Lost in Transaction

Can merchants be everything to everyone?

Volume II

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Introduction

More than two decades since the advent of the web, successful digital business strategies remain an elusive target for many e-commerce operators and vendors.

Intense competition, an increasingly complex blend of marketing channels, cross-border challenges, fraud, risk, and a multitude of digital distractions all conspire to make life difficult for merchants – not least when it comes to payments, the critical component in successful sales transactions.

Today, the primary battleground for attracting customer spend is the so-called customer experience. Make life easy and enjoyable for customers, the argument goes, and the money will inevitably follow; a mantra currently driving design and implementation strategies across the whole continuum of digital retail environments.

The big question for retailers is how well these strategies really translate into greater sales volumes. Innovation around customer experience is clearly a vital factor in attracting and keeping customers. But many other factors continue to play a critical role in converting experience over to transactions. Concerns about fraud in particular and the safety of merchants' payment methods in general remains a serious barrier to completed transactions. The abandoned shopping cart, in particular, has long been a thorn in the side of digital vendors, representing not just lost immediate sales but future growth and advocacy too.

Finding the right balance between customer convenience and confidence in transaction security is one of the greatest challenges that merchants face. As payment methods proliferate and customer preferences shift accordingly, that balance will become even harder to maintain.

In *Lost in Transaction: Volume I*, we looked at the trends in payments methods, and how consumer preferences are changing. This report, *Lost in Transaction: Volume II*, looks at how businesses can meet challenges set out by a fast moving payments industry and ever-evolving consumer demand. In particular, it examines the reality of consumer expectations around experience and security; why merchant attitudes towards payment methods might not be sufficiently well aligned to those expectations; and, ultimately, how they may be losing significant business and revenue as a result.

67% of people have abandoned an online shopping cart in the last month

Key findings

The most significant finding from this report is that convenience matters less then security to the majority of consumers.

The widely-held belief that consumers value convenience above all is a potentially dangerous one; investment in customer experience is undoubtedly important, but not at the expense of trust and security.

The second key finding of this study is the sense that security and trust customers have for a merchant is directly correlated to how their data is protected. High-profile stories of major brands suffering data breaches – credit monitoring agency Equifax and payday loan company CashNetUSA are just two of the most recent examples – continue to dent consumer confidence. So too has growing public awareness of the threat of identity theft. The practical impact of these threats is a real and measurable one; our research shows that most consumers would readily accept more stringent methods of payment security, including two-factor authentication, if it could lead to a reduction in fraud.

Thirdly, there is also a high correlation between trust in merchants and the payments methods they use, even if that trust is misplaced. Merchants offering trusted payments mechanisms are seen as secure by extension, despite the fact that even the most well-known payments brands are vulnerable to fraud – 8% of consumers surveyed here were victims of fraud through digital wallet usage in the last year.

Finally, fraud reduction must be a priority for merchants across the board. While many merchants are investing in experience, they must also continue to invest in payments methods that not only make consumers feel safer but which actually are more secure. Reduction in the incidence of fraud in particular must be a key objective for any merchant conducting transactions online. Failure to do so will lead to financial losses for companies and consumers alike. Conversely, the merchants that successfully reduce fraud and demonstrate robust security will have more trusted relationships, greater frequency of purchases, and fewer customers lost in transaction.

> “Customers have spoken. It’s not about making paying online easier anymore. It’s about making it safer. Businesses need to listen.

Oscar Nieboer, Chief Marketing Officer, Paysafe Group

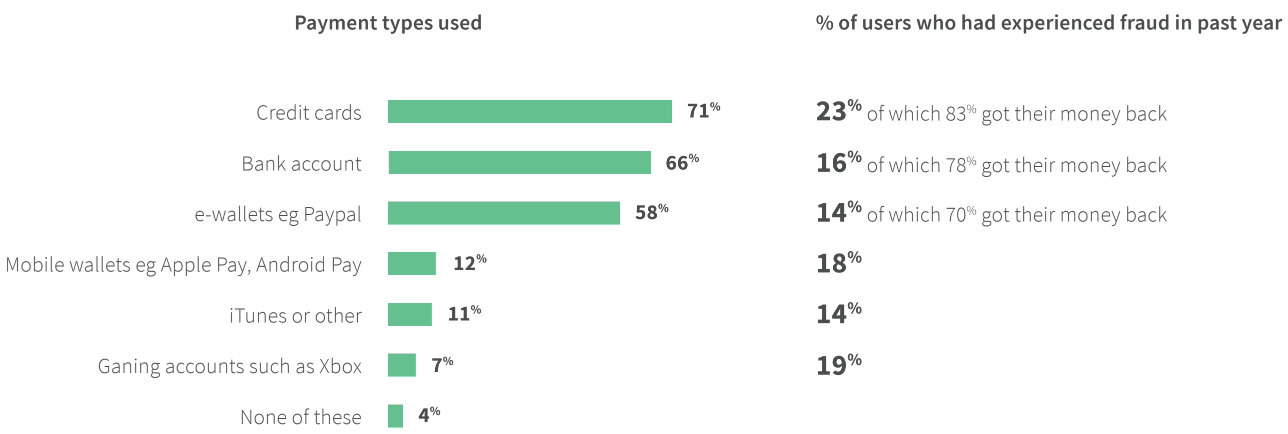
The Consumer View

An inevitable risk?

Online fraud is hardly a new phenomenon. Since the beginning of the e-commerce explosion in the late 1990s, the web has been a fertile ground for hackers and fraudsters targeting consumers with weak security defences. What is new, however, is that consumers now view fraud as an inevitable part of shopping online. Consumers are more conscious of, and educated about, fraud than they ever have been; in surveying three key retail markets (US, Canada and the UK,), our study found that around half of the consumers in each country see fraud as an inevitable risk if they use online retailers1. At the same time, 81% of consumers avoid shopping via unsecured or public networks, a clear behavioural response to the very real threats of fraud.

Of those who do fall victim to fraud, many eventually recover their losses – 83% of credit card users, 78% of bank account users and 70% of digital wallet users. Across those three payment channels, however, more than one in five shoppers suffer permanent losses, often running into hundreds of dollars or pounds. Even those who are reimbursed are likely to have a negative view of the whole experience – not just the merchant involved but the payment method used too. For example, the 70% of consumers who have experienced fraud via a digital wallet are likely to have greatly diminished trust in both the retailer and the payments platform from then on.

Fig. 1: What payments systems do you use? / Have you suffered from fraud and, if so, did you recover your losses?



Right the wrong balance

It is unsurprising, then, that consumers are starting to favour security and fraud protection over the convenience of quick and easy online purchases. Exactly how businesses are responding to this trend is less clear-cut. Just over half (54%) of merchants believe their consumers are not fully aware of the risks of fraud according to this study – and 36% fear their customers will resist further fraud reduction measures that might compromise convenience.

This dichotomy is illustrated by the imbalance between buyers and sellers in terms of their acceptance of better security. 58% of consumers said that they would be willing to accept whatever security measures are necessary to eradicate fraud, with two-thirds being open to a two-step authentication process – a clear challenge to the idea that all consumers want password-free, one-click payment methods rather than more secure processes that, by their very nature, take more time. Yet only 36% of merchants say that they would increase security regardless of the impact on convenience.

This balancing act is now at the heart of every modern digital business.

> “We're all guilty of saying one thing but doing another. Consumers say they're up for extra security measures but will they continue to be engaged when if, for example, they encounter double authentication?
>
> **Daniel Kornitzer, Chief Product Officer, Paysafe Group**

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Merchant Payment Methods

Navigating the payments landscape.

Life for today's digital merchants is complicated by the sheer number of online payments options that consumers demand. Inevitably, cards continue to dominate the landscape – despite the fact that nearly 40% of merchants would like to see less use of both credit and debit cards, according to this research. One notable feature of this breakdown is the difference in adoption rates of digital and mobile wallets. Despite the dominance of mobile devices in consumers' lives and the dramatic increase in so-called commuter commerce, adoption rates of cloud-based digital wallets such as PayPal still greatly exceed that of device-based mobile wallets among retailers (77% versus 55% respectively). Perhaps the most surprising trend here is the presence of blockchain-based systems such as Bitcoin, already offered by 23% of retailers we surveyed – an indication that cryptocurrencies are rapidly getting a seat at the table.

Fig. 2: Online payment methods offered

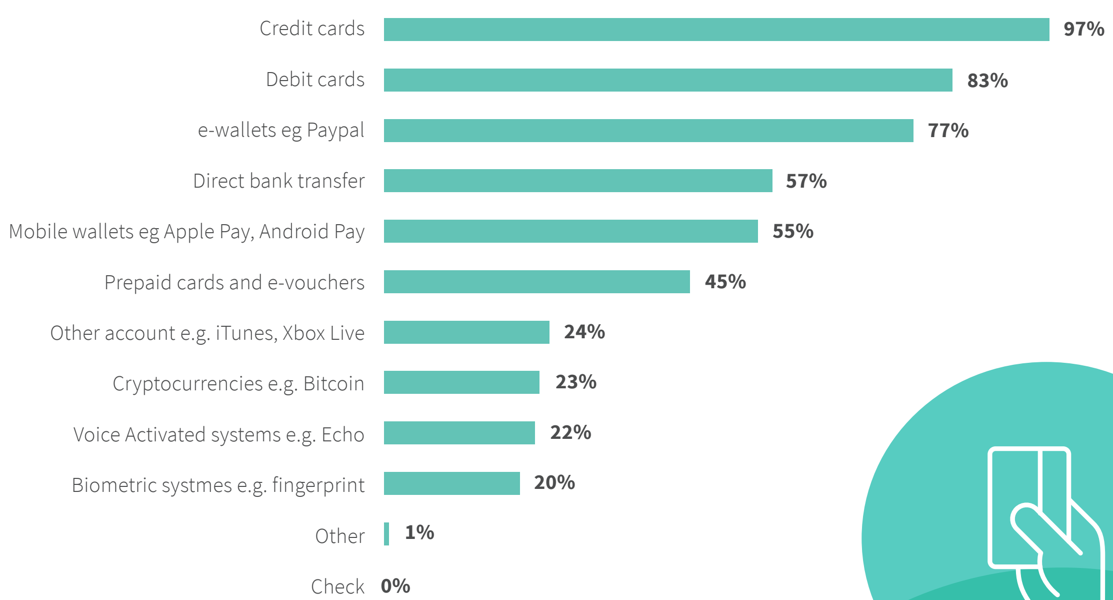

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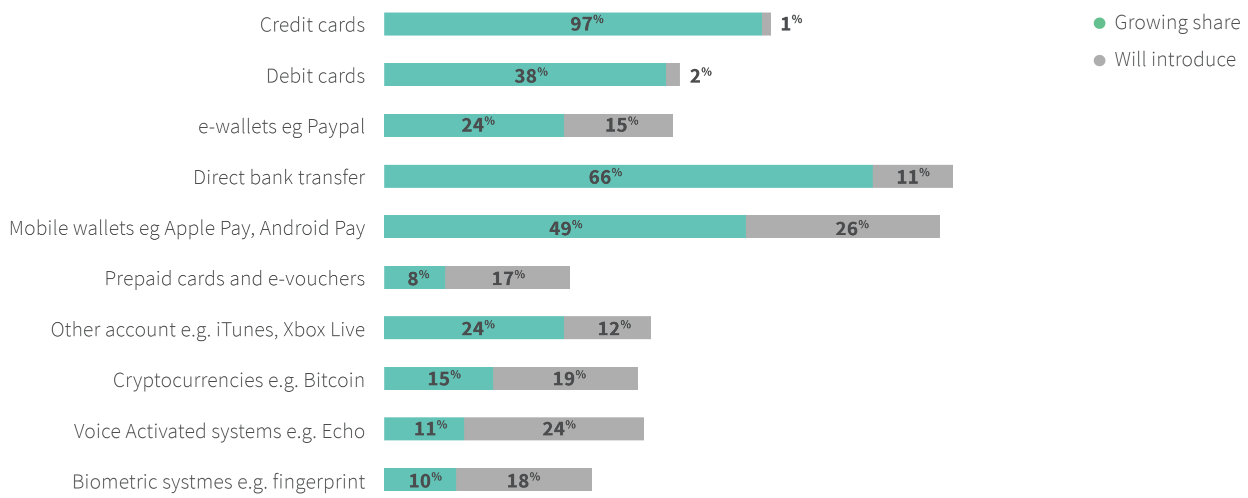
Fig. 3: Payment methods offered by country

	Online			Offline		
Credit cards	96%	98%	98%	79%	77%	65%
Debit cards	88%	94%	68%	77%	82%	72%
Check	-	-	-	74%	60%	57%
Prepaid cards and e-vouchers	42%	43%	51%	41%	29%	39%
e-wallets e.g. Paypal	74%	80%	77%	35%	30%	24%
Mobile wallets e.g. Apple Pay, Android Pay	62%	59%	45%	35%	37%	30%
Other account e.g. iTunes, Xbox Live	24%	20%	28%	-	-	-
Direct Bank Transfer	57%	60%	55%	41%	46%	29%
Crypto Currencies e.g. Bitcoin	23%	22%	23%	11%	13%	17%
Voice-activated systems e.g. Echo or Alexa	21%	18%	26%	-	-	-
Biometric systems e.g. fingerprint	18%	20%	21%	16%	18%	13%

How will this picture evolve over the next two years? *Lost in Transaction: Volume I* showed that 89% of people believe they will be using their mobile wallets much more in two years' time, and that a quarter (23%) agree that cryptocurrencies such as bitcoin are a key element in the future payments landscape. Both of these findings are supported by the merchant adoption plans highlighted in this study. Merchants expect significant growth in traditional card-based methods, but Fig. 4 shows that the big news is in wallets; both digital and mobile wallets are expected to make increasingly important contributions, with retailers either prioritising their use, introducing them or (in the case of digital wallets) both.

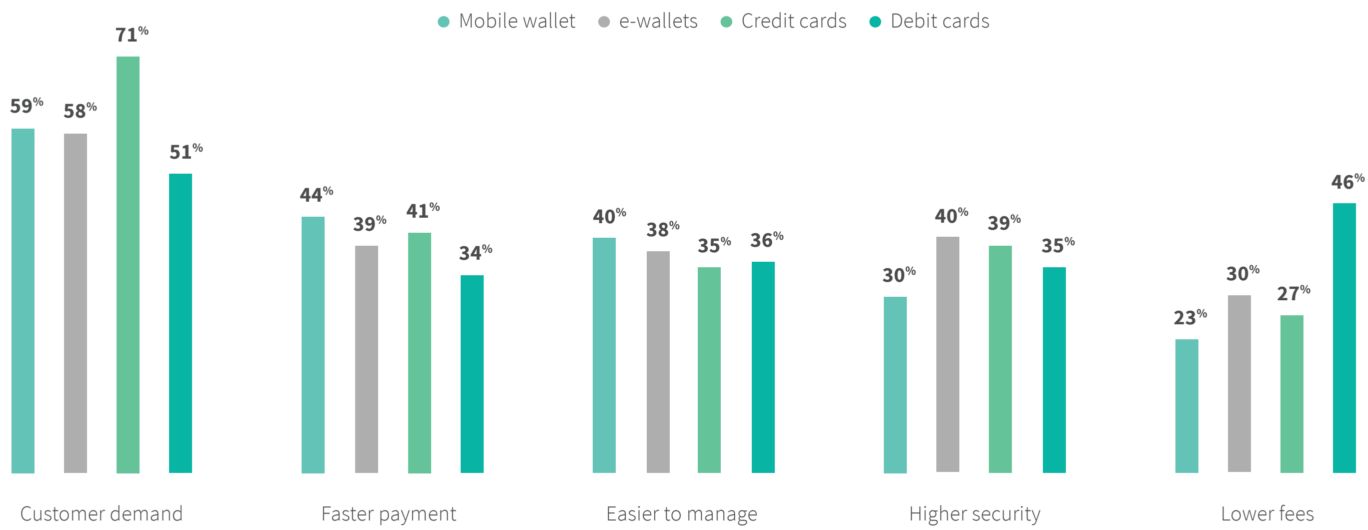
Voice-activated systems like Amazon's Alexa, too, will become more widespread, with 24% of respondents planning to adopt them by 2019; and the growth in cryptocurrencies is set to grow too, with one in five retailers planning to introduce them over the same period. The key challenge for merchants adopting these still emerging technologies will be to ensure that they meet consumer expectations around security and trust – still an unknown quantity at large scale in the retail world.

Fig. 4: Which of these payment methods do you currently accept and expect to see growing over the next two years? And which do you plan to introduce in the next two years?



It's not just consumer demand that is driving these adoption patterns. This study shows that several other factors – fees, ease of management, speed and – crucially – security also come into the picture for merchants assessing the suite of payment methods they offer, as Fig.5 shows.

Fig. 5: What is driving the growth in usage of payment methods?



Fighting Fraud on Three Fronts

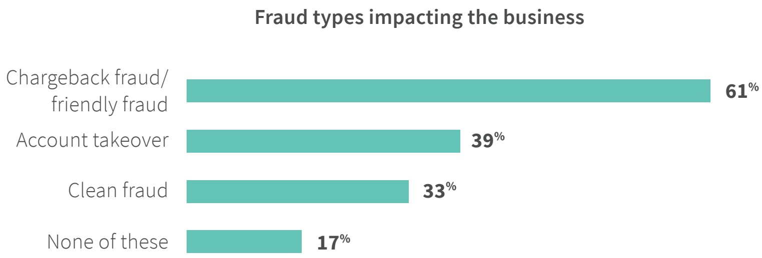
One critical factor for consideration when adopting new technologies is their susceptibility to fraud. Only once that is fully understood can merchants make accurate assessments about the balance of risk and convenience to consumers. The reverse is also true; by determining risk, they can also make better decisions about which technologies to phase out.

As part of this research, Paysafe sought to identify a link between specific payment methods businesses are looking to phase out and how susceptible they are to fraud.

Traditional cards are at the top of the list of methods that retailers are looking to retire; nearly two-thirds (60%) of businesses think credit cards are most vulnerable to fraud.

Just as important are the types of fraud committed, and how these are intrinsically linked to certain payment methods. Fig.6 explains which forms of fraud businesses are most likely to suffer from. Chargeback fraud is causing the greatest global impact overall, and is hitting US businesses the hardest. On the other hand, clean fraud is having a significant impact on Canadian businesses.

Fig. 6: Which of the following types of fraud are currently impacting your business, and which is having the greatest impact on your business?



	Greatest impact			
Chargeback fraud/ friendly fraud	46%	49%	45%	44%
Account takeover	24%	27%	26%	20%
Clean fraud	30%	24%	29%	37%

As new technologies develop to improve consumer experience, so too will new types of fraud. To maintain the balance between security and convenience, fraud detection methods and processes will need to adapt accordingly – and they will need to do so quickly.

> “A sense of fraud control is just as important as convenience to consumers; something that merchants haven't ranked as highly in the checkout experience.
>
> **Andrea Dunlop, CEO Acquiring & Card Solutions, Paysafe Group**

The Three Key Types of Fraud

1 Chargeback/ Friendly fraud: Friendly fraud occurs when a merchant receives a chargeback because the cardholder denies making the purchase or receiving the order, yet the goods or services were actually received.

2 Account takeover fraud: The use of limited personal information such as a name and credit card number to conduct payment fraud. In this scenario, a fraudster poses as a genuine customer and gains control of an account, changing a few details, such as email or address, to allow them to make transactions.

3 Clean fraud: A method whereby a fraudster has been able to carry out a purchase by using a complete profile of stolen data that makes the transaction appear legitimate, rendering the merchant unable to identify that fraud has been committed.

How prepared are today's merchants?

Fraud readiness at the front line.

How prepared are merchants to combat fraud? This study measured their readiness by examining three critical factors: what verification factors they use, how often they review their IT security and the level of their anti-fraud investment.

Fig.7 looks at the verification measures used by country. Conventional fraud detection techniques such as bank account checks and address verification systems are still the most widely-used, although the growing amount of data available about individuals is having a significant impact on the availability and usage of fraud detection methods; biometrics, social media usage and geo-location are all in use by merchants, most prominently in the US.

Fig. 7: Which of the following identity verification techniques does your organisation currently use?

Note: figures in green indicate above-average usage; figures in red indicate below-average usage

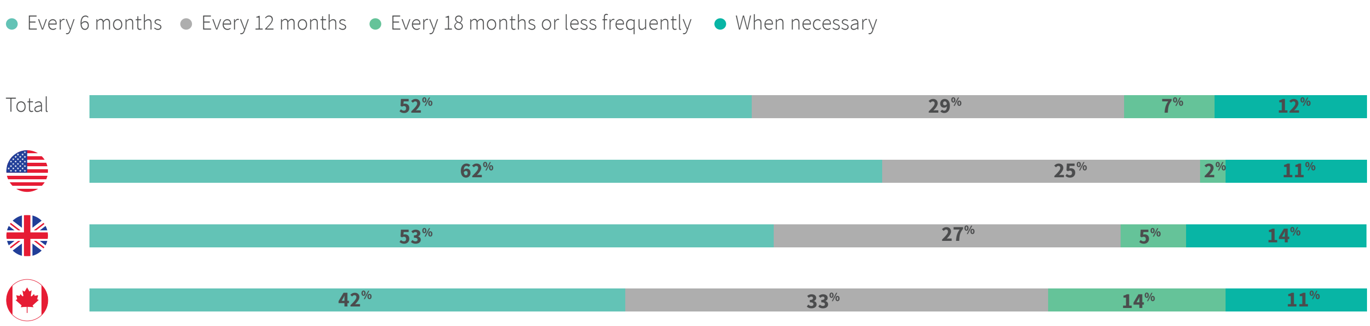
	Used			Used to target mobile		
	US	UK	Canada	US	UK	Canada
Fraud rules	53%	63%	53%	28%	37%	32%
Bank account checks	57%	65%	33%	29%	32%	12%
Address verification systems	48%	56%	36%	16%	28%	18%
CVV checks	49%	49%	42%	30%	29%	22%
Email checks	36%	53%	46%	14%	22%	20%
Device checks	33%	40%	41%	18%	27%	27%
Geo-location checks	27%	24%	27%	11%	15%	14%
Social media	24%	21%	23%	8%	11%	12%
Biometric screening techniques	25%	20%	17%	15%	14%	14%
Voice recognition systems	20%	19%	17%	11%	11%	14%
BIN number validation	20%	19%	16%	9%	13%	9%
3DS	12%	15%	10%	4%	8%	5%

Fig.8 shows us that just over half (52%) of businesses across our three surveyed markets review their anti-fraud measures every six months. More worryingly, 36% of respondents review their fraud measures only every 12 months or less – a potential problem given the rapid evolution of fraudulent behaviour and activity in the digital realm.

More than 40 percent of all businesses surveyed report that more than 5 percent of their transactions are fraudulent.

Fig. 8: How often do you review your anti-fraud measures?

Frequency of review of anti-fraud methods



> The evolution of big data will make payments smarter and easier and help to redress the balance between security and convenience. Big data will be the ultimate key to tightening up security at POS, online and bricks and mortar environment.

Todd Linden, CEO Paysafe Payment Processing North America

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The anti-fraud paradox

Part of the difficulty in making sensible decisions about fraud reduction is that its resolution often conflicts with business targets. While there is widespread agreement that it's a serious problem – 71% of respondents say that transactional fraud is a top priority at board level – there are conflicts over how best to deal with it. Three-quarters (74%) of businesses say that there is pressure to reduce fraudulent transactions through more effective verification methods; yet a nearly equivalent number (65%) say that there's pressure to increase transaction volumes by reducing ID verification thresholds, thereby exposing the business and its consumers to greater risk.

There is already significant pressure on businesses to put the consumer first when addressing this paradox. Merchants who do not utilise measures such as AVS, CVV2 and 3DS/VbV will have their consumers' transactions seen as high-risk by card issuers. Their systems will then likely automatically decline their transactions, so that 'easy merchant checkouts' equals 'quickly declined transactions.' Good merchant anti-fraud measures actually increase transactions success, and thus customer satisfaction and long-term retention.

	Overall			
There is pressure on our business to produce more effective verification measures in order to reduce fraudulent transactions	74%	78%	76%	66%
There is pressure to increase transaction volumes and customer sign-ups by reducing risk thresholds for ID verification in our business	65%	69%	67%	60%
Transactional fraud is a top priority of boardroom discussions	71%	77%	73%	62%

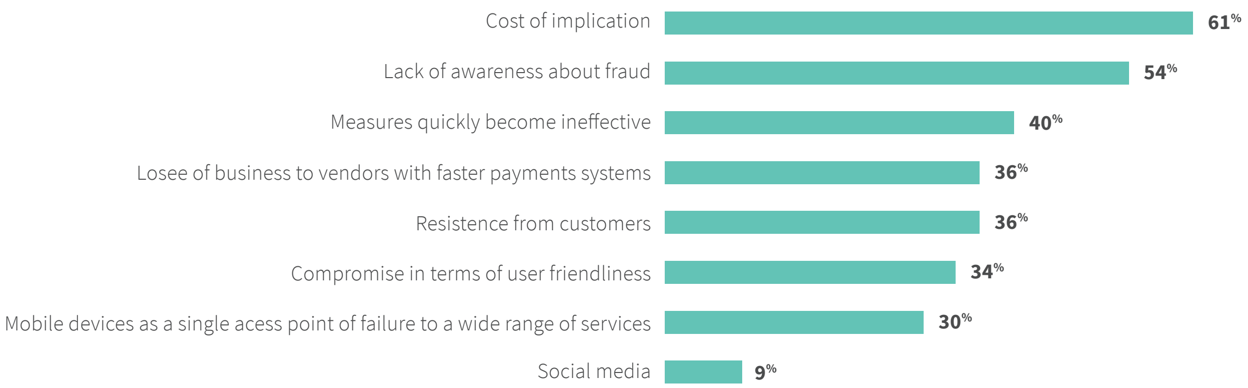
> "Fraud mitigation measures aren't optional in today's business environment – they're a critical part of building and maintaining good long-term reputations with consumers.
>
> **Shaun Lavelle, VP Risk, Payment Processing, Paysafe Group**

Challenging a fixed mindset when it comes to fraud

The good news is that most businesses agree. Eight in ten businesses intend to increase their anti-fraud spend by at least 10% in the next 12-24 months. Nearly two thirds (64%) of them have a positive view of anti-fraud expenditure, viewing it as a strategic means to reduce losses to the business and increase profits. More worryingly, though, only 35% think the business itself benefits from fraud prevention, viewing it principally as a measure which impacts the bottom line – not a fundamental basis for building trust with consumers and the increased prosperity that results from that trust.

One likely factor contributing to this cynical view of fraud prevention is the sheer difficulty and complexity of managing fraud in retail environments. While there is widespread agreement that anti-fraud implementations are expensive – identified by 61% of respondents as the most significant challenge to managing fraud – many other perceived barriers exist. Lack of consumer awareness about fraud (54%) combined with their resistance to anti-fraud measures (36%) are seen as potential obstacles; so too is the risk that measures quickly become ineffective due to the constant and rapid evolution of fraudulent activity (40%). Just over a third of those we interviewed placed high importance on a good user experience and see anti-fraud capabilities as part and parcel of the full customer journey.

Fig. 9: What are the top three challenges of identifying, managing and protecting against fraud across different payment methods?



Conclusion

Finding the balance: winning payments strategies for businesses and consumers.

Today's smartest merchants are abandoning long-held assumptions and rebooting their thinking about customer desires and expectations. Our research across both volumes of Lost in Transaction shows that new payment methods are on the rise; customers increasingly love e-wallets, mobile payments and cryptocurrencies, and there are clear signs that early adopters are quickly embracing these.

Trends like these clearly suit businesses too. New digital payments methods avoid the potentially hefty charges that are associated with taking credit card payments, but they can also avoid the most obvious and unavoidable type of fraud that occurs when cards are stolen – both critical factors in the rate of adoption of new technologies requiring more robust authentication measures.

The shift to new forms of payment comes not just with new security requirements, but broader concerns too. Lost in Transaction: Volume One showed that consumers were increasingly worried about security, especially around lost phones and contactless cards. But they also want convenient modern payment methods; not just contactless cards and digital wallets, but cryptocurrencies and voice recognition too.

Prevailing industry wisdom suggests that convenience should be the winner in this battle. That idea is the driving force behind today's experience-focused retail channels designed for minimum friction and maximum throughput; channels that put the fewest possible barriers between buyers and their good as possible.

Lost in Transaction: Volume II shows how important both sides of this equation are. In particular, it demonstrates the need for merchants to balance experience and security extremely carefully. However easy customers want their lives to be, they also want them to be secure and private; and that means robust, thorough security, even if speed of service is impacted. The challenge for merchants is how to utilise new payments technologies in a way that offers the right balance of convenience and security.

Finding that balance is not just about investing in technology. As this report shows, many variables are in play for merchants seeking to maximise their revenues while optimising experiences for customers – not least a coherent strategy around anti-fraud measures which takes full account of their value as a foundation for trusted business, not just another burden on the bottom line. The reality is that all payments methods carry some element of cost and risk; the trick for merchants is to accurately assess those factors before adoption, so that its impact against convenience can be accurately measured.

As the number of payments methods and technologies proliferates, the challenge for businesses in assessing and implementing them grows accordingly. Making good decisions about which to invest in – and, inevitably, which to phase out – is no longer a decision that can be made by web designers or finance departments alone. It's a strategic, business-critical decision that needs to be made alongside experienced payments partners with the expertise and insight to take full account of specific business needs.

Paysafe is one of those partners. For more than twenty years, we've been helping our customers find the right balance of risk and convenience for their business and their customers. We're firmly entrenched in every aspect of the digital payments environment, from conventional card to digital and mobile wallet-based technologies and beyond; from blockchain to voice recognition, we're investing heavily in emerging technologies that will become critical components of future payments models that come to fruition next year or in the next decade. We're still culturally tied very closely to the physical world too, as part of our direct relationship with a truly global merchant and consumer community around the world. Whatever challenges lie ahead in commerce, Paysafe is already working to help you solve them.

> “The challenge facing merchants is clear. It's about achieving the right balance between delivering the most frictionless consumer experience possible, while enhancing verification methods to reduce risk thresholds. The interplay between risk and convenience is about more than just technology.
>
> **Danny Chazonoff, Chief Operating Officer, Paysafe Group**

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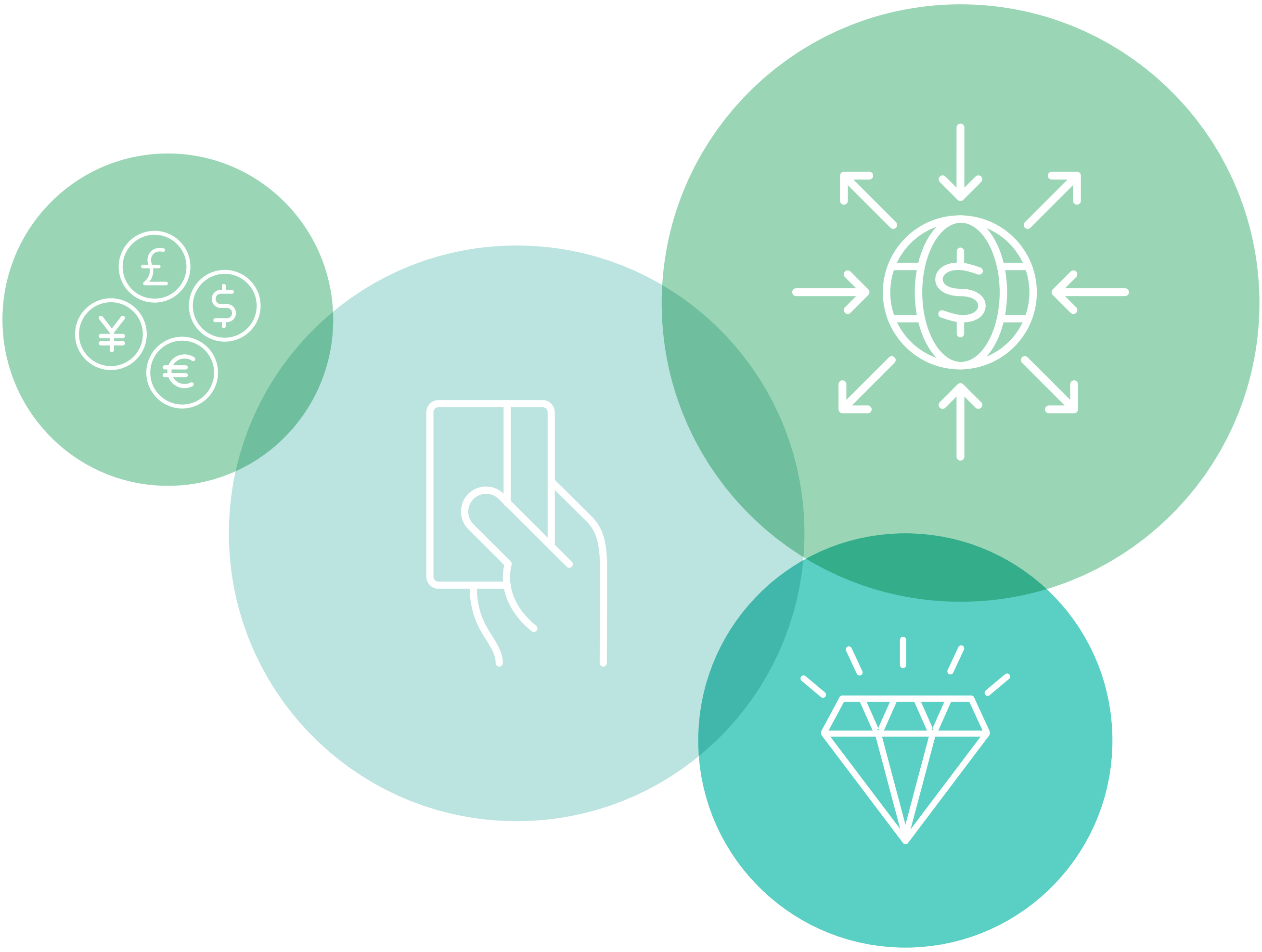

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