

Online Transaction Fraud Risk: Geography Matters

Question

Is the risk of transaction fraud in the online retail environment significantly greater when the buyer is foreign?

Answer

Unfortunately, yes. The Internet breaks down geographic distance and national boundaries, expanding markets for even small local sellers to a global scale. However, the risk of fraud when the transaction originates cross-border is significantly higher, with specific countries of particularly high risk. Merchants and issuers need to proceed with utmost caution in identifying, reviewing and accepting these transactions.

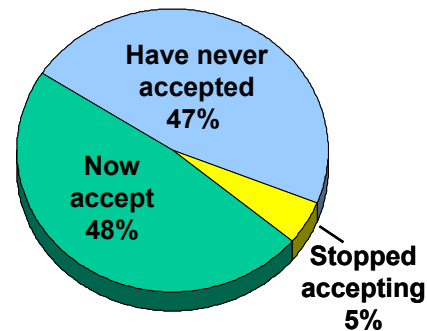
Merchants have strengthened their ability to detect and screen high-risk transactions. But some tools that minimize the fraud rate for domestic transactions are less effective or unavailable for foreign-based transactions. For example, Address Verification Service (AVS) is a tool that matches the address supplied by the buyer with the billing address on file with the card issuer. However, the percentage of legitimate transaction attempts that are not matched is generally too high for AVS to be used solely as a determinant to accept or reject transactions. This method does provide a red flag for further screening, but AVS is not available for most countries, including countries with the highest fraud rates. The method of last resort—prosecution when card fraud occurs—is the end of the fraud-tracking process. It is difficult to prosecute domestic fraud occurrences successfully. It is pointless to try to prosecute international instances unless losses are very sizable.

Cross-border fraud is higher. According to Gartner research, four of five major U.S. merchants believe that internationally based orders are riskier than domestic orders. This view, based largely on past experience, impacts merchants' order acceptance policies (see Figure 1). Slightly more than half (52%) of major Internet merchants do not accept foreign-based retail transactions. Roughly 10% of these merchants have accepted them in the past, but have now stopped. Some merchants do not accept international orders because of shipping and export restrictions, language, currency or tax issues, but fraud risk is also a huge factor guiding their policies. Losses for some merchants have outweighed the benefits of international sales revenue. The fraud rate for merchants that do accept international orders runs, on average, two-and-one-half times greater than the rate for domestic orders.

Ken Kerr

"For some merchants, the losses from fraud outweigh the benefits of international sales revenue."



Figure 1: U.S. merchant acceptance of non-U.S. orders

Source: GartnerG2, September 2002

International frauds can conceal their locations. Shutting down all internationally based orders is a harsh policy for merchants positioned for high sales volumes in international markets. This approach, however drastic, does not provide full protection against frauds that operate on foreign soil. Foreign crime rings know that many merchants will block all cross-border orders or those from specific countries. They use techniques to appear to merchants as if they are domestic buyers. Some of the techniques include:

- Using stolen or generated card numbers from the merchant's home country. With a domestic BIN number, the buyer appears to be domestic.
- IP (Internet Protocol) address spoofing. Since sophisticated merchants check the IP address of the buyer to determine the buyer's location, frauds log onto the Internet through a server in the merchant's country to give the cover of a local buyer.
- Using freight forwarders. Since many merchants do not ship goods to foreign locations, frauds use the shipping address of a domestic freight forwarder, who then reships the goods to the fraud's foreign destination.

Not all international orders are equally risky. Transactions originating in Western Europe, the United States and Japan have relatively low fraud rates. Conversely, many countries in Eastern Europe have extraordinarily high fraud rates. Currently, Ukraine, Indonesia and Lithuania are the countries with the highest fraud rates for orders placed with U.S. merchants, averaging an amazing 20% of all transactions. Romania, Egypt and Bulgaria are in the second tier of high risk, with fraud rates near 10% as a percentage of all transactions. These statistics are not static; the origin of fraudulent transactions is geographically mobile, often hidden, and is generally growing.

GartnerG2 Recommends

Merchants with high sales potential in international markets must build expertise and acquire tools or contract with fraud-detection services to determine the origin of transactions and then screen out fraudulent attempts while maximizing international sales. Detection and prevention information must be constantly updated to keep pace with shifts in fraud methods.

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Report: [Online Fraud and Prevention Methods Get More Sophisticated](#)

By Ken Kerr and Avivah Litan (17 January 2002)

Q&A: [Best Practices for Managing Online Transaction Fraud Risk](#)
By Ken Kerr (26 April 2002)

Methodology

Findings are based on primary and secondary research through public domain periodicals and subscription information services and interviews with industry leaders.

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