How Credit Card Chargebacks Really Impact your Bottom Line

Reducing Fraud, Chargebacks, and Lost Profits for Recurring Merchants

There are many considerations to take into account when attempting to prevent, recover, or represent chargebacks. To begin, review your current process already in place, what high-risk flags exist, the amount of disputes and costs of responding, and the chances of winning a dispute. This is particularly important for recurring merchants to grasp when evaluating how chargebacks actually impact their bottom line.

Recurring merchants provide goods or services through a subscription or recurring transaction model (Dollar Shave Club, Stitch Fix, fitness club memberships, etc.). With these transactions, the cardholder authorizes the merchant to automatically charge their account on a recurring basis. While this process offers speed and convenience, it also opens the door for increased chargebacks. In fact, chargebacks cost recurring merchants millions of dollars every year[1], and it's vital to the health of the business for the company to aggressively pursue the recovery of funds lost to chargebacks as quickly and efficiently as possible.

Chargebacks occur when a cardholder disputes a merchant charge and a debit is made to the retailer's account. The issuing bank charges merchants a fee for every chargeback received. Merchants with a high ratio of chargebacks may also receive additional fines and run the risk of losing their payment processing privileges altogether.

The chargebacks mechanism was created to protect consumers against fraudulent behavior, but some consumers have found it easy to dispute legitimate charges. This form of friendly fraud creates a significant financial burden for recurring merchants. While recovery from chargebacks is a necessity for merchants, identifying and resolving disputes before they become chargebacks is critical. Chargebacks are avoidable with the right tools and systems in place. Prevention through an information-sharing platform that clears up billing confusion and validates the sale is in the best interest of both the merchant and issuer, and makes for a positive cardholder experience.

Why Do Credit Card Chargebacks Happen?

Credit card charges are disputed for a number of reasons. In subscription models, a cardholder might claim he or she didn't know it was a recurring transaction or automatic renewal, or they thought they cancelled their subscription. Maybe they simply don't recognize the charge on their statement. Billing descriptors on credit card statements can be limited to a handful of characters, which allow for confusion. To dispute a transaction, the cardholder simply contacts the credit card company and says, "I didn't do it." This type of friendly fraud puts the burden of proof on the merchant to show that the debit or credit card was used in good faith and authorized by the cardholder.

The most common reasons for chargebacks for recurring merchants include[2]:

- Criminal fraud
- Friendly fraud
- Credit not processed
- Cancelled recurring transaction
- Items not received
- Fraudulent multiple transactions
- Counterfeit transactions
- Technical problems
- Not as described or defective merchandise

86%

Based on recent findings, as many as 86% of the time, cardholders will call the issuer and bypass the merchant entirely.

The burden of proof can be expensive. There are many costs associated with chargebacks. A recent LexisNexis report estimates merchants incur a $240 loss for every $100 in fraud losses.[3] The total losses for a business are based on a number of factors:

INEFFICIENT USE OF RESOURCES AND STAFF

The dispute resolution process is complex, time-consuming and labor intensive, and it requires an expert understanding of payment network rules. From manual processing, reconciliation and reporting to interacting with various issuing banks, inefficiency takes many forms and is not always evident on the balance sheet.

LACK OF RELEVANT INFORMATION

When a cardholder disputes a charge, more often than not they will call their issuing bank. The issuer might have no more information than what appears on the cardholder's statement, and, in an effort to keep the customer happy, the issuer will initiate the chargeback process. This lack of information is damaging to merchants who might not know about the dispute until it's too late in the process—or sometimes not at all—which doesn't allow them to correct the problems going forward.

$100

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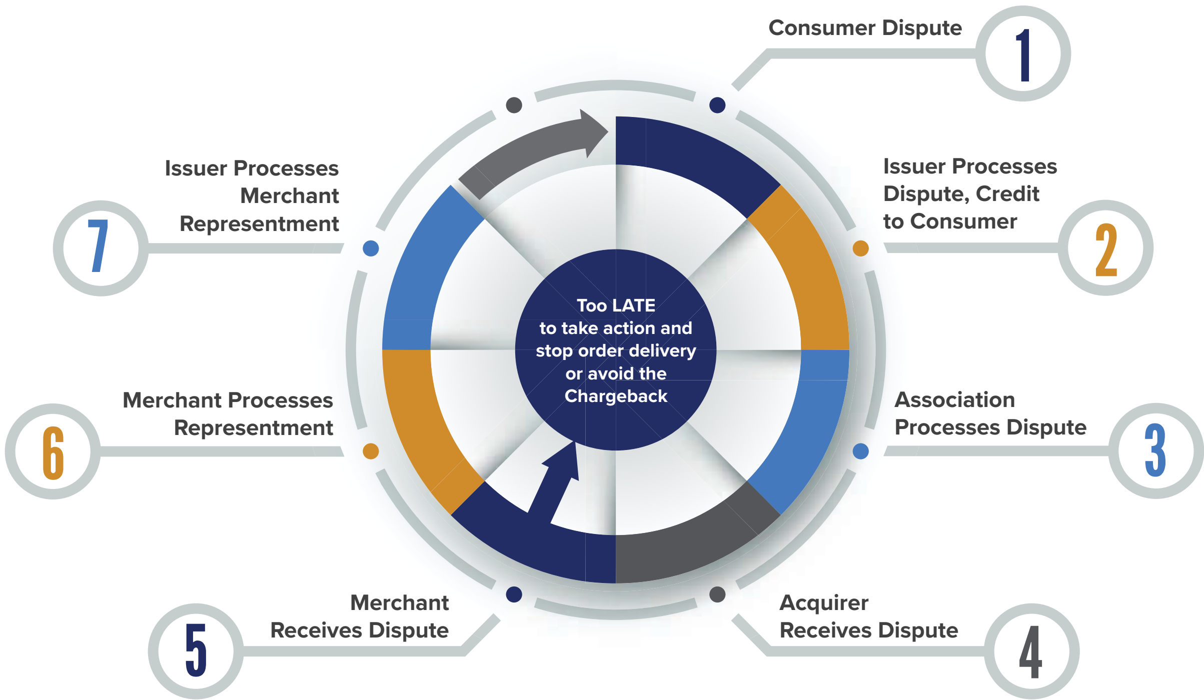
Chargebacks are often mistakenly viewed as a cost of doing business. Nothing could be further from the truth.



The Chargeback Process is Complex and Time Consuming

• **CHARGEBACK FEES**

Regardless of whether the chargeback stands or is successfully disputed, merchants are charged fees for the process. Essentially, you pay for the time the card companies spend investigating the credit card chargeback.

• **PENALTIES**

Businesses that exceed a chargeback rate of 1-1.5% (depending on the card association regulations) for several consecutive months may incur penalties. To protect customers' best interests, credit card companies often charge fees and penalties to merchants who exceed chargeback rates, and may even disqualify these merchants from payment processing in the future. These fees increase if the merchant continues to develop chargeback rates of 1-1.5% or higher. Some credit card companies may charge "review fees" or other fines to merchants who do not have a chargeback reduction plan in place. These can quickly add up to many thousands of dollars.

• **MERCHANDISE**

For many merchants, there is the very real cost of merchandise not returned. The matter may be complicated with SaaS businesses or those selling subscription or membership services. In such cases, the goods are non-tangible, leaving nothing to return. This means the costs associated with rendering the service have been lost, or that basically the software provided by a SaaS company has been delivered for free.

• **EXCESSIVE REFUNDING**

In some cases, merchants provide a customer the same refund more than once. The fact that a refund has already been provided by the issuer does not guarantee that a chargeback won't be initiated. It also means that a customer that has already filed a chargeback won't try to seek a refund directly from the merchant.

To recover funds lost from the chargeback process, the best way for a recurring merchant to contest a chargeback is to provide the bank with evidence that proves the transaction was authorized and that the cardholder was aware of or received value from the purchase. This is done by providing evidence that's usually captured in a merchant's CRM, such as:

- Customer identity (PII data—email, address, physical address, name, DOB, etc.)
- Purchase history and usage information
- Shipping details where applicable
- Contact history

This is no easy task. Resolving disputes takes time, and during this time, the revenue from the sale is withheld from the merchant's account. Unfortunately, time spent on these tasks is time away from making sales and supporting customers.

Credit card chargebacks are often viewed as a cost of doing business, and many recurring merchants believe there is nothing they can do. Nothing could be further from the truth. Aggressively preventing chargebacks from occurring and recovering funds lost to chargebacks should be a priority for every merchant.

Winning the Battle

How should a recurring merchant prevent chargebacks from occurring and recover funds lost to chargebacks?

According to Matthew Katz, founder and CEO of Verifi, Inc., there are overlapping strategies that a recurring merchant can employ to reduce and recover the costs of chargebacks:

IMPROVE THE PROCESS
Streamlining workflow and eliminating human error reduces the time and resources needed to process a chargeback. Automation allows for merchants to remain current on credit card processing rules and makes the dispute process much simpler.

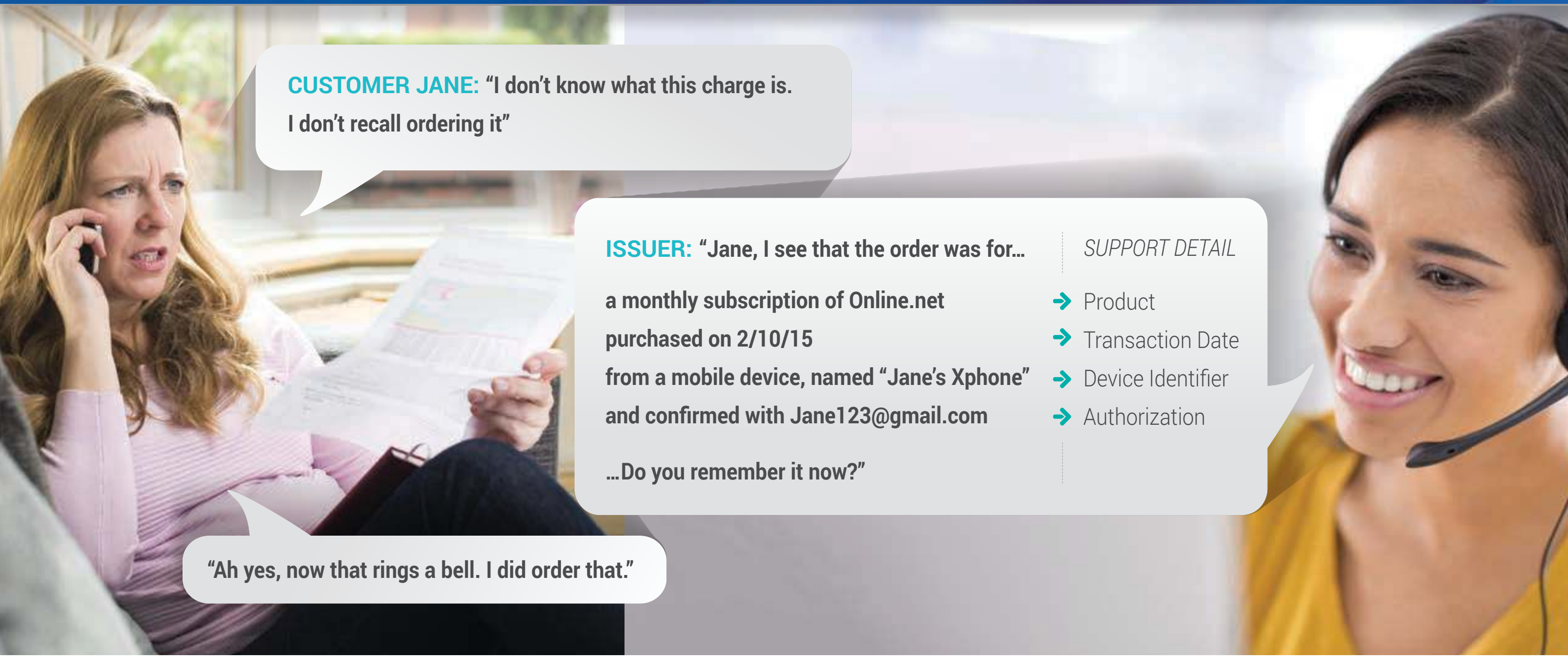
PRIORITIZE
Businesses should have a fight-or-flight policy built into the chargeback process. It makes no sense to spend time disputing a chargeback than one would incur in commensurate chargeback fees.

DATA CONTROL Collecting information from chargebacks allows the merchant to adjust business practices, if necessary, and identify internal issues.

CLEAR BILLING By including a URL or contact number in the descriptor field on bills, it makes it easier for customers to recognize purchases made with their credit cards, and reduces the chance of a mistaken chargeback by a customer who thinks he or she has been incorrectly charged.

FIX OPERATIONS Excessive chargebacks might be an indication of problems in operations, but this can be fixed. Whether it is a quality control issue with merchandise, ineffective or misleading product marketing, or another root cause, identifying and addressing these issues can significantly reduce the occurrence of chargebacks and help to recover funds lost to chargebacks. It doesn't have to be complicated. For example, consider the way cardholders are billed. Is this why you've seen an increase in credit card chargebacks? Some recurring merchants use negative option billing. Negative option billing is a model that includes goods or services that are provided automatically, wherein the customer must pay for the service or specifically decline it in advance of billing. This method can create friction between the cardholder and recurring merchant. Merchants who do choose to employ this billing system should carefully follow industry standards and be as clear as possible about the timing of charges and the merchandise/services for which the cardholder is being charged. But there are solutions to address this friction and reduce chargebacks.

OUTSOURCE
Managing chargebacks can be a complicated task during the transaction life cycle. From preventing chargebacks, and resolving disputes, fighting chargebacks to recovering chargeback losses, without a third-party partner, tackling all of the chargeback process can take up significant time, resources, and money. Bringing on an outside company to help manage the stragegizing process can easily free up those valuable resources so you can spend more time on running your business.



Facilitating Collaboration

Regardless of what strategies are chosen, it is important to seek new ways to minimize credit card chargebacks and increase the availability of data. The most cost-effective way to do so is to ensure a steady stream of data is available to enable all parties involved to have access to the same information at the time they need it most. Typically, purchasing data is left in merchants' systems, leaving the issuer little choice but to issue a consumer's inquiry about an item on a billing statement chargeback or file the inquiry as fraud. Because there isn't the enough data sharing between the merchant, issuer and the cardholder, the process becomes confused and convoluted.

As many as 86 percent of cardholders will call the issuer and bypass the merchant entirely to dispute a charge.[4] This leaves the resolution left in the issuer's hands and leaves little for the merchant to do. What this then leads to, by default, is lost revenue and lost customers, which can damage brand reputation.

Merchants don't have the opportunity to address cardholder issues directly, and issuers don't have the information they need to resolve confusion, so the merchant is stuck in a race to the refund. When merchants receive a chargeback notice, it is often too late to salvage customer relations or resolve the issue. Less-than-efficient dispute resolution procedures can hurt cardholder satisfaction, damaging the merchant's brand and contributing to lost customers and profit leakage. This has a trickle-down effect on merchants, who typically do not come out on top of disputes.

What solves those pain points is a data-sharing platform that can provide merchants and issuers with the specific order details they need to help resolve disputes before they become costly chargebacks. Such details would include device used to make the purchase, a complete description of the product/service, location of the purchase, prior dispute history, etc., these and other details may be needed to generate compelling evidence to support the legitimacy of the sale, reduce profit leakage, and prevent "double dipping,"—acquiring a second refund from the merchant who might not have otherwise known any better. With real-time visibility on transaction details, this can help resolve disputes faster and prevent further chargebacks from occurring. With the proper data available, friction between parties can be avoided, leaving less chance that a legitimate purchase is flagged as fraud.

With real-time visibility on the customer outcome, this can help resolve disputes faster and prevent further chargebacks from occurring.

By facilitating collaboration among the customer, merchant, and issuer, the major pain points on each side of the transaction life cycle can be better addressed in a way that benefits each party involved—faster, cheaper and more effectively. By providing the cardholder and issuer with more detailed purchasing information from the merchant, it decreases the chance a customer would file an accidental chargeback. This is one of the major reasons fraudulent chargebacks (friendly fraud) are filed. With better ability to identify and reduce fraud and chargebacks, cardholder, merchant, and issuer collaboration is enhanced and enables purchase details to be shared equally upon inquiry.

The benefits simply trickle down from there; now merchants can: avoid unnecessary chargeback fees, fines, and operational drain on researching and resolving disputes that could have been addressed without escalation; access compelling evidence requirements with the issuer to prevent disputes from becoming a chargeback; remove cardholder confusion by validating the purchase with details designed to increase customer awareness of the purchase.

Other benefits include[5]:

- Faster dispute resolution
- Increased interchange revenue
- Reduced chargeback inventory
- Fewer resources devoted to dispute management
- Less exposure to regulatory compliance issues and legal risks
- Increased cardholder satisfaction

It's also important to analyze data for chargeback risks, which means identifying the high-value items that are frequently targeted by fraudsters (gift cards, electronics, etc.), and determining what sort of processes need to be in place to spot and mitigate those fraud risks. This also means being able to identify data to better understand fraud patterns, so your full risk can be fully assessed and prevented in the future.

After all, fraud and risk management should be a priority for every merchant. Today a business can implement all of the best practices mentioned above and have a full-strength chargeback recovery program. Protection against thieves or unscrupulous customers requires a solid strategy for recovering funds lost to the chargeback process and preventing them from occurring in the future.

About Verifi

Verifi, an award-winning provider of end-to-end payment protection and management solutions, was founded in 2005 to help merchants effectively manage the payments challenges they face every day. Verifi helps merchants safely process payments, combat fraud, prevent and resolve costly chargebacks, as well as increase billings and keep loyal customers. Our best-in-breed solutions and white glove support are trusted by a wide range of industries, from emerging companies to the Fortune 500. Headquartered in Los Angeles, California, we process more than $20 billion transactions annually and currently serve more than 25,000 accounts globally. For more information, visit: www.verifi.com.

Chargebacks cost merchants millions of dollars and divert attention from core business. Verifi provides merchants the tools and information they need to resolve disputes quickly, fight tens of thousands of chargebacks each month, and successfully recover up to 50% of all disputed charges.

Why Choose Verifi?

Partner with Verifi to reduce your payments risks, streamline business processes and lower operational costs. Whether it's stopping fraud, maximizing your billings on our flexible and robust global gateway or our award-winning chargeback prevention and dispute management services, our team of experts and custom solutions will protect your payments and boost your profits across the entire transaction lifecycle.

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