White paper

SPSS
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Fraud report 2009: Staying ahead of the game

Business leaders' attitudes toward the risk of fraud and debt for organisations in the current recession

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Introduction – A risky recession

Cutting costs, increasing efficiency and streamlining processes are the three main ways in which organisations cope with difficult financial circumstances – and it's no secret that, despite small signs of recovery, the economic outlook continues to be bleak. Between December 2008 and February 2009, the UK economy contracted by 1.8 percent and this trend is set to worsen indefinitely.[1] Hence business leaders will naturally look for further areas to make savings without compromising on quality as the recession intensifies.

One issue that plagues companies of all sectors, however, is the question of financial risk and (especially) fraud – whether they are benefitting from a boom or trying to survive a bust. Some large organisations put significant portions of revenue aside to anticipate and deal with fraud, while others devote costly employee attention to chasing up funds lost as a result of suspicious or fraudulent behaviour. The end result, however, is that some potential revenue will be at risk from the direct result of fraudulent behaviour.

So how will the recession affect this standard? Essentially, business leaders are facing a double challenge of fraud as the recession continues to bite. Firstly, their ability to spend time and resources to investigating lost revenue or minimising risk could be diminished as a result of cost cutting or team restructures. And, even more importantly, cases of fraud are likely to rise in difficult economic circumstances. Already, figures indicate around a 16 percent overall growth in fraud throughout the UK – including a startling 207 percent rise in third-party takeover fraud (the fraudulent use of somebody else's bank account) and a rise in fraudulent use of funds (such as writing bad cheques) of over two thirds (69 percent).[2]

To compound the issue, cases of bad debt – rising from legitimate behaviour from those also suffering from the contracting economy – are also likely to increase. While this is unfortunate, it presents an additional challenge to businesses that need to isolate and exclude risk. As a result, integrated data strategies are evolving that deal with the issues separately and as an overall risk reduction strategy.

SPSS, an IBM Company, a leading global provider of predictive analytics software and solutions, sought to gauge exactly how corporate risk and fraud levels are being affected by the recession, through conducting extensive research. How are companies equipped to deal with fraudulent behaviour? How will the challenging financial conditions affect business strategies in the face of a greater potential for financial risk? And, crucially, in what direction will business leaders take their fraud prevention policies?

SPSS, an IBM Company, questioned 100 senior IT decision makers (mainly CIOs, IT directors and IT managers) in large companies (of 1,000 people or more) about their attitudes towards risk. The respondents – who come from a range of sectors including finance, manufacturing, retail and transport – were asked whether they are likely to evaluate the quality of their customers more closely to prevent risk, in light of the tougher financial climate.

[1] *Estimate from National Institute of Economic and Social Research (NIESR).*

[2] *UK Credit Industry Fraud Avoidance Service (CIFAS) figures from end 2008.*

Section 1: The current outlook for fraud

To present the current outlook for fraud, participating company leaders were asked to assess whether or not their fraud levels have been affected by the recession; how prepared their organisation is to fight fraud; and how important an issue fraud is for their company in general.

Key Findings – At a glance

- 12 percent of companies reported an overall rise in fraud
- Financial services companies are the most affected by rising fraud (26 percent)
- However, only 9 percent of financial companies rate fraud as a large issue – the lowest of all sectors
- A fifth of the largest companies questioned (with more than 3,000 employees) have noted an increased level of fraud
- Two thirds of participants believe fraud is not a big issue for them
- Retail, distribution and transport companies believe themselves most prepared for fraud (80 percent say they are prepared or very prepared)
- Overall, three quarters of companies believe they are well or very well prepared to combat fraud
- 12 percent of retail, distribution and transport companies have actually noted a decrease in fraud
- Other commercial organisations (professions such as accountancy firms, architects and law firms), utilities and technology companies are the least affected by fraud (80 percent believe it's not an issue)
- Manufacturing companies are the least prepared to combat fraud

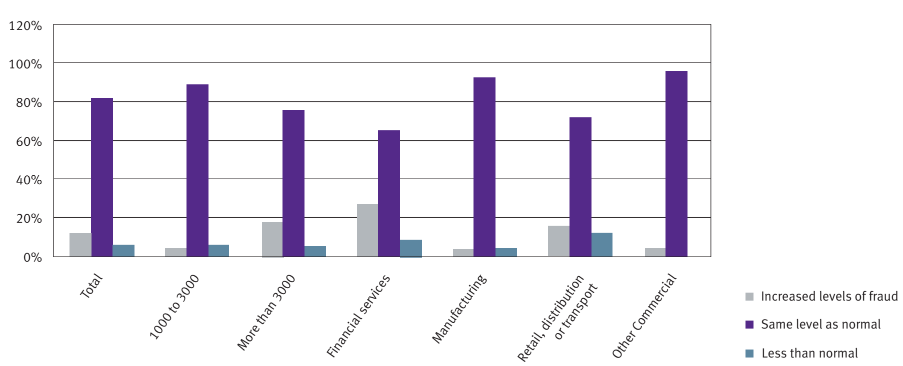
Analysis

Overall, a small but significant percentage of recipients (12 percent) noted an increase in fraud, while 82 percent asserted its constancy. Financial services companies and organisations with over 3,000 employees have been the most affected by recession-driven fraud, with 26 percent and 19 percent respectively seeing an increase. In contrast, commercial companies and those with between 1,000 and 3,000 employees only noted a four percent rise in fraud.

Overall, 12 percent noted an increase in fraud

A smaller number (six percent) of business leaders noticed a decrease in levels of fraud, with the highest proportion coming from the retail (12 percent) and financial sectors (nine percent). Fraud has remained the most constant in the commercial sector, with nearly all (96 percent) of respondents indicating that fraud levels have stayed the same despite the changing economic circumstances.

With consumer household incomes under increasing pressure, is your organisation experiencing:



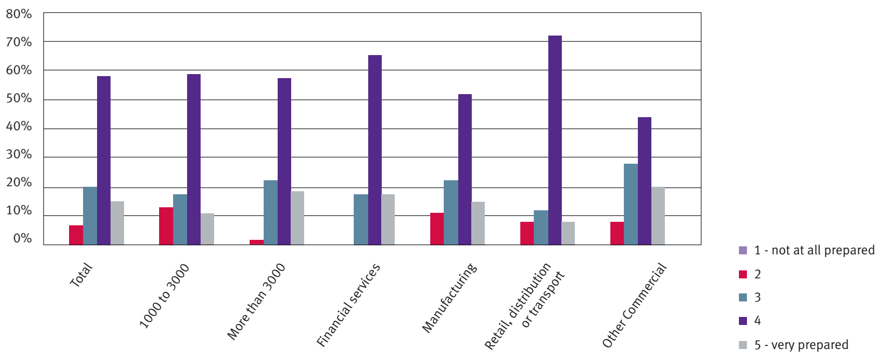
Participating companies were asked to rate how prepared they feel in terms of combating fraud on a scale of one (not at all prepared) to five (very prepared). While no one admitted to being completely unprepared, 13 percent of companies with between 1,000 and 3,000 employees rated themselves as relatively unprepared (with a score of two out of five). No financial companies rated themselves lower than a score of three.

Overall, three quarters of participating companies (73 percent) rate themselves as four or five on preparedness – including 17 percent of financial organisations giving themselves five out of five. Significantly, this seems to reflect necessity rather than preparation, as financial companies have already been the hardest hit by increasing recession fraud. Conversely, retail companies have reported the most significant decrease in fraud across all business sectors (12 percent), and just eight percent scored themselves five out five for preparedness.

Thirteen percent of companies rated themselves as relatively unprepared

Financial companies are the most likely to use data analysis to discover suspicious customer behaviour, which could explain why they are the best prepared to combat fraud (see Section 3).

How prepared is your organisation to combat fraud?

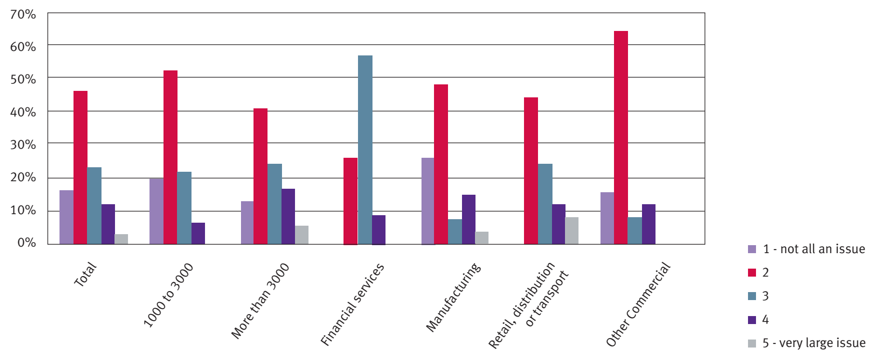


Startlingly, particularly given the economic conditions and ongoing banking crisis, financial services companies are the least likely to see fraud as an important issue to their organisations – with only nine percent crediting fraudulent activity with importance, compared with 19 percent in manufacturing and 20 percent in retail, distribution and transport companies. However, despite the significant increase in recession-driven fraud in the financial sector, tighter regulations and the use of predictive analytics by financial companies (see Section 3) are beginning to have a beneficial effect.

Nine percent of financial services companies think fraud is an important issue

The research revealed a contrast between the effect of fraud in businesses with between 1,000 and 3,000 employees and those with over 3,000. Only seven percent of the smaller companies see fraud as a significant issue, while nearly a quarter of the larger organisations see it as either an important or very important issue. This disparity can be explained by the fact that larger companies are more likely to carry out financial transactions online, while nearly two thirds of smaller companies fail to engage in e-commerce (see diagram in Section 3).

How big an issue is fraudulent activity to your organisation?



Section 2: Business priorities in the recession

Businesses of all sectors are more concerned with cutting costs than increasing revenue during the downturn (68 percent over 32 percent)

In order to understand business leaders' attitudes towards fraud in the recession and to make predictions for the future of fraud, SPSS, an IBM Company, asked participating organisations about their priorities and areas of concern – particularly given the current financial pressures – and about how effectively they are currently tackling fraud.

Key Findings – At a glance

- Overall, acquiring new customers and growing revenue from existing ones emerged as the top two priorities for UK companies (35 percent each)
- Retail companies in particular are prioritising customer acquisition (52 percent)
- A fifth of companies prioritise customer retention during the recession
- Debt prevention is only prioritised by a tiny 3 percent of companies
- No financial companies see debt collection as an overall priority
- Businesses of all sectors are more concerned with cutting costs than increasing revenue during the downturn (68 percent over 32 percent)
- 70 percent of all companies believe they tackle fraud well or very well
- However, only 10 percent prioritise debt collection and prevention
- Nearly half of other commercial companies are most concerned with growing revenue from existing customers
- Three quarters of manufacturing companies are more concerned with cost cutting than increasing revenue

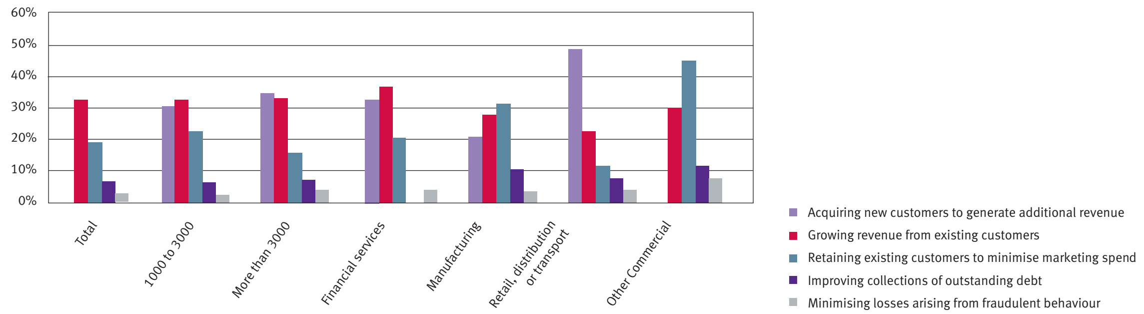
Analysis

The research uncovered an even split between attracting new customers and growing revenue from the existing client base: these two initiatives emerged as the two main priorities during the recession, each drawing 35 percent of votes overall. Retail, distribution and transport companies are particularly biased towards customer acquisition with over half of organisations (52 percent) prioritising customer outreach – while for the ‘other commercial sector’, nearly half of participants (48 percent) are biased towards growing revenue from existing clients.

Fifty-two percent of retail, distribution and transport companies are focused on customer acquisition

Customer retention is a priority for a fifth of companies overall, although this is most prevalent in the manufacturing industries (33 percent) and least prevalent among retail and other commercial organisations (12 percent each). The issue of debt – both in terms of collection and prevention – emerged as the most neglected business initiative – even for the financial services sector, with only three percent of businesses prioritising debt minimisation. However, for some companies, debt prevention and collection could be seen as an integral element of growing revenue from existing customers.

In current market conditions, which internal projects are being prioritised over others?



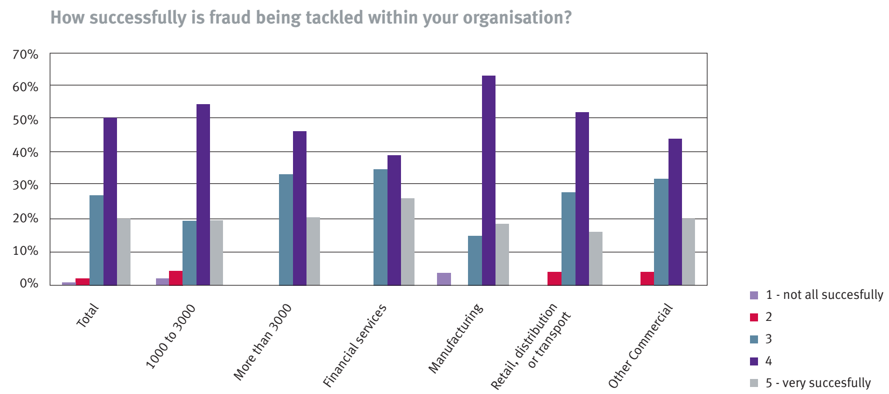
Over two thirds of businesses overall (68 percent) are prioritising operational cost cutting over increasing revenue (32 percent) as a result of the recession – and this is particularly noticeable in the manufacturing sector (74 percent). However, while so many businesses are keen to cut costs internally, the data indicates that many fail to look elsewhere to save money – particularly in terms of debt collection and fraud prevention, which only attract seven and three percent of priority votes respectively.

Sixty-eight percent of companies are prioritising operational cost cutting

Therefore, the research demonstrates a clear bias towards internal, operational cost cutting – but this can be seen to contradict the previous emphasis on customer acquisition over customer retention (35 percent against 20 percent). Similarly, it brings into question the lack of importance credited to debt minimisation, which is an important way to cut costs – both in terms of the fewer resources needed to collect debt and the reduction in revenue squandered on ‘untouchable’ fraud.

The vast majority of participants expressed confidence in their organisations’ fraud tackling policies, despite them being apparently low on their list of priorities. Nearly three quarters of business leaders (70 percent) believe their company is either successful or very successful in tackling fraud – even though 12 percent have noticed an increase in fraud since the recession began. This suggests that they may be looking at new methods to help them deal successfully with the rise in recession-driven fraud, such as predictive analytics to pre-empt and avoid potentially risky customers (see Section 3).

Only respondents from the manufacturing sector admitted to having completely unsuccessful methods of tackling fraud – and then only four percent of them admitted it. But perhaps their relatively low level of fraud overall can be explained by the fact that 70 percent of manufacturing companies fail to engage in online transactions (see Section 3).



Section 3: Prevention rather than cure

More than a fifth of financial organisations fail to identify potential debtors

Finally, the study probed how effectively UK business leaders seek to reduce fraud and mitigate risk – that is, by actively avoiding customers who are likely to represent additional risk. This includes using data mining and predictive analytics and even marketing schemes designed to target the right customers and avoid potential debtors. In this instance, companies were asked about all kinds of risk reduction, from improving the security of online transactions to techniques for better customer profiling.

Key Findings – At a glance

- A quarter of all businesses analyse buying behaviour to identify abnormal purchasing patterns
- Financial organisations (43 percent) and retail companies (32 percent) are most likely to engage in this analysis
- Retail companies have done the most to increase online security (64 percent)
- A fifth of retail companies fail to integrate their risk and marketing schemes
- Financial companies are most likely to integrate risk and marketing (73 percent)
- Almost a third (30 percent) of financial services organisations have risk and marketing programmes that are 'very well integrated'
- Over three quarters of businesses identify potential debtors
- More than a fifth of financial organisations fail to identify potential debtors
- A quarter of companies restrict purchases from particular locations
- Only 15 percent of manufacturers identify potential debtors

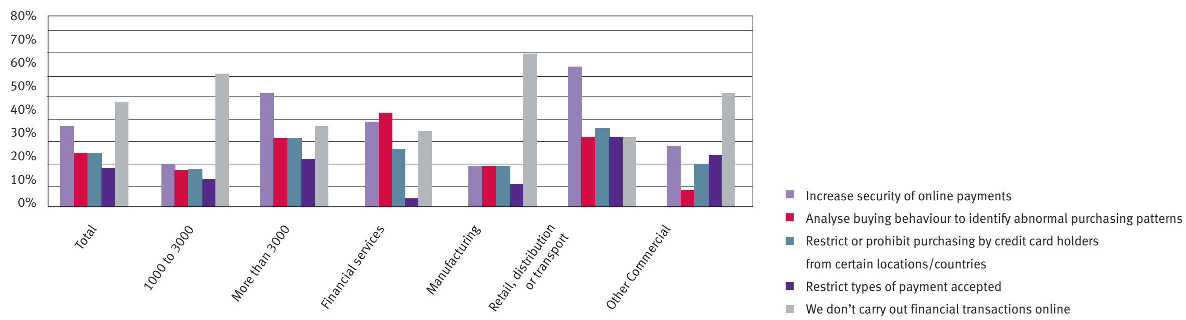
Analysis

A quarter of companies overall analyse buying behaviour to identify abnormal purchasing behaviour via online channels – and the same portion also restrict or prohibit purchases from certain countries or geographic locations to avoid suspicious activity. 37 percent of businesses have attempted to increase the security of online payments, including more than two thirds of retail companies – so this emerges as the first choice for fraud prevention online, particularly in sectors that rely on online transactions.

Thirty-seven percent of businesses have attempted to increase the security of online payments

However, predictive analysis is the preferred fraud prevention method for financial services companies, with 43 percent choosing this method, followed by increased payment security (39 percent), purchase restrictions based on location (26 percent) and restricting payment types (just four percent). Retail, distribution and transport companies are the most likely to increase online security and restrict certain purchases – perhaps because they are also most likely to use e-commerce in the first place.

What measures have you taken to reduce fraudulent transactions online?

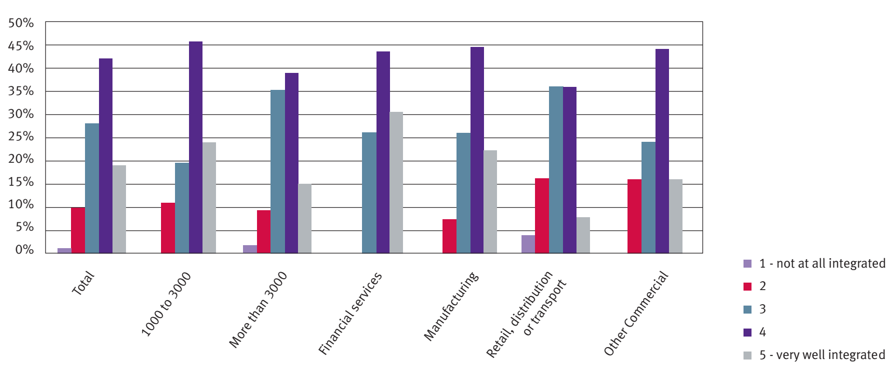


Another way that businesses can pre-emptively reduce business risk is by tailoring their marketing methods to attract the most profitable customers and avoid spending marketing funds on suspicious ones. This means that marketing initiatives and risk assessment programmes would be integrated to avoid potential debtors. Overall, nearly two thirds of business leaders (61 percent) believe that their risk and marketing initiatives are either well or very well integrated in their organisations, with financial services topping the list with 73 percent.

Seventy-three percent of financial services companies think their risk and marketing initiatives are very well integrated

Conversely, a fifth of retail, distribution and transport companies expressed that their risk and marketing programmes were not well integrated – compared with just seven percent in manufacturing and no companies whatsoever from the financial industries. This is perhaps unsurprising given legislative and compliance issues from the Financial Services Authority (FSA) – and the renewed pressure on financial institutions to avoid potentially toxic debt.

How integrated are your risk and marketing programmes to minimise the threat of acquiring high risk / fraudulent customers?

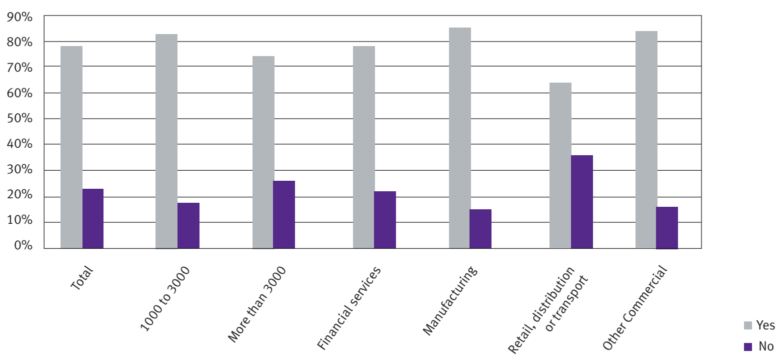


One of the most effective ways to reduce risk is to drill down into customer information – using granular detail to identify potential debtors to circumvent arrears. In this way, businesses can know exactly which customers to target through marketing and which customer is likely to be the safest and most profitable. In fact, over three quarters of UK businesses (78 percent) proactively identify the customers most likely to default on payments.

Manufacturers and other commercial industries are more likely to analyse customer behaviour than the financial industry

While this is an ostensibly high percentage, a surprisingly high portion of financial services companies (22 percent) fail to identify these high-risk customers – particularly given the economic circumstances. In fact, manufacturers and other commercial industries are more likely to analyse customer behaviour than the financial industry (both 84 percent in contrast with 78). However, organisations from the retail, distribution and transport industries are the least likely to avoid debtors proactively, with less than two thirds (64 percent) engaging in customer analysis.

Does your business proactively identify potential debtors to prevent bad debt and arrears?



Conclusion: Doing more with less

The recession has led to a steady increase in fraud and debt levels for UK organisations, owing partly to reduced consumer budgets. This problem has been somewhat mitigated both on an organisational and a government level. Based on survey results, the majority of business leaders questioned are not concerned with potential increasing levels of fraud and bad debt within their organisation, so they are not applying any stricter standards to evaluating the quality of their customers. Most notably, financial services organisations – which are the most affected by rising fraud – appear to be the least worried about fraud within their institutions.

However, businesses across the board indicate that during the downturn, cost cutting measures are being prioritised over acquiring new customers and increasing revenue from existing ones. At the same time, though, the issues of fraud detection and debt collection emerged as the most neglected business initiatives among those measures. Toughened FSA restrictions initiated by the government have catalysed more stringent safeguards against debt, including the proactive analysis of potential debtors, as well as some tighter precautions against online fraud.

A quarter of all businesses state they analyse buying behaviour to identify suspicious purchasing behaviour, especially via online channels. In addition, more and more companies are aligning their marketing outreach with customer profiling. Some marketing campaigns are actually created to avoid risky customers and attract the most trustworthy prospects. In this way, UK companies are looking at increasingly innovative ways to fight the rise in recession fraud and debt risk during these difficult financial times.

What the study shows, therefore, is a first step in the fight against recession-related fraud. But while the will is there – accompanied by growing confidence across most sectors – there is still some way to go. Ultimately, fraud is still on the increase and much more work must be done to prevent it from eating into corporate budgets. This means organisations must become more innovative and proactive in tackling the issue.

Already, companies are looking into predictive analytics technology to effectively detect fraud and mitigate risk. This provides them with actionable insight on suspicious customer behaviour, allowing them to deal with problems of risk before they occur. Using advanced analytics to drill down into customer behaviour will allow organisations to understand risk better than ever. But again, this understanding needs to be achieved on a wider level if recession risk is to be avoided.

Through tough financial times, organisations are more likely than ever to assess the way they allocate their revenue internally. With a significant emphasis placed on operational cost cutting throughout this research, UK businesses must continue to do more with less. This will involve analysing information right through the customer experience – from marketing to selling to billing and beyond.

About SPSS, an IBM Company

SPSS, an IBM Company, is a leading global provider of predictive analytics software and solutions. The company's complete portfolio of products – data collection, statistics, modeling and deployment – captures people's attitudes and opinions, predicts outcomes of future customer interactions, and then acts on these insights by embedding analytics into business processes.

SPSS solutions address interconnected business objectives across an entire organization by focusing on the convergence of analytics, IT architecture and business process. Commercial, government and academic customers worldwide rely on SPSS technology as a competitive advantage in attracting, retaining and growing customers, while reducing fraud and mitigating risk. SPSS was acquired by IBM in October 2009. For more information, visit **www.spss.com**.

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