ways, and in shorter windows. Fraud prevention professionals are understandably rattled and looking for ways to respond to threats that have materially harmed their businesses. But they must resist a natural inclination to tighten the screws, inadvertently insulting valued customers.

Advanced methods to delineate the problem of declining legitimate orders have placed more certainty around their effect on revenue than ever before. Merchants don't know all the numbers. But, the numbers uncovered by Radial's analysis are frightening. Thousands of dollars per customer, per year, are at risk, and that is only from customers who return.

To retain that revenue, merchants must recalibrate to appropriately consider the true threat of all types of fraud and false positives to their businesses. All merchants should be engaged in ongoing analysis of not only approval and manual review rates, but also conversions and how to raise those rates and reduce risk to increase bottom-line revenue. While the cost of false positives is sometimes difficult to quantify, it takes recognition of the problem to uncover and defeat it. Failure to address this risk that's lurking behind the scenes can be catastrophic.

References

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ABOUT CARD NOT PRESENT®

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ABOUT RADIAL

Radial is a leader in omnichannel commerce technology, payments and fraud, and operations, enabling brands and retailers to profitably exceed customer expectations. Radial's solutions connect supply and demand through efficient omnichannel technologies, fulfillment and transportation options, intelligent fraud, payments, and tax systems, and personalized customer care services.

Hundreds of retailers and brands confidently partner with Radial to simplify their post-click commerce and improve their customer experiences. Radial brings flexibility and scalability to their supply chains and optimizes how, when, and where orders go from desire to delivery. Learn how we work with you at www.radial.com.

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