

## **Fraud Will Cost Online Retailers \$500 Million During the Holidays**

**A new Gartner survey highlights an enduring challenge of online retailing: credit card fraud and suspect transactions, which will cause U.S. electronic retailers to lose about \$500 million during the 2002 holiday shopping season.**

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**Event:** On 3 December 2002, Gartner released the results of an October 2002 survey of 25 of the largest U.S. e-tailers. The survey indicated that U.S. e-tailers will lose nearly \$500 million during the 2002 holiday shopping season due to fraud and suspect transactions. Gartner bases its conclusions also on a survey of more than 50 leading e-tailers in June 2002 and on GartnerG2's projection of \$15.66 billion in U.S. online sales for 4Q02.

**First Take:** Missed sales opportunities cost e-tailers two times more than losses from completed but fraudulent transactions. Credit card fraud causes e-tailers to lose about 1 percent of their transaction volume and sales revenue while e-tailers reject 6 percent of consumer purchase requests because they look suspicious. As e-tailers move aggressively to weed out fraudulent transactions, the 6 percent of sales that e-tailers reject represents \$950 million in revenue for 4Q02. E-tailers likely *mistakenly* reject about one-third of that amount, or 2 percent of total sales, due to unfounded suspicions and therefore lose about \$315 million in sales. Fraud will cost e-tailers another \$160 million in 4Q02.

Fraud attacks have become more sophisticated, frequent and menacing. Despite concerted and increased efforts to curb online fraud, the rate of fraud has stayed constant at about 1 percent since mid-2000, when Gartner first started surveying online U.S. merchants. Moreover, 7 percent of 1,000 online adult consumers surveyed by Gartner and Harris Interactive in September 2002 reported being victimized by credit card fraud in the preceding 12 months — a jump of two percentage points from 2001. Parallel fraud-fighting efforts in the physical world eventually led to fraud rates of less than 0.06 percent. Online merchants do not have as much success since online fraud is easier to perpetrate.

With online holiday sales likely to increase 32 percent from 2001, fraud attacks have increased at a similar rate. Reducing fraud and the number of unnecessarily rejected transactions remains a challenge that risk-management departments still must solve. E-tailers mainly rely on their own resources to survive increasingly malicious fraud attacks. Gartner recommends a three-tiered program:

- Apply real-time checks to look for fraudulent activity based on patterns of fraud abuses.
- Weed out suspect transactions for further manual review (roughly 5 percent of transactions, which account for 80 percent of fraud).
- Engage in chargeback recovery to collect money from issuers for chargebacks that e-tailers wrongly absorbed.

**Analytical Source:** Avivah Litan, Gartner Research

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## Recommended Reading and Related Research

- “VeriSign Outsmarts Fraud With Old-Fashioned Intelligence” — VeriSign succeeded in reducing fraud by taking a holistic and “sharpshooting” approach using three lines of defense. **By Avivah Litan**
- “MasterCard’s Visa 3-D Secure Support Aids Authentication” — MasterCard’s support for Verified by Visa will only accelerate adoption of these technologies and demonstrates needed cooperation among the card associations. **By Avivah Litan**

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