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E-retailing on the line

Christopher T Heun , 1-Jul-2002

Stacey Pinkerd wants to clarify a few things about Internet credit-card fraud. First, it is rare that thieves snatch credit-card numbers during online transactions. Chances are, the numbers came from paper, thanks to a dishonest waitress or a receipt fished out of a garbage can.

And yes, fraud is far more likely to occur online than in a store, but it is still rare—1.14% of all transactions, according to IT advisory firm Gartner.

On the Side

- Anti-fraud programs: how they work

"I do not think consumers understand exactly how fraud is happening or the infrequency of fraud. Most consumers have not been exposed to this," said Pinkerd, senior vice-president of E-commerce products at Visa USA, which says that only 0.25% of its online transactions are fraudulent.

Despite all that, fear of cyber-thieves remains the biggest drag on the growth of e-commerce.

The major credit-card companies and banks, along with a few dozen e-retailers, are trying to address that by developing password-based systems to reduce fraud.

Yet the credit-card companies have not come together to agree on a standard approach to security, and that could mean slower adoption of anti-fraud tools.

And the card companies and banks that issue credit cards are not offering the kind of direct financial incentives that could prompt merchants to adopt the programs more quickly.

Chicken and egg question
Until it is considered secure, e-retailing has no hope of moving from its current status as a nifty but niche sales channel into a genuine mass-market shopping avenue.

Pinkerd is evangelising about the security of online shopping because he is heading Visa's latest anti-fraud initiative, called Verified by Visa. MasterCard International is also deploying improved security programs for its cardholders and online retailers.

Online merchants have an obvious stake in improving confidence in e-commerce: more sales, plus the chance to gather personal data directly from customers. The credit-card companies have a stake as well, because e-commerce helps them reach a valuable

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market. “The people online tend to be higher income and lower credit risk,” said James Van Dyke, an analyst with Jupiter Media Metrix.

However, credit-card companies and retailers face a problem—getting consumers excited about these new anti-fraud initiatives.

MasterCard and Visa already exempt customers from paying online fraud charges. Yet, for the new safeguards to succeed, consumers must sign up—which they have little incentive to do.

So far, the credit-card companies have not offered any new ideas to entice them.

Legislation puts a damper on anti-fraud programs as well. In Singapore, for instance, the Monetary Authority of Singapore (MAS) has barred banks from adopting Verified by Visa, while it has no objections to MasterCard’s solution as it does not involve outsourcing of the authentication function.

Even if the programs are accepted by local legislators, credit-card companies also need more retailers and banks to get on board.

The programs’ advocates face a chicken-and-egg problem: Online merchants will not bother until there is sufficient consumer interest; the banks that issue the cards will wait until merchants and customers sign up; and consumers will not see the benefit until their favourite sites comply.

Because all credit-card companies face the problem of fraud, it might seem logical for them to team up on a program to make life easier for the whole industry. The problem is, the card companies already tried that, and it did not work.

In February 1996, MasterCard and Visa teamed up to create a technical standard to safeguard e-commerce. The standard, known as Secure Electronic Transaction (SET), used digital certificates to authenticate cardholders and merchants. The fatal flaw was that it required consumers to download a 4-MB software onto their PCs. Shoppers balked at the hassle and the standard died.

Visa has eliminated the need for consumer downloads in this generation of its software.

MasterCard still requires software downloads, though it said its program is now smaller and easier for consumers and merchants to use.

Hurdle after hurdle

Retailers and banks are taking a cautious approach to the programs, and cost is a big reason.

“There does not seem to be large budgets to implement these standards. They are all taking a pilot-based approach,” said George Burne, CTO at software vendor Trintech Group, which will help an undisclosed European bank install MasterCard’s system in the next couple of months.

To get Verified by Visa up and running using outside consultants, merchants will spend US$10,000 to US$20,000 and take three weeks, plus any software-licence fees a vendor would charge, Burne estimates.

The cost for banks depends on the number of cardholders it has, but he estimates it would be between US$100,000 and US$200,000 plus annual maintenance fees.

For retailers, the payback may be worth the cost.
Credit-card issuers hit retailers with chargebacks of US$10 to US$25 for each fraudulent purchase, on top of the cost of eating the transaction itself. By verifying card numbers before purchases, retailers could reduce those charges significantly.

Visa and MasterCard are associations owned by banks that issue credit cards. A bank can spend as much as US$50 in labour and administrative costs fielding one consumer’s complaints and investigating a disputed charge, Visa’s Pinkerd said, not including the potential loss in consumer online confidence.

Credit-card companies have also been slow to offer direct incentives to get merchants involved.

In the thin-margin world of retail, saving money on each transaction could give a nice lift to the bottom line.

If Visa told retailers it would cut processing fees to around 1.3%, merchants would jump, predicts Avivah Litan, vice-president and research director at Gartner. “If Visa had more confidence its system would be adopted and used, it should be able to lower its fees accordingly. It is obviously not confident yet,” Litan said.

Pinkerd counters that Visa’s goal is to eliminate costs associated with fraud—for both the retailer and Visa.

Still, the odds are slim that merchant fees will fall anytime soon.

“Credit-card companies are huge, amorphous groups, and getting them to lower fees for merchants is like getting the Titanic out of the path of a humongous iceberg,” Litan said. “They will be slow to make any significant changes.”

In fact, as early as next year, companies that process credit-card transactions could raise their rates for retailers selling goods more likely to be stolen for resale, or for those that do a poor job of preventing fraud and have a high chargeback rate, said Jeff King, director of risk-product management at security vendor CyberSource.

MasterCard, which has 256.2 million cards in the US, will try a different financial incentive for merchants to sign on to its program.

In April, MasterCard presented its Secure Payment Application (SPA), the company’s latest and most secure system. By November, merchants worldwide that support the system will no longer be liable for fraud, regardless of the issuer and cardholder.

“There is a need to accelerate the liability shift to accelerate adoption of secure payments,” said Bruce Rutherford, MasterCard’s vice-president of E-business and emerging technologies.

“We are anticipating significant demand from merchants without substantial [payment] infrastructure changes.”
Visa could speed up adoption simply by requiring issuing banks and retailers to join the program, but it has no plans to do so yet.“Our goal would be that this becomes the standard way cardholders shop online,” Pinkerd said.

But what concerns Trintech’s Burne is Verified’s potency, or lack of it. Protecting consumer passwords from merchants is a good idea, but it does not change the fact that shoppers still type in their credit-card numbers on a merchant’s site.

"When the merchant has the card number, the opportunity for fraud exists,” he said. Once Visa scrapped the SET effort with MasterCard and began work on new software that emphasised consumer friendliness, it lost some teeth to prevent fraud.

“If you have no security at one end and SET at the other, Verified is closer to no security at all than something like SET,” Burne said. “It is much, much weaker technically.”

It becomes a balancing act. Retailers and credit-card companies need something tough enough to stop crooks, yet simple enough that online customers will use.
“We do not want to mess with the customer experience,” Pinkerd said. “We did not want to sacrifice convenience because of security.”

The problem is, unless consumers are confident that their transactions are safe, there will not be enough e-shoppers to make it an issue.