Organizing for Success

eCommerce Merchant Payments, Fraud and Risk Management Organization Survey Results

By Jay DeWitt, Glenbrook Partners, April 2, 2012

At Glenbrook Partners, eCommerce merchants often ask us questions such as: "How do others organize their payments and fraud and risk management organizations? What are 'best practices' among other merchants like me?" To better understand what merchants are doing, we decided to conduct a survey asking merchants about their organizational reporting structures, duties and staffing levels. The respondents provided benchmarks that should be useful to others as they seek to understand if they are following organizational best practices.

Key Findings

For the most part, our survey confirmed what we'd heard anecdotally when talking to eCommerce payments and fraud and risk managers:

- Most organizations do have consolidated Payments and Fraud and Risk Management (FRM) groups, with the practice of having a single organization for both Payments and FRM providing real benefits
- Payments organizations tend to mostly align with Treasury and Finance, while FRM groups are likely to either align with Treasury/Finance or Operations.
- Large merchants have successfully constrained headcount growth in several manual functions, likely through technology but perhaps also by employing outsourcing

We'll have more to say on each of these findings at the conclusion of this brief.

Survey Overview

This research brief summarizes the results of our survey in January and February of 2012. In our survey, we asked a number of questions related to eCommerce merchants' organizational structure, from both a payments and fraud and risk management (FRM) perspective. Additionally, we asked questions about staffing levels for certain functions. Finally, we investigated whether merchants were combining these two units under single leadership, and if so, if they were finding benefits in doing so.

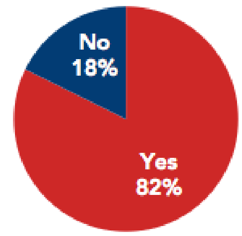
In total, we had 130 respondents to this current survey, although not every participant responded to each question. We asked participating merchants to identify themselves as either primarily retail, travel, digital goods or virtual goods merchants and also to specify their size by number of transactions, in order to compare like merchants and identify differences and trends by these groups.

Payments Organization

Our first questions centered around the payments organiziation.

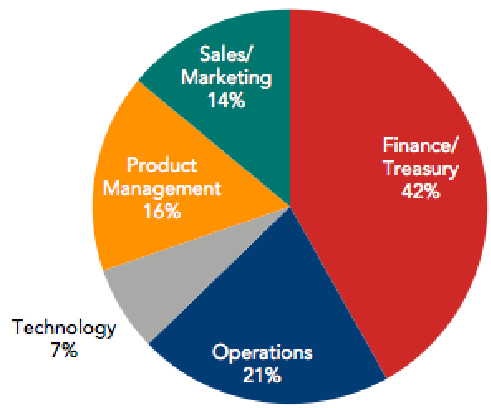
Question 1: Does your organization have one organization mainly responsible for Payments?

We weren't surprised to find that a large majority of respondents organize their payments functions together; it seems like a smart move from our perspective, in order to promote cost efficiencies and coordinated operational strategies. What was interesting is that, among retail merchants (as opposed to travel, digital goods and virtual goods) only about 60% had a centralized payments function, which might be due to the fact that retail merchants are more likely to have cross-channel attributes and legacy payment operations that support their brick and mortar POS.



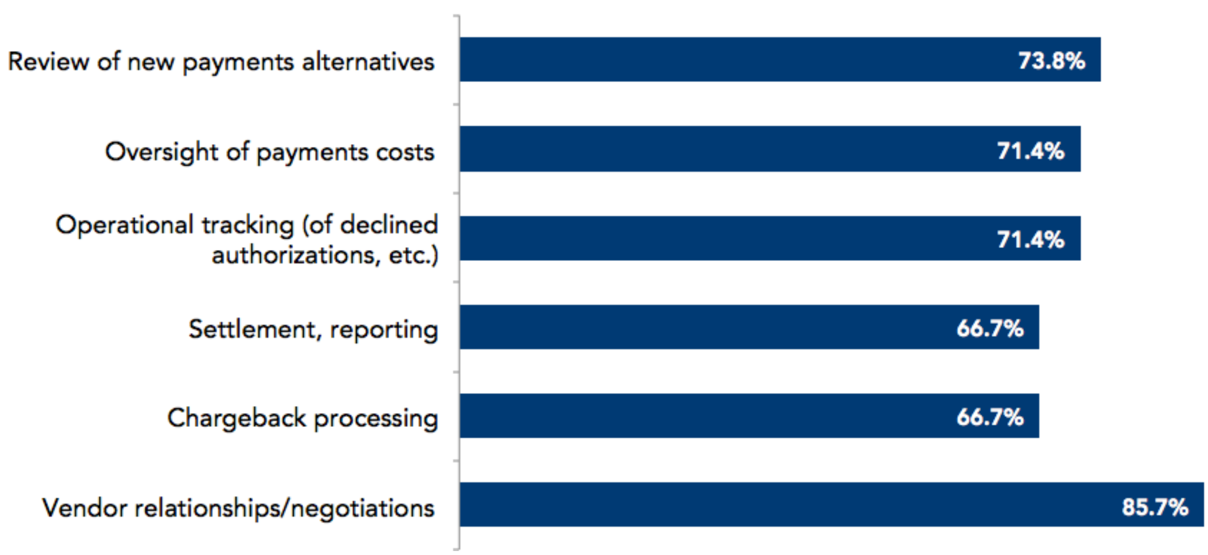
Question 2: Into what organization does your Payments organization or function report?

In our next question, we asked those respondents that had a single payments group about the reporting structure of the payments organization. A significant number of merchants indicated that their payments function reported into product management or sales and marketing, versus the more common finance and treasury reporting line. We believe that merchants who recognize payments as both an opportunity to drive top line sales – rather than just being an expense line to manage – are most forward-thinking and encourage this as a best practice. Having payments report to product and marketing is a great step in this direction.



Question 3: What functions exist within the Payments organization?

Clearly, one reason to have a unified payments organization is to group like functions and we saw a lot of that in the survey results.



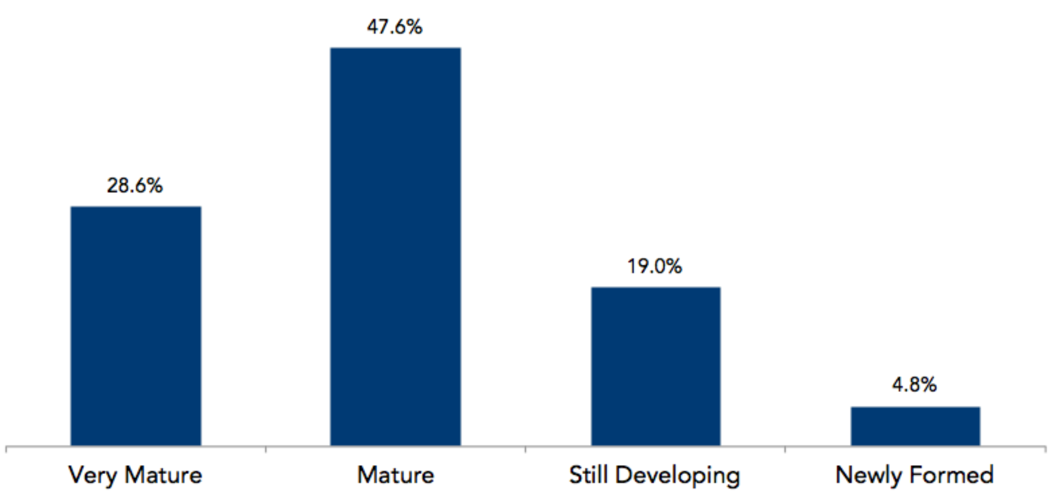
While there was a lot of uniformity in responses, with the group in total showing relatively high inclusion of the identified functions in the payments group, only 25% of the respondents performed *all* payments related functions within one department.

Settlement management/reporting were most likely to be performed by another department, outside of the payments organization. Chargeback processing and operational tracking were the other functions mostly performed outside of the group.

Question 4: How would you rank the maturity of your Payments organization?

For this survey, we defined organizational maturity as the "establishment and effectiveness of processes and procedures." Surprisingly about 75% of the respondents felt that their organizations were "mature" or "very mature" a response we wouldn't expect in a fast growing industy where thing are often developed "on the fly".

Drilling down a bit, we found that larger merchants and digital goods merchants tended to rank themselves higher on the maturity scale. That larger merchants are more mature makes sense – they've probably had more time to ramp up their internal processes. That digital goods merchants (both larger and smaller) said the same is a curiosity – does the nature of their business somehow require them to be more rigorous about establishing and practicing common processes and procedures?



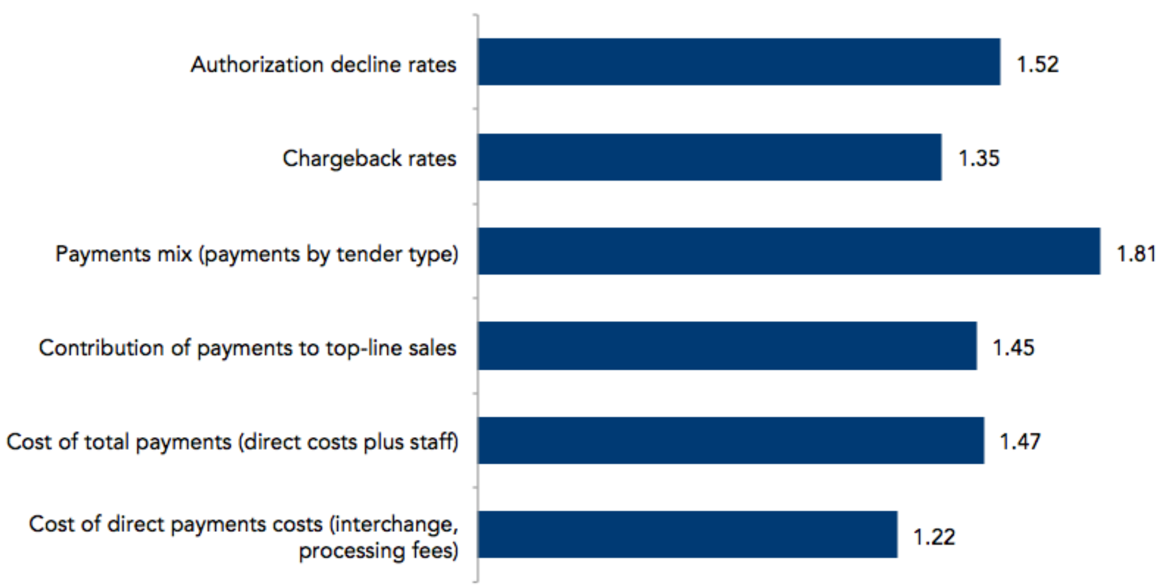
Question 5: How many FTE are directly involved in the following functions?

Merchant Size (Xactns/Year)	Vendor Negotiation	Chargeback Processing	Settlement, Reporting	Operational Tracking	Oversight of Payment Costs	Review of New Payments Alts.
0 to 20,000	0.4	0.4	1.2	0.4	0.4	0.4
20,000 to 200,000	0.8	1.0	0.6	0.7	0.7	0.7
200,000 to 2 million	1.2	1.3	0.9	1.7	1.0	1.2
2 million to 20 million	1.6	2.4	2.2	2.2	1.1	1.2
Over 20 million	1.2	2.4	1.2	1.2	1.2	1.2

We expected responses to our question about FTEs (full time equivalent staff members) devoted to particular functions to correlate with merchant size, and for the most part it did, with larger merchants devoting more staff to functions than smaller merchants. What is remarkable, though, is the clear effects of scale when it comes to staffing: larger merchants weren't devoting significantly more staff to activities than their "mid-tier" brethren, and in many cases were devoting the same or fewer resources to any one function.

We think this makes sense, as larger merchants realize that in order to scale, they can't just keep adding staff, but need to refine procedures, look to automated tools, or potentially outsource some functions. Our survey results clearly show this progression.

Question 6: Indicate the importance of the following metrics to measure your Payments function.



We were interested to understand how eCommerce merchants measure their payments function – was it mainly from a financial perspective? Or did they include operational metrics as well as an indication of the contribution payments make to top line revenue?

At Glenbrook, we've long been proponents of merchants having a holistic "payments dashboard" approach to their business, with a management level view of the many ways payments impact the business. While it wasn't clear from the survey that merchants were using a dashboard approach, we were heartened to see the relatively high rates of importance merchants attributed to all the metrics we identified.

The chart above provides a weighting among responses consisting of "very important", "somewhat important" and "not important/not used" with higher scores representing higher importance. We weren't surprised to see payments mix as most highly rated; merchants are acutely aware of cost differences between payment types and even between card brands and are always curious about ways to effectively manage their individual mix. Consistent with our survey skewing towards more mature organizations, for example, we see that the cost of direct payments was relatively less important than the total cost of payments, or even the contribution of payments to top line sales. This indicates more advanced approaches when it comes to payments. Also of note was the fact that virtual goods merchants (merchants with no or minimal underlying costs of goods) rated each of these payment metrics (except cost of direct payments) as more important than was rated by every other merchant sector, reflecting a high sensitivity to both costs and consumer impacts of payments (and, as we'll see later, fraud and risk management).

Question 7: Indicate how important the following factors are in deciding which payment options to offer

We weren't too surprised that the rankings on this question (weighted ranking across "very important", "somewhat important" and "not important") were fairly equal. We suspect the high ranking of "banking relationships" reflects a common enough idea that if a merchant's current set of service providers can provide a new payment option, it can clearly influence the possibility that the new option gets adopted.

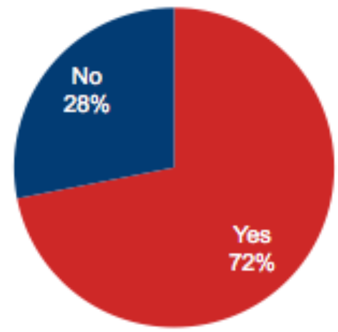
Also of note was the relatively high ranking of "enabling foreign buyers to purchase with local payment methods". While this was only moderately ranked by retail and travel merchants, it was clearly vital to digital and virtual goods merchants who don't have the same sot of logistical challenges as physical goods merchants.

Fraud and Risk Management (FRM) Organization

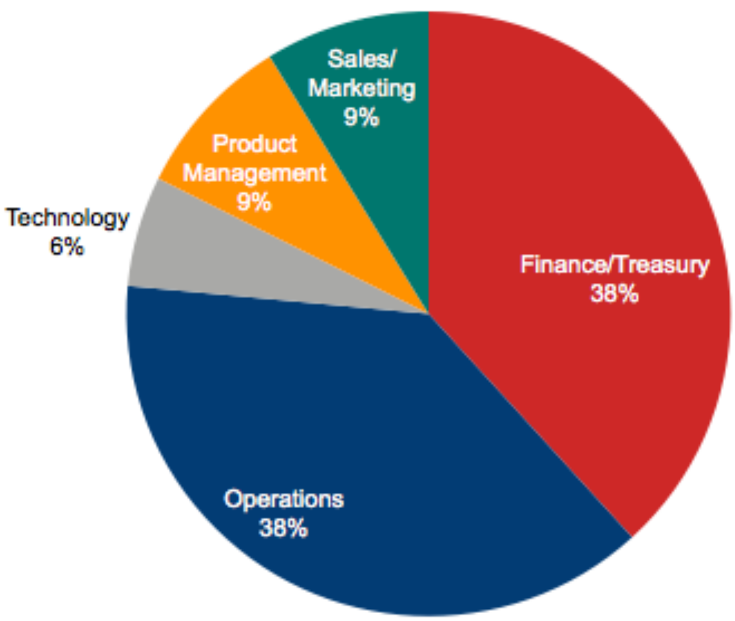
We asked similar questions related to the fraud and risk management organiziation.

Question 8: Does your organization have one organization mainly responsible for FRM?

Similar to the payments organization, we found a large number of eCommerce merchants had a single risk organization. This organizational approach was dominant with digital goods merchants, while only 60% of merchants classifying themselves as retailers had a single organization. But in virtually all cases, very large merchants had a consolidated fraud and risk management group



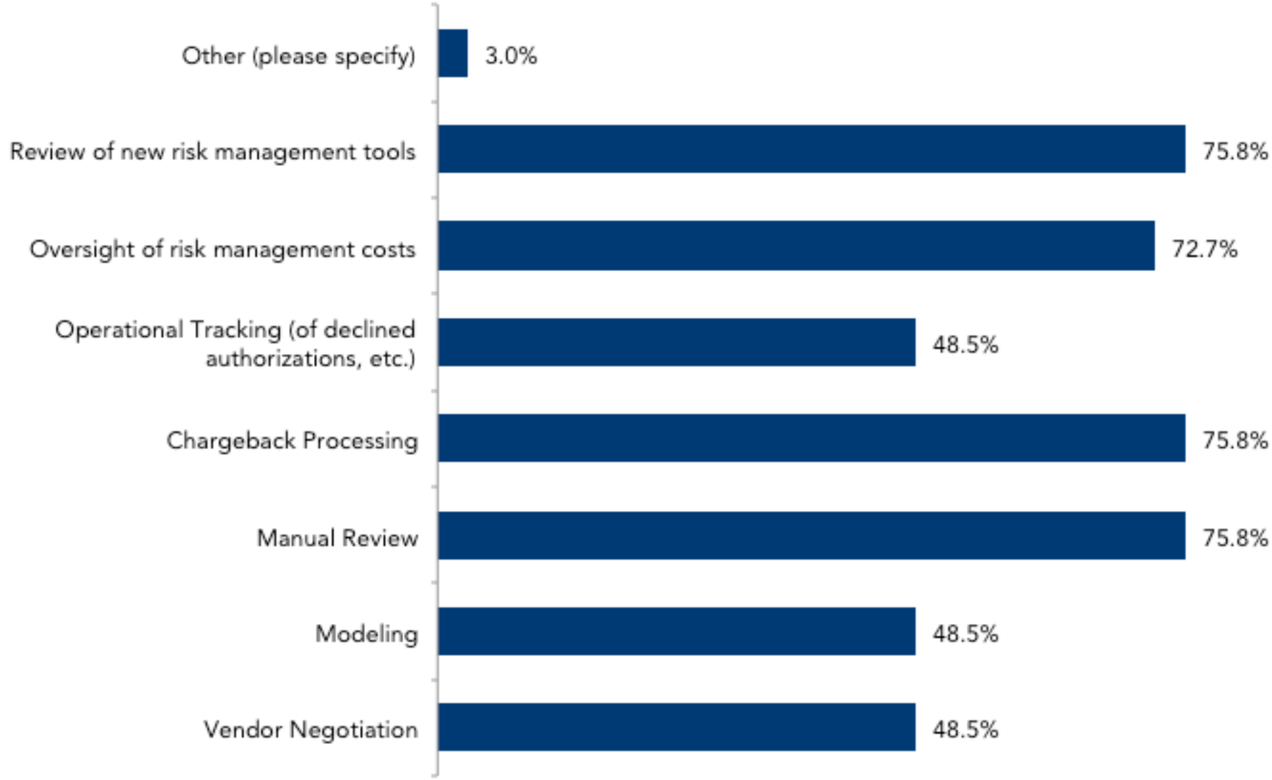
Question 9: Into what organization does your FRM organization or function report?



When fraud and risk management reside in a single group, it was commonly reported that the function is aligned either with the Finance/Treasury group or with Operations. This makes sense; FRM can be seen primarily as a Finance related cost management activity (where the orientation would be fraud loss dollars), or as an Operations-like activity which requires management of activity queues. In our survey, the operational approach was most likely found in the travel and digital goods sectors, with Retailers much preferring the more traditional Finance/Treasury alignment.

Interestingly, organizations that combined both Payments and FRM into one organization showed this same propensity to generally align either in Finance/Treasury and Operations.

Question 10: What functions exist within the FRM organization?



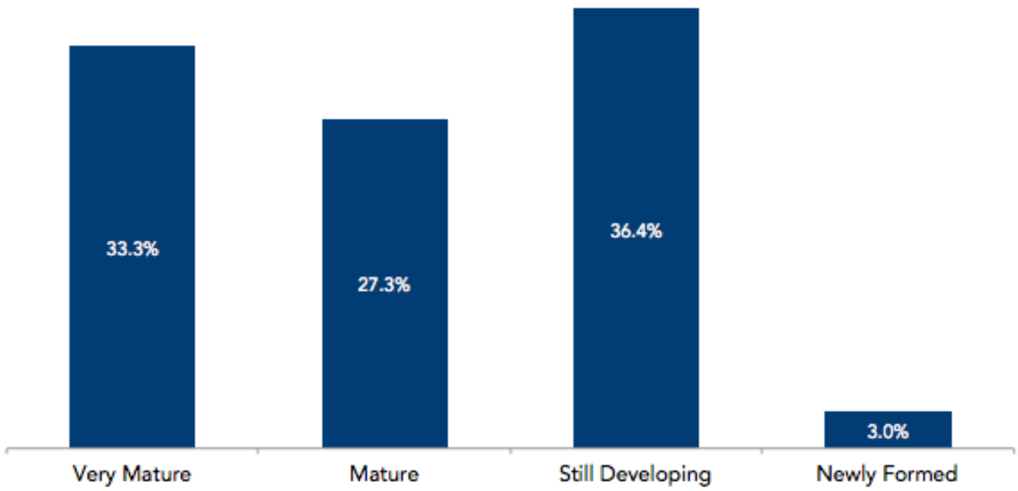
We observed slightly less commonality of functional alignments in FRM organizations compared to Payments. This is likely owing to the fact that FRM groups are more likely to align either with Finance or Operations – in fact, oversight of risk management costs and review of new risk management tools were more likely to be in the FRM group if it reported into Treasury, while manual review was the most common function when the group reported into Operations.

Interestingly, in the few instances that FRM reported into a Product group, the modeling function was virtually always in the group. This seems to speak to organizations recognizing the impact that FRM practices have on good consumers and, if true, speaks to a more advanced way of thinking about FRM.

Note that "Other" was most often reported as the "compliance" function.

Question 11: How would you rank the maturity of your FRM organization?

FRM organizations were much more likely to rank themselves as "still developing" maturity versus the payments group. This makes sense to us – combatting fraud is a constantly evolving battle with new approaches to fraud and fraud prevention occurring regularly, so constant development of new techniques is mandatory.



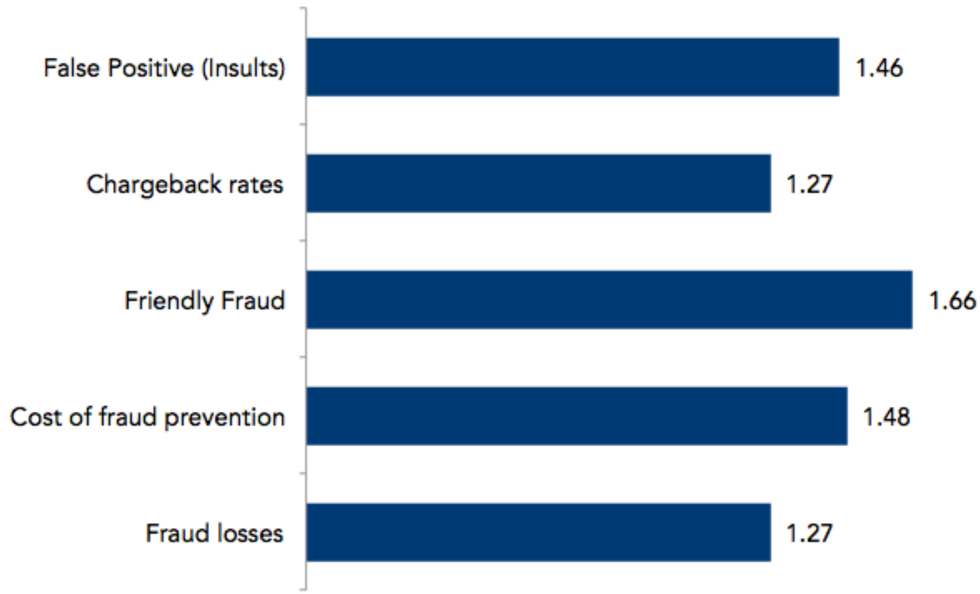
Digital goods merchants were those most likely to mark themselves as "still developing" although it was common across all merchant sectors. Of interest was the fact that self-reported risk and fraud maturity didn't seem to correlate to merchant size, except at the very high end, indicating that many mid-tier merchants continue to feel that they are still developing FRM expertise.

Question 12: How many FTE are directly involved in the following functions?

Merchant Size (Xactns/Year)	Vendor Negotiation	Modeling	Manual Review	Chargeback Processing	Operational Tracking	Oversight of risk mgmt. costs	Review of new risk tools
20,000 to 200,000	1.7	1.0	-	0.1	0.4	0.7	0.7
200,000 to 2 million	1.0	0.6	1.2	1.2	1.5	1.0	1.3
2 million to 20 million	1.6	1.4	5.6	2.1	2.3	1.0	1.2
Over 20 million	1.0	2.5	1.0	1.5	1.0	1.0	1.5

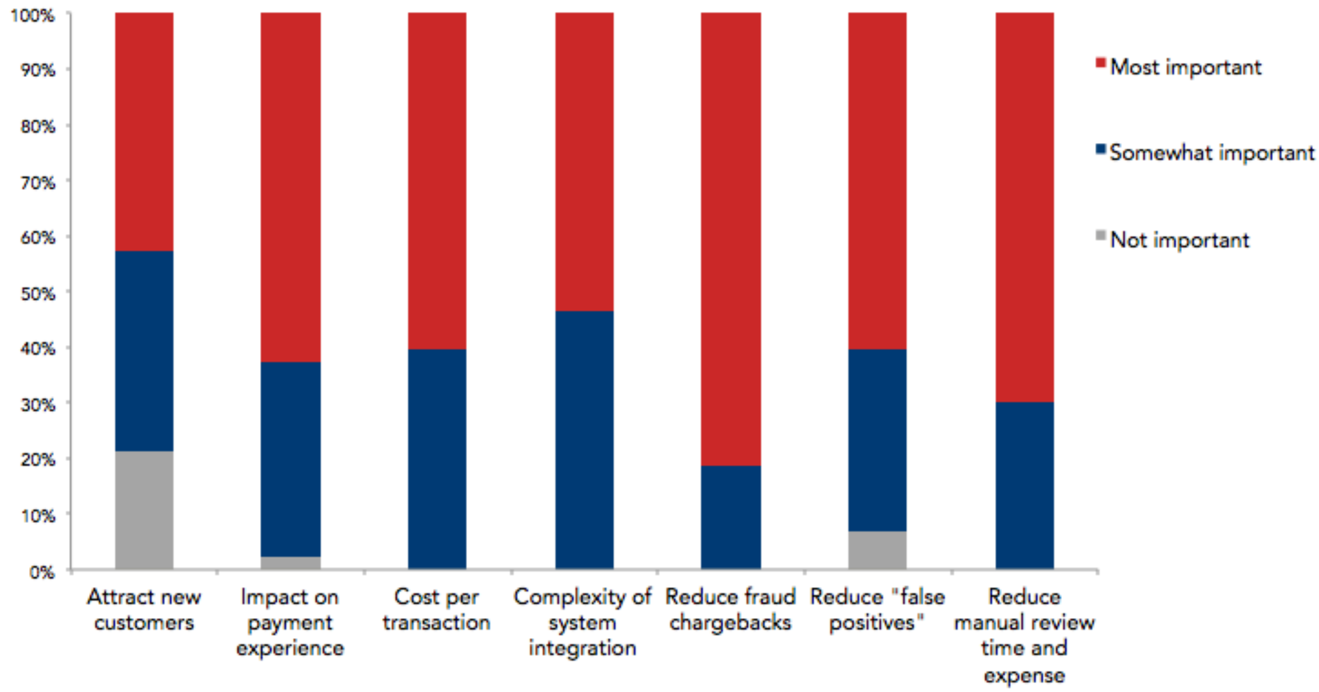
Interpreting the reported FRM FTEs (full time equivalent staff members) responses was challenging as not all respondents provided every data point, leaving us with relatively sparse information in some categories. However, as with payments, we generally observed that larger merchants benefitted from scale, devoting fewer resources per activity than their smaller peers. The exception to this rule is with modeling: larger merchants had significantly more resources devoted to this. Pair this with the dramatically lower number of staff devoted to manual review, and we see a pattern of larger merchants investing in technology (modeling) to avoid the high overhead of manual review and investigation. This is a strategy we have heard reported time and again in merchant interviews.

Question 13: Indicate the importance of the following metrics to measure your FRM function.



The table above provides a weighting among responses consisting of "very important", "somewhat important" and "not important/not used" with higher scores representing higher value. Note that friendly fraud was a major concern across all merchant sectors. This is consistent with Glenbrook's anecdotal conversations with eCommerce merchants. We were heartened to see that false positives are an important metric, indicating that most merchants have an understanding that FRM activities can affect good sales while also catching the "bad guys". Lastly, although it scored relatively lower across all merchant sectors, we noted that chargeback rates were very highly ranked by digital and virtual goods merchants, reflecting their sensitivity to card network rules about fraud rates which they are more prone to bump up against given the nature of their goods.

Question 14: Indicate the importance of the following in deciding which risk management tools to utilize



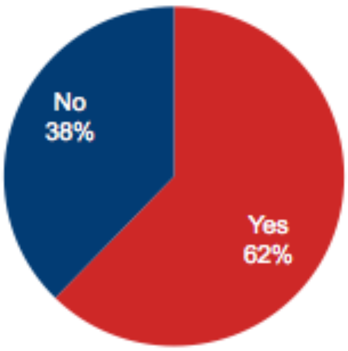
We didn't see a lot of differentiation in the criteria used to evaluate risk management tools, although it's no surprise that those most highly ranked focused on functions more likely to be highly manual – order review and chargeback processing. Fraud and risk managers don't see attracting new customers as a primary concern of theirs, although they have clearly been sensitized to how preventing fraud can have impact on good customers by adding friction to the customer experience and in generating false positives.

Chargeback rates are a primary decision criteria for digital merchants, with few clear sector preferences otherwise evident. Larger merchants tended to place less emphasis on reducing manual review – perhaps because, as we've seen, they've likely already made investments to reduce that activity – but showed the same interest in reducing fraud chargebacks as other merchants.

Combined Organization

Our last few questions centered on whether eCommerce merchants are combining their Payments and Fraud and Risk Management organizations into a single unit, and if so, exploring the attributes and benefits, if any, of doing so.

Question 15: Do your FRM and Payments functions both report to the same individual?

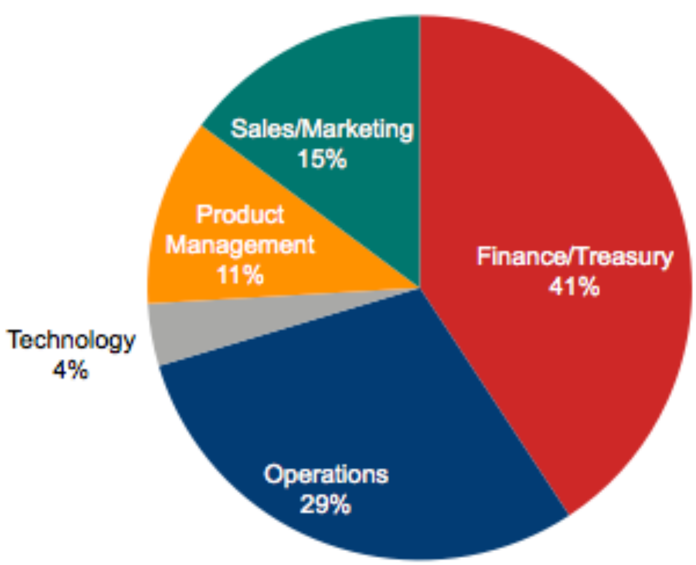


We were impressed by the relatively large number of merchants that recognize the value of combining payments and risk functions into a single organization. At Glenbrook, we've been observing this trend for several years and have come to believe that these two functions are "two sides of the same coin", interacting to encourage good sales and discourage bad ones as efficiently and cost effective as possible.

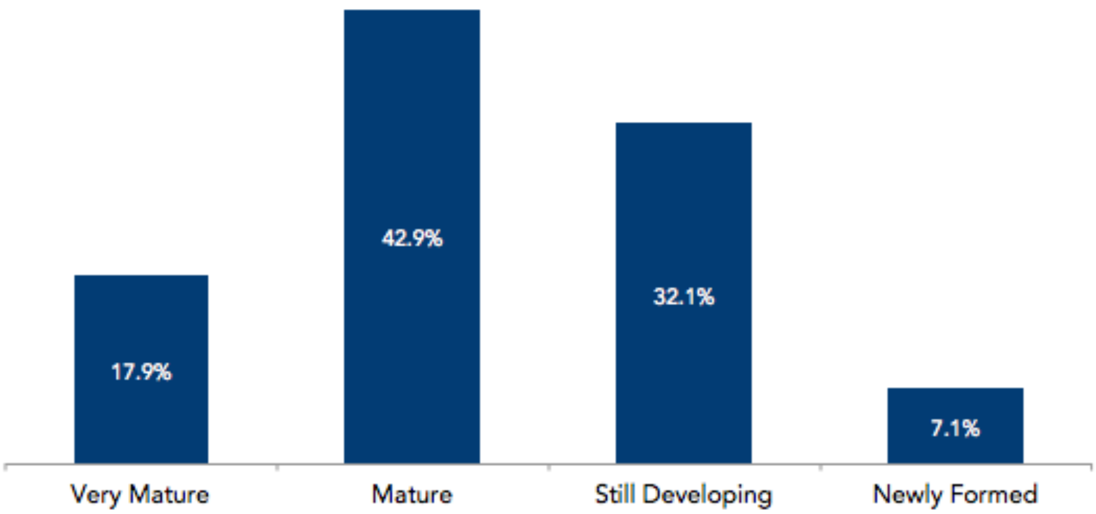
In our survey, retail sector merchants were slightly less likely to combine organizations, while travel sector merchants were generally more likely. For retailers, this possibly reflects the complex, multi-channel nature of their businesses and back offices.

Question 16: Into which area does your combined FRM and Payments organization report?

When deciding where to place the combined group in the organization, Finance, the traditional home of Payments, gets the nod over Operations (where we often found FRM). As mentioned earlier, we appreciated that the Payments organization was located in Sales/Marketing or Product Management 30% of the time, so were a bit surprised to see it representing only 25% of our survey sample here – we would have expected an even stronger showing of this "best practice". As we will see when we consider organizational maturity, this is perhaps owing to the relatively new nature of this organizational approach. We were interested to note that it was the digital/virtual goods merchants that most often organized their combined organization in this way, perhaps because these groups are more highly sensitive to the customer experience, since margins can be extremely high and any customer loss due to payments or FRM "friction" is acutely felt.



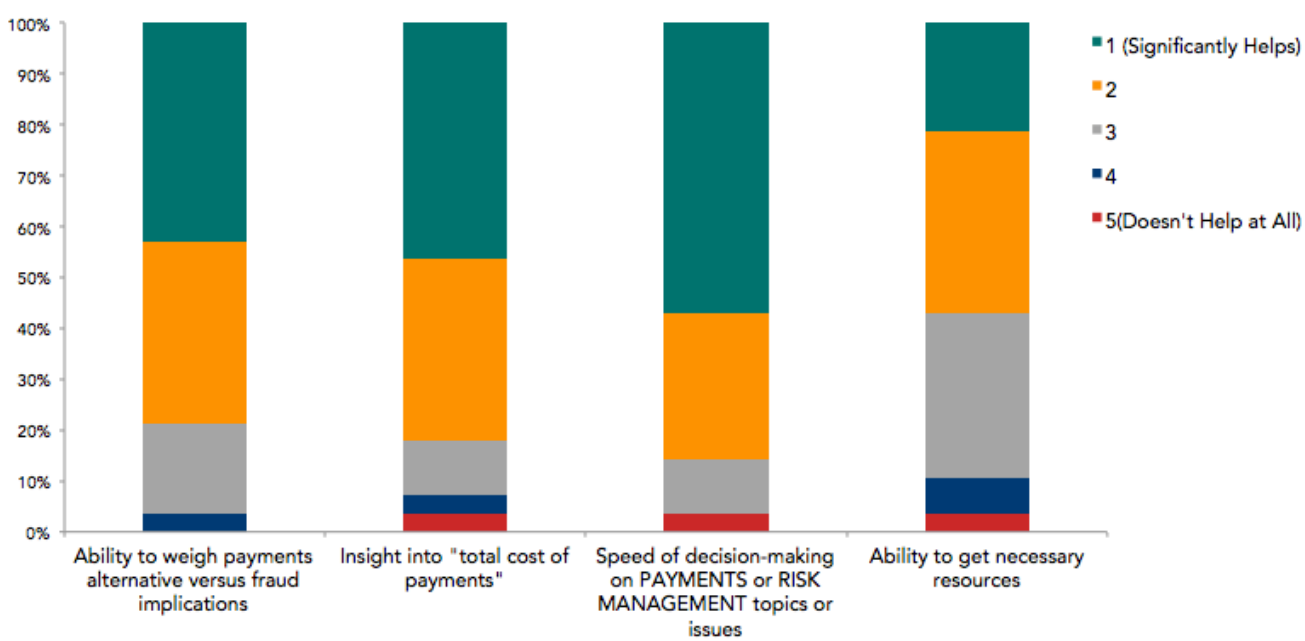
Question 17: How would you rank the maturity of your FRM and Payments organization?



Respondents to this question ranked the combined organization as slightly less mature than respondents to either of the other maturity questions in the survey – lowest in the "very mature" category and highest in the "newly formed" category. This is not surprising as we think this way of organizing is just now coming into its own. Digital and virtual merchants tended to rank themselves as more mature while retailers less so, consistent with the propensity of both groups to organize this way (question 15).

Question 18: What are the effects of this organization structure on the following?

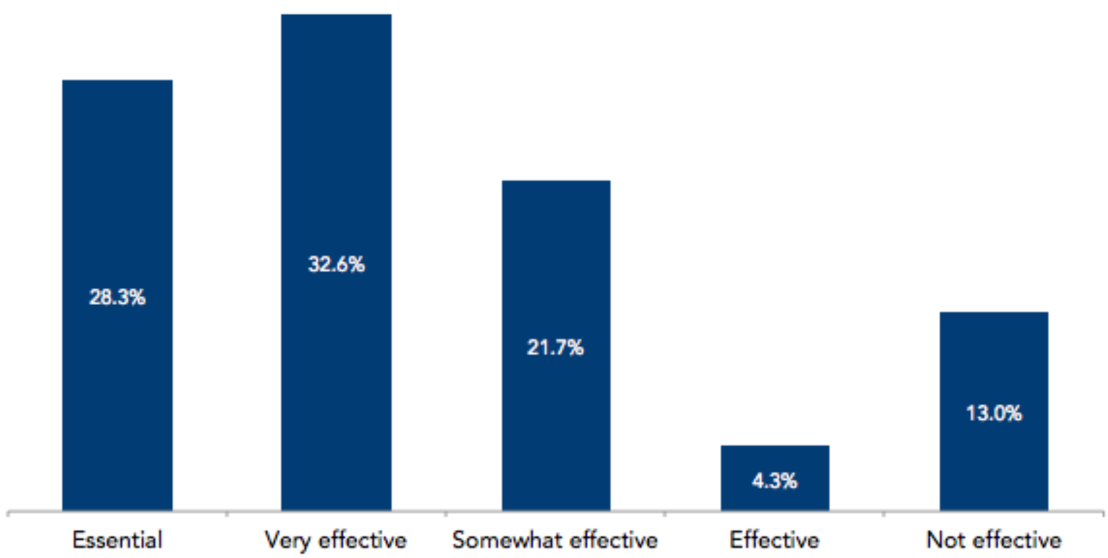
As shown in this chart, respondents saw value in having a combined Payments and FRM organization… but improving their chances at getting resources allocated wasn't one of them!



Actually, larger merchants did see that the combined organization helped in getting necessary resources, likely because the combined unit had a better chance of reporting higher into the organization and thus more say at the table then they might have otherwise.

There was a consistent opinion among respondends that the combined organization helped in speeding the decision process on relevant topics, as well as providing a more complete view of the overall costs of payments. This makes complete sense to us: often, choosing payment strategies influences risk and risk strategies influence costs; a combined organization allows the company to identify and evaluate the trade-offs inherent in these decisions in a much more efficient manner.

Question 19: How effective do you believe it is for both the FRM and Payments organizations to report to the same individual or organization (regardless of how it is organized in your company)?



Our last survey question indicated that a large percentage of respondents saw value in a combined organization, regardless of whether they themselves are organized in this way. These opinions were consistent regardless of merchant sector, size and maturity and provide a strong reference point for those considering a combined structure and should serve as a strong endorsement for merchants who are planning to organize in this manner.

So what? Glenbrook's Key Takeaways

Reflecting on these survey results, we believe that eCommerce merchants should consider three implications:

1. **Integrating the payments and fraud risk management groups is a "best practice" with important benefits**

   More and more eCommerce merchants are organizing this way and those that do perceive benefits in doing so. This is clearly an evolving industry trend and merchants are experiencing clear benefits such as faster decision making and a deeper understanding of their total payments costs.

2. **Merchants should decide what payments and risk management "mean" to them and should align the payments and risk teams accordingly**

   If payments and risk is purely a cost issue, merchants should align those groups with Treasury or Operations (also if highly manual), at least according to our survey. We appreciate the more nuanced view, however, that payments and risk are just part of the overall customer experience with the ability to influence top line sales as well as customer satisfaction and admire those companies that align (or at least closely associate) their payments and risk group(s) with the product and marketing side of the house.

3. **The largest merchants have successfully figured out how to solve the back office scale question, likely through technology means but possibly also through outsourcing. Mid-tier merchants should look to emulate this strategy.**

   The survey data shows that merchants – particularly larger ones – have figured out to keep manual costs in check while their transaction volume scales up. Use of technology to be smarter about which transactions to devote manual effort to (order review, chargeback processing) is clearly implied, but it is also likely that outsourcing of manually intensive functions is also in play. We think this is an important marker for mid-tier merchants, and they should begin planning to achieve similar efficiencies now rather than later, when they find themselves in a real headcount "crunch".

About Glenbrook Partners

GLENBROOK

Glenbrook Partners is a consulting and research firm that helps clients working in the financial services market, particularly in the areas of payments, security, and identity management.

Glenbrook assists leading clients with strategies, market development, new product conceptualization, packaging/pricing strategies, organizational design, and competitive research and analysis. We combine our unique range of skills, years of hands-on operating experience, and a global network of relationships with a razor-sharp business focus, helping our clients achieve leadership positions that set them apart at the head of the pack.

We also publish the PaymentsNews.com blog with over 14,000 daily readers and a companion blog with our commentary, PaymentsViews.com.