CHARGEBACK GURUS

MANAGING CHARGEBACKS IN THE SUBSCRIPTION ECONOMY

Report by Chargeback Gurus & Juniper Research

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MANAGING CHARGEBACKS IN THE SUBSCRIPTION ECONOMY

1. Key Takeaways

1.1 Key Takeaways

1.1.1 Subscription Billing Is Growing Rapidly, as Is Friendly Fraud

Our subscription economy research data shows the extreme proliferation of subscription billing across many different segments, such as TV & video and physical goods boxes, with growth of over 200% forecast between 2022 and 2026.

At the same time, the rate of illegitimate chargebacks, also known as friendly fraud or first-party misuse, is on the rise. According to data from the Merchant Risk Council, it was the fastest-growing type of fraud between 2019 and 2021.

As merchants across industries expand their subscription billing operations, mitigating the risks posed by chargebacks will be key to long-term success.

1.1.2 Declines Represent a Mixed Picture

Decline rates vary widely across industries. Of the industries included in the data, telecoms had the highest payment acceptance rate at 99.8%, with TV, video and gaming coming out lowest at 90.9%.

The study also found that decline reasons are often difficult to interpret for merchants, adding to the challenge of reducing overall decline rates. Identifying the true reasons for declines is key to maximizing payment acceptance rates and minimizing involuntary churn.

1.1.3 Most Subscription Chargebacks Claim Fraud or Cancelled Services

Claims of fraud accounted for 52% of all subscription chargebacks analyzed. The second most common claim was cancelled services at 18.4%.

In the subscription economy, many customers are turning to chargebacks when customer service does not meet their expectations, creating a significant drain on revenue for subscription merchants.

Subscription Billing & Chargebacks Summary

01

Growth of over 200% in subscriptions globally, 2022-2026

02

Telecoms and mobile transaction success rate - 99.8%

Source: Juniper Research, Chargeback Gurus & Vindicia

03

TV, video and gaming transaction success rate - 90.9%

04

Proportion of chargebacks which are fraud fraud-related - 52%

MANAGING CHARGEBACKS IN THE SUBSCRIPTION ECONOMY

2. Subscription Billing Data

2.1 Introduction to the Subscription Economy

Subscription economy is an umbrella term for the market surrounding subscription services. Juniper Research defines a subscription service as:

> 'A product of service that is bought or accessed via a recurring payment, and that requires no additional action to terminate beyond cancelling the recurring payment.'

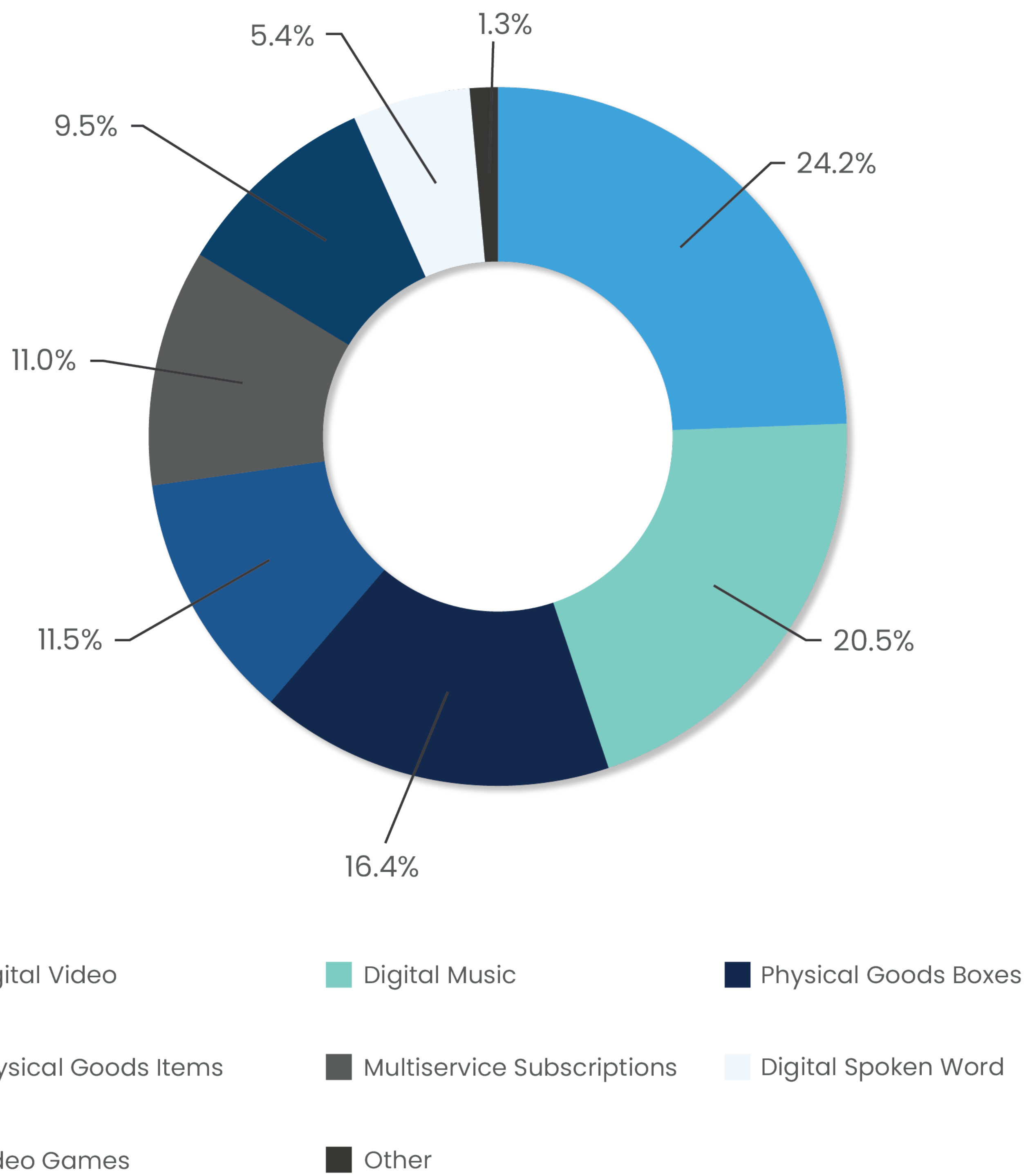
Although subscription services have been available for some time, they have only recently been applied to the consumer marketplace at scale. In recent years, the subscription model has spread to a wide variety of new industry verticals.

The subscription economy is growing rapidly, with Juniper Research forecasting growth of over 200% between 2022 and 2026. One reason as to why companies are adopting this business model is because it provides predictable revenue.

Subscription payments are less volatile than one-time purchases, so companies that implement this business model can reliably predict revenue as payments are scheduled. Subscriptions also increase customer retention by making repeat purchases automatic. These advantages have driven the expansion of subscription services into sectors that might not seem like an obvious fit for the model, such as physical goods.

As can be seen in figure 2.1 to the right, subscriptions are now common in a variety of different categories, though more established verticals such as streaming services (both video and music) still make up a large percentage of the market.

Figure 2.1: Total Number of Subscriptions per annum (2.4 Billion), by Category in 2022



Source: Juniper Research

2.1.1 Transaction Approval & Decline Rates

For this section, we will examine some of the most popular industries for subscription payments and look at approval and decline rates, which are highly important for merchants.

Based on data from Vindicia, TV, video and gaming had the worst approval rate, at 90.9%, with telecom and mobile having the highest rate, at 99.8%. Some key thoughts on this data are below:

• Many telecom companies are large enterprises that have used subscription billing for decades, so they have had the time and resources to thoroughly optimize their billing practices. In addition, these services are often a higher priority for customers.

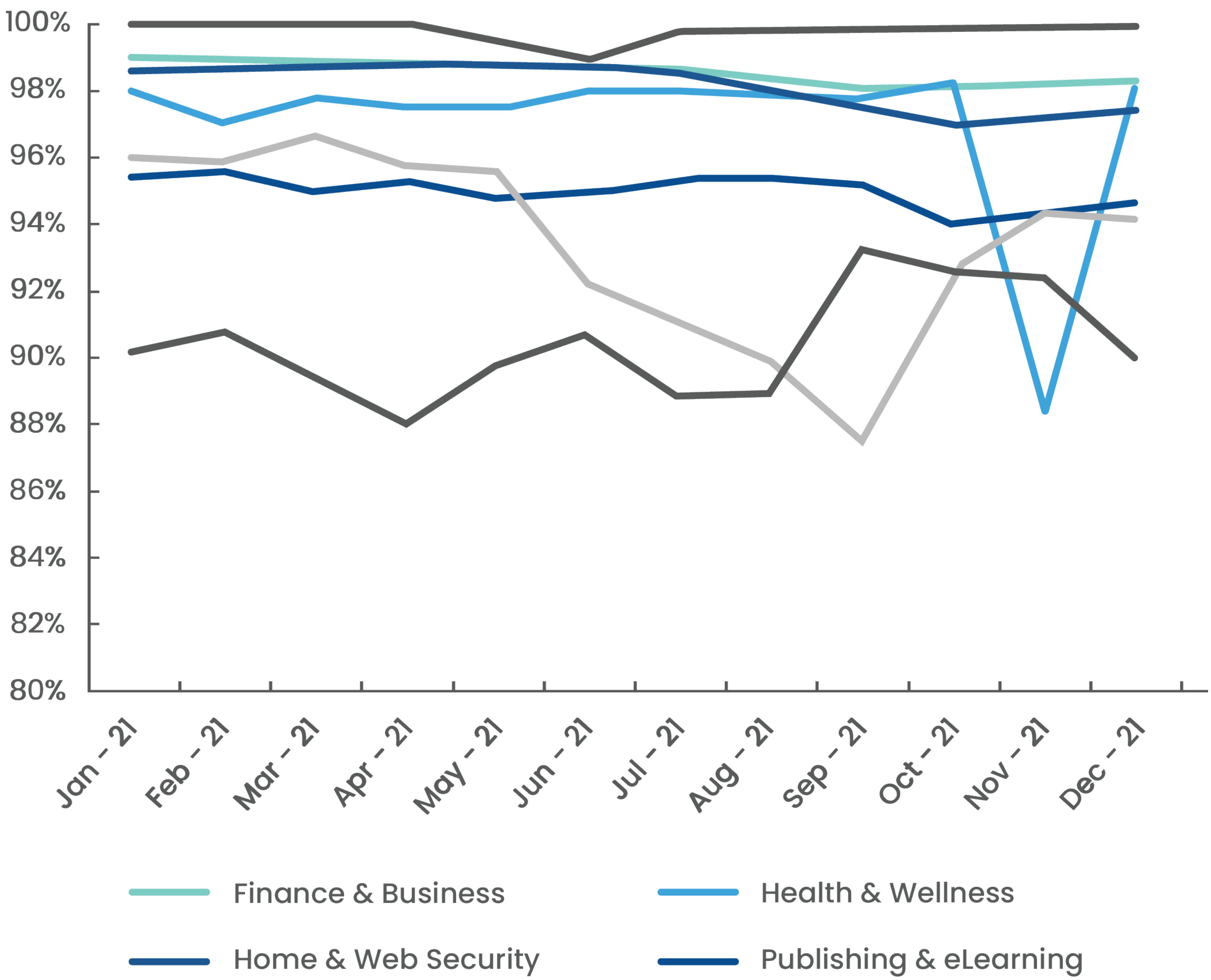
• The higher decline rates for entertainment-focused subscriptions may reflect the fact that when customers are facing financial difficulties, these services are typically low on the list of priorities. This could result in additional declines caused by insufficient funds.

In figure 2.2 to the right, we can see that over 2021, the rates of success were relatively consistent. However, there were some spikes that were notable:

• Health and wellness significantly declined in November 2021 but recovered in December.

• TV, video and gaming was worst in April 2021, with a low period in summer 2021 as well.

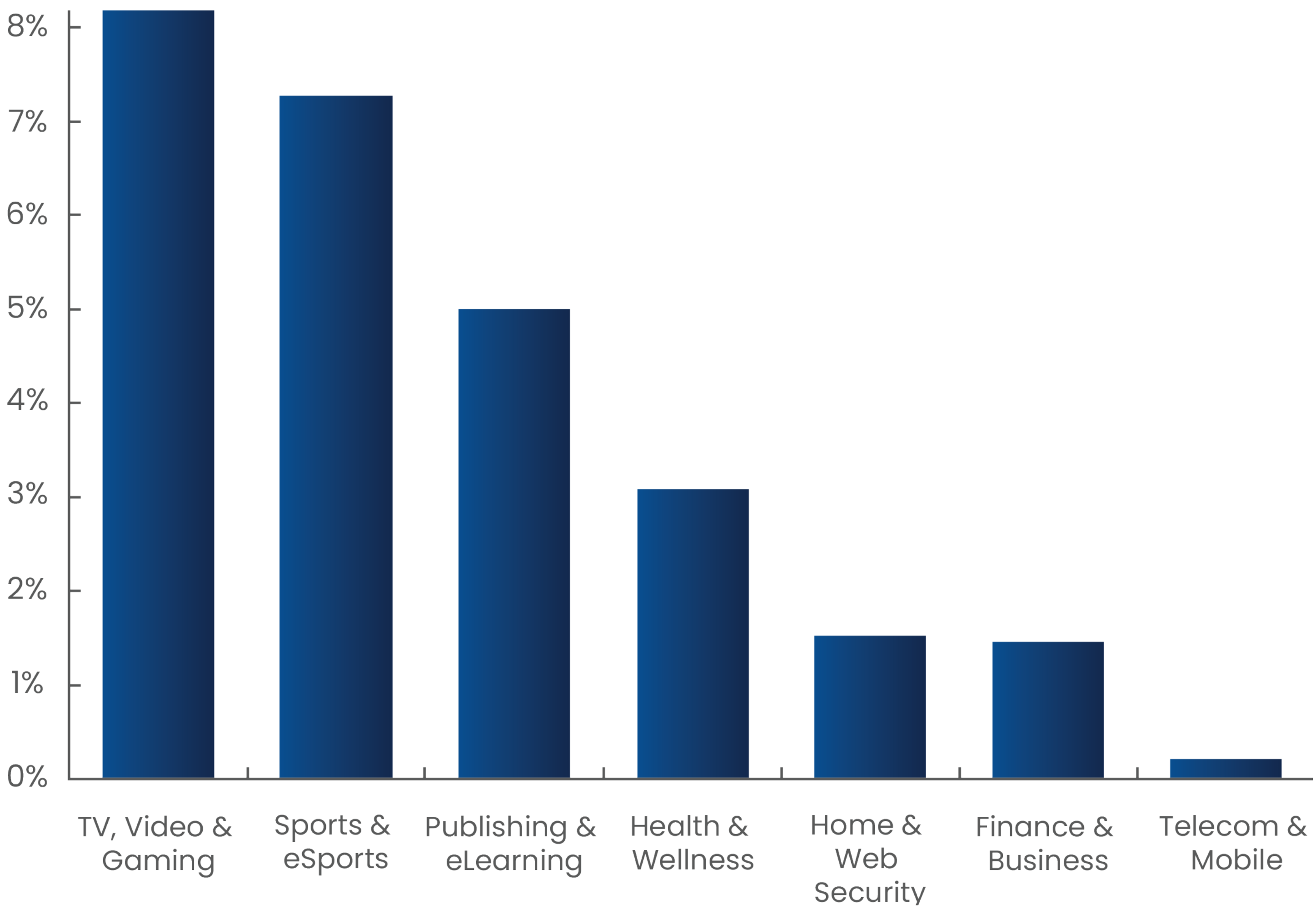
Figure 2.2: Overall Success Rate for Subscription Billing Attempts, January to December 2021, Split by Industry (%)



Source: Vindicia

In figure 2.3, we can see that TV, video and gaming had the highest rate of declines of any industry, followed by sports and eSports. Given that TV, video and gaming are all digital services, that are typically subject to high levels of fraud, both friendly and otherwise, and often are forgotten about by users, this is unsurprising.

Figure 2.3: Overall Decline Rate for Subscription Billing Attempts, 2021, Split by Industry (%)

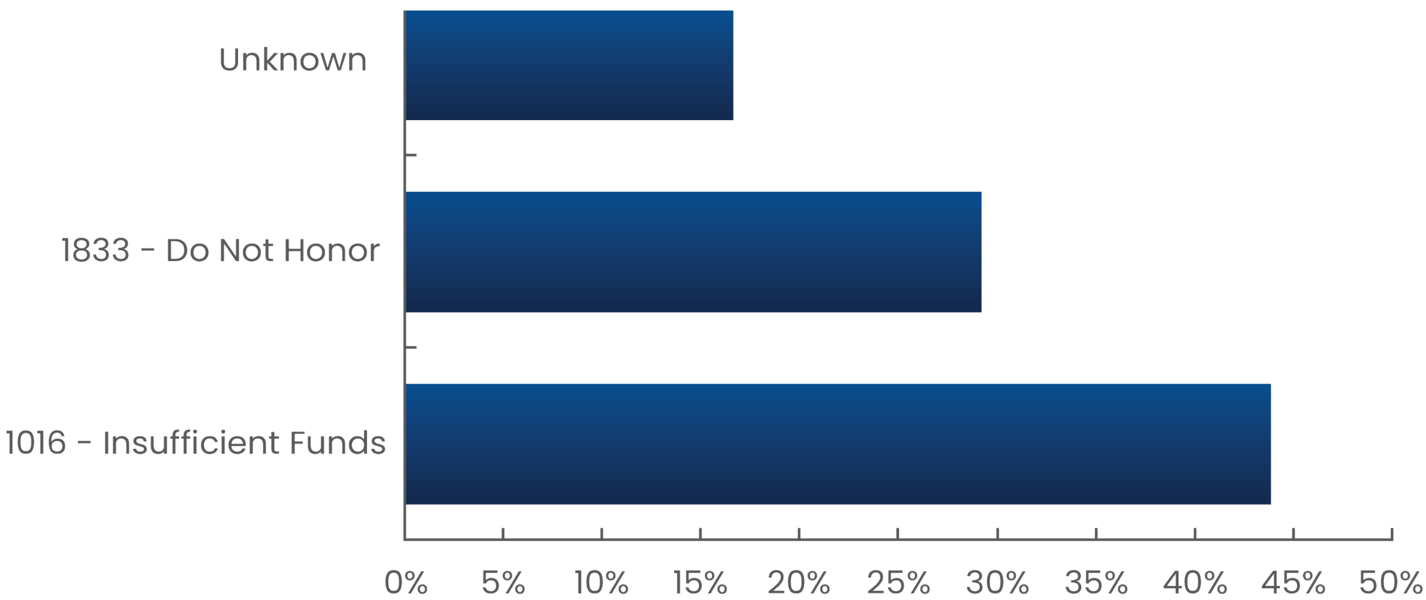


Source: Vindicia

2.1.2 Digging Deeper into Declines

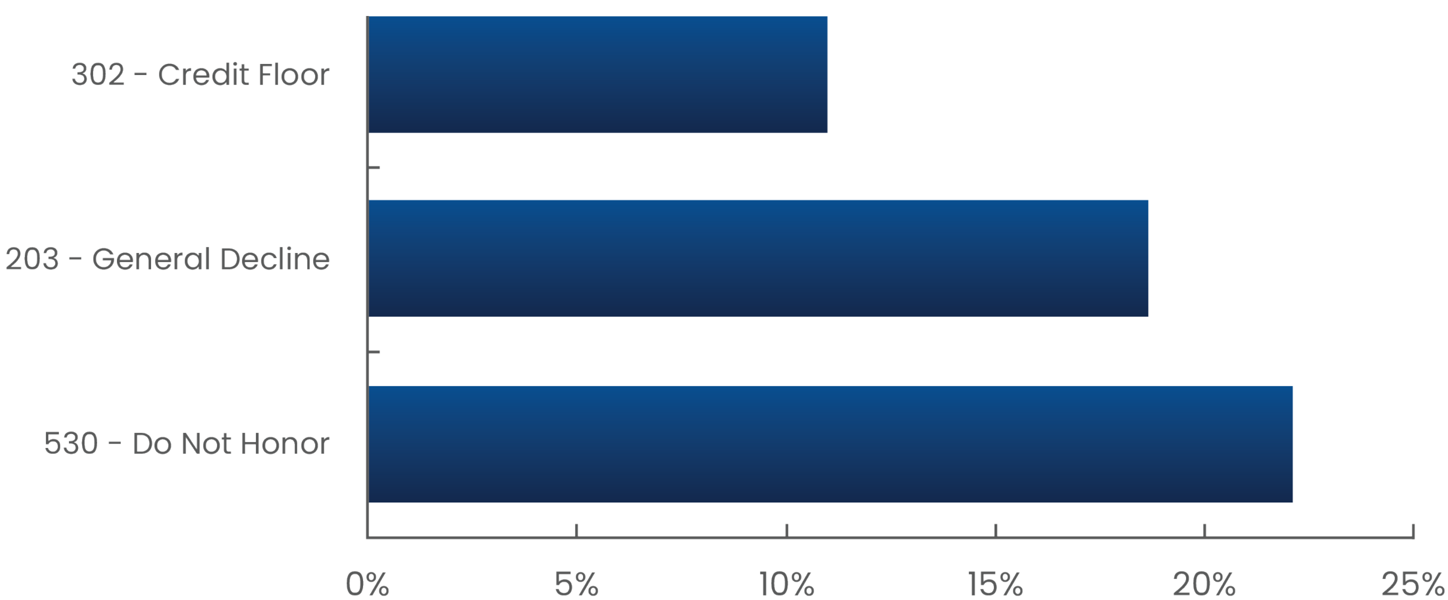
The below set of graphs show the top decline reasons for 2021 split by industry, based on Vindicia's data, and is analysed after these are present.

Figure 2.4: Top Decline Codes, 2021, Proportion of Total Declines (%), Finance and Business



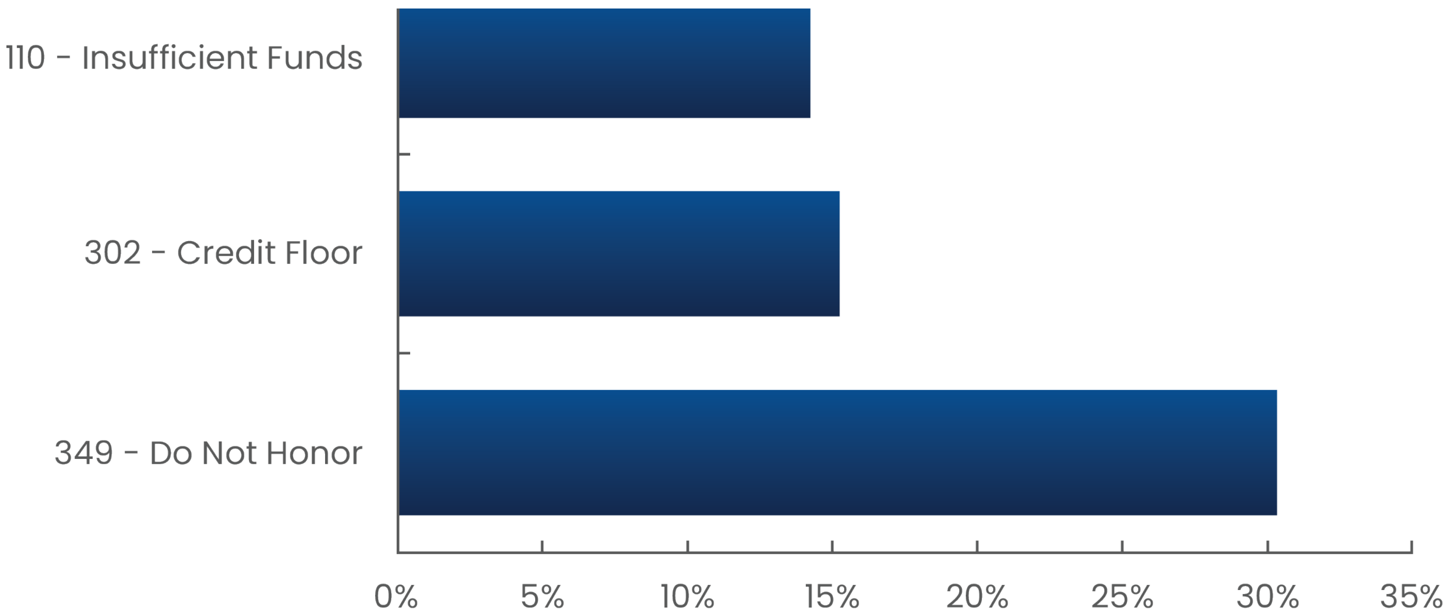
Source: Vindicia

Figure 2.5: Top Decline Codes, 2021, Proportion of Total Declines (%), Health & Wellness



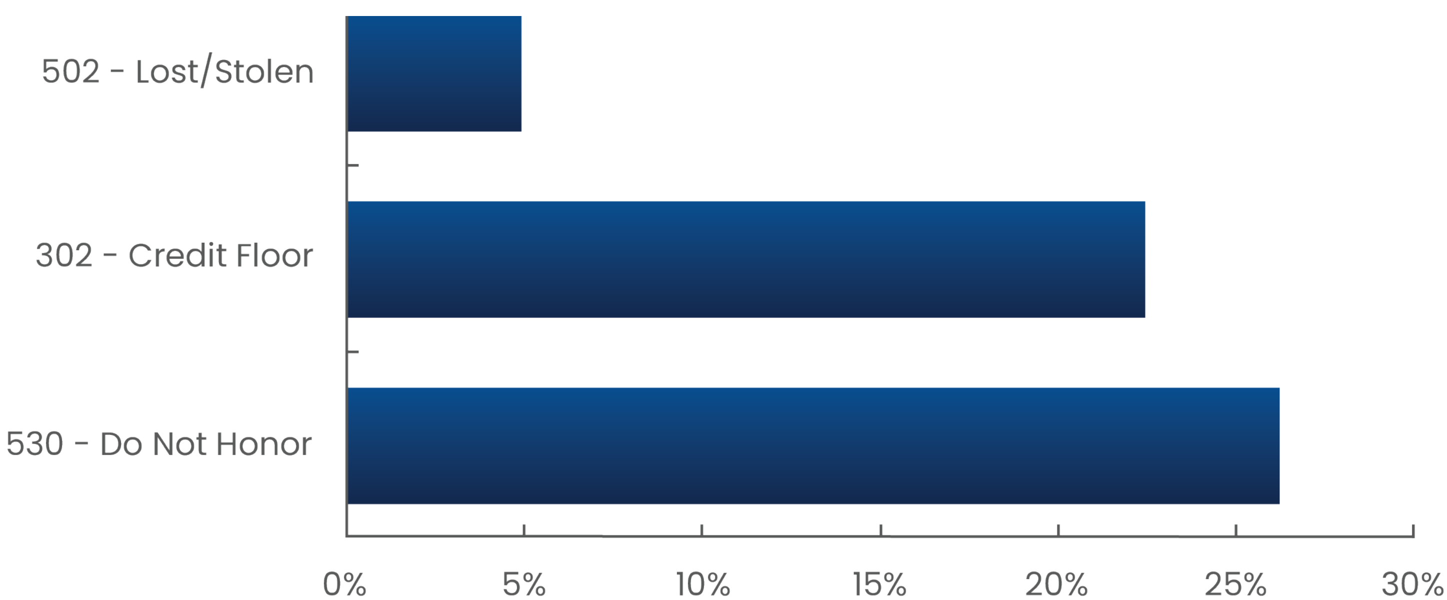
Source: Vindicia

Figure 2.6: Top Decline Codes, 2021, Proportion of Total Declines (%), Home & Web Security



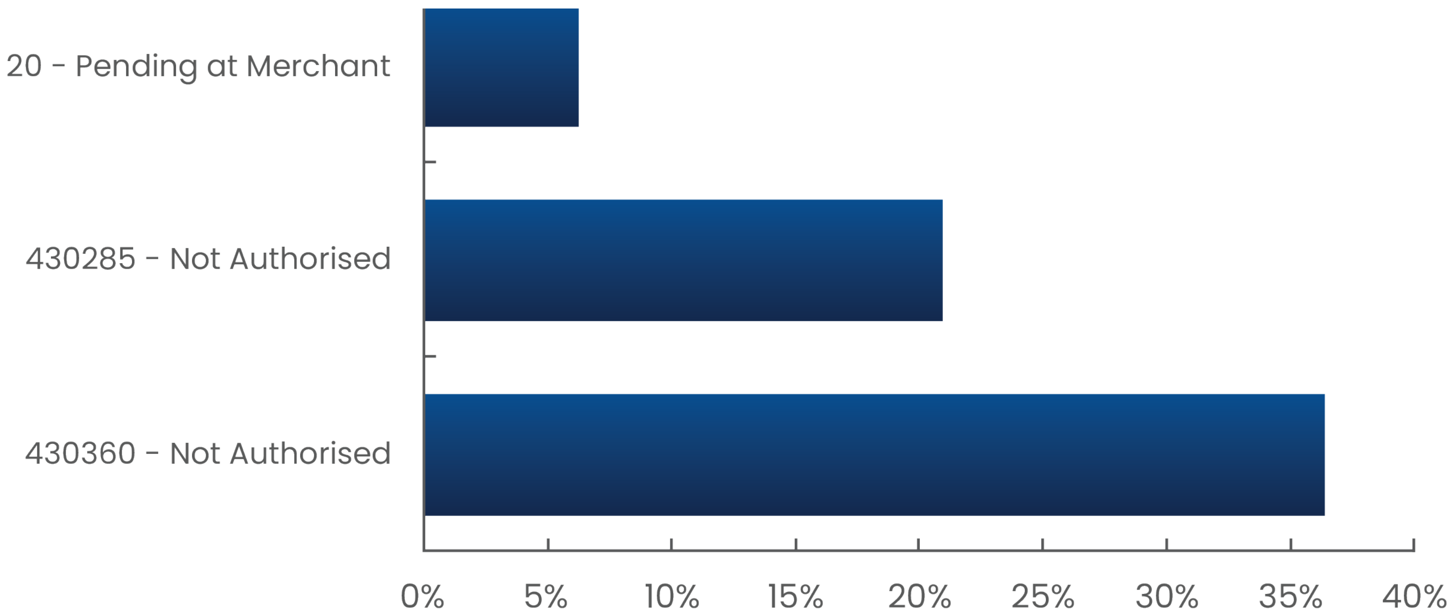
Source: Vindicia

Figure 2.7: Top Decline Codes, 2021, Proportion of Total Declines (%), Publishing & eLearning



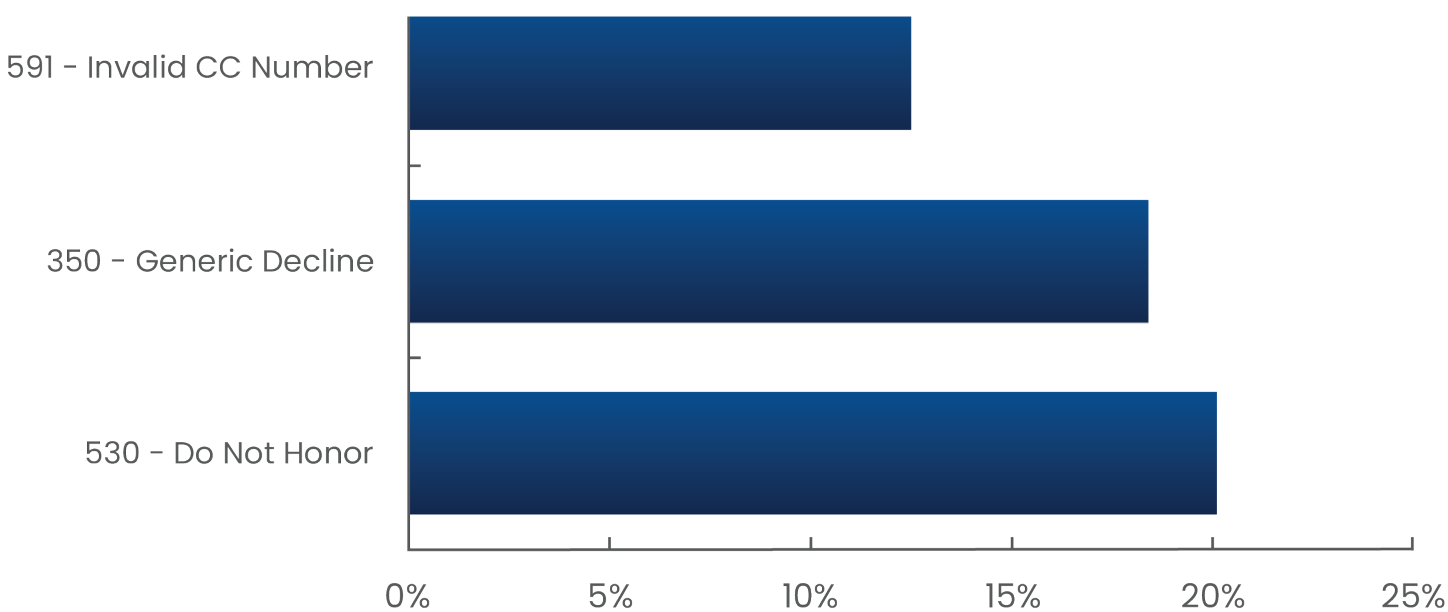
Source: Vindicia

Figure 2.8: Top Decline Codes, 2021, Proportion of Total Declines (%), Sports & eSports



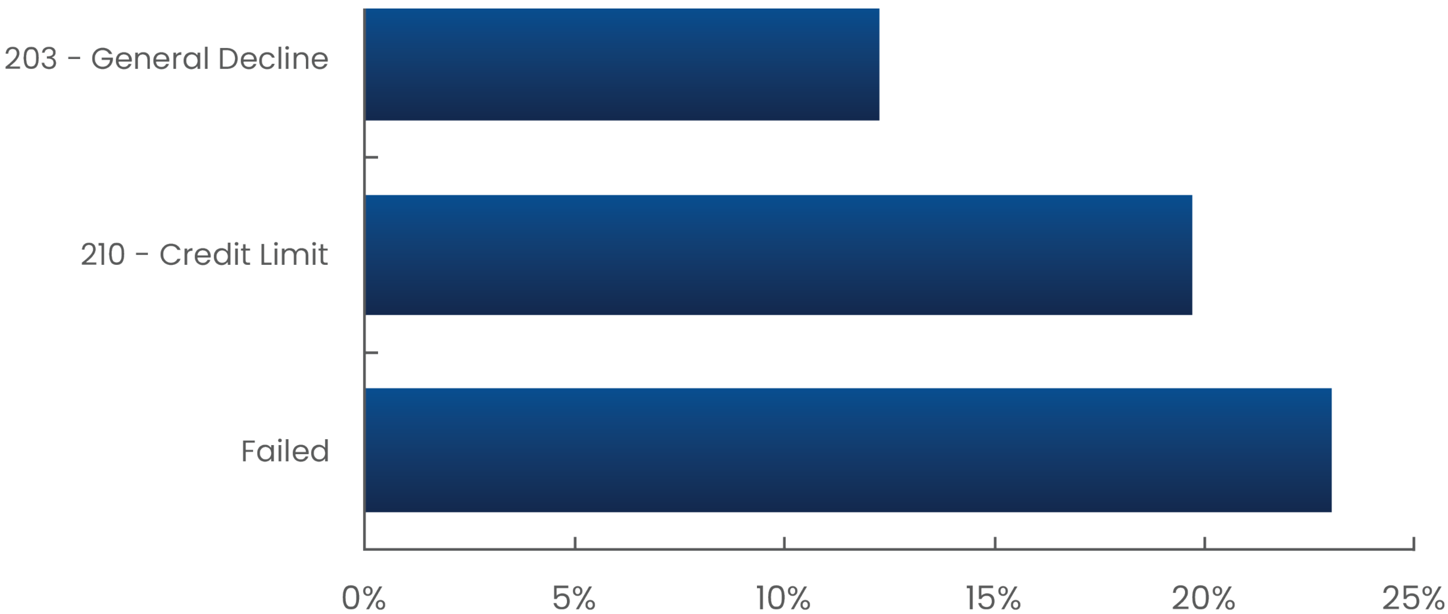
Source: Vindicia

Figure 2.9: Top Decline Codes, 2021, Proportion of Total Declines (%), Telecom & Mobile



Source: Vindicia

Figure 2.10: Top Decline Codes, 2021, Proportion of Total Declines (%), TV, Video & Gaming



Source: Vindicia

There are several insights we can take away from the data shown in this section.

• Decline responses often do not provide much information, which can make determining how to prevent future declines challenging.

• Insufficient Funds makes up a significant percentage of declines in the financial services industry, indicating that this is a major issue in that sector.

• Both Credit Floor/Insufficient Funds and Do Not Honor are common decline codes across multiple industries.

Given the vagueness of decline responses and the fact that they vary widely from one industry to the next, it would be highly advantageous for merchants xto work with a partner that has experience handling payment declines across a diverse set of industries.

2.1.3 Churn

Churn is the percentage of customers that stopped using a businesses' services during a certain set time frame. Churn is inevitable with any service but is more pronounced in subscription-based billing models. A few reasons for this, and key accompanying trends, are explained below:

• Subscriptions are frequently taken out by consumers to try new services, often at a discounted rate. When this is increased to the standard rate, customers may respond by cancelling the service. Some subscription services may decline in perceived value over time. For example, users of a video subscription service may no longer see the value after they have watched the specific television show or film they were interested in.

• The subscription market is highly competitive, especially in industries such as video steaming. There have been numerous cases where services grew rapidly, then saw a decline in user numbers as competition increased, with Netflix being one notable example. As such, there may be a high rate of churn as users change to competing services.

• The subscription market has seen expansion to a range of different areas, including physical goods boxes and subscriptions to specific physical goods items. Among consumers, there is a low level of familiarity with these services. Users are trying them out, then cancelling when they decide the subscription does not provide as much value as they expected.

2.1.4 Why Do Users Churn – The Industry View

This section will analyse why customers churn, and what this means for each of the industries involved.

• **Finance and Business:** In this market, user relationships are often longer-lived, making churn a less common event than in other industries. Churn is often customer service related in this market, with trust being central to the delivery of financial services. Once trust is broken, this almost inevitably results in churn, which is problematic in a highly competitive market.

• **Health & Wellness:** Subscriptions in this area are often for services such as gym memberships or digital fitness services. These services will suffer from a large degree of seasonality, with consumers taking out subscriptions with the best of intentions in January, but then not sticking to strict fitness regimes. As such, a high level of churn is relatively inevitable in this space.

• **Home & Web Security:** This sector sees relatively long-term relationships, particularly within the physical security space, where many security systems will have optional cloud features that are subscription-based. Where physical systems are fitted, churn is unlikely, but where the service is cybersecurity/web-based, churn is a lot more likely, as the market is highly competitive. Users are likely to churn due to cost reasons, with a lot of discounting in this market.

• **Publishing & eLearning:** This is a broad market, covering services including access to eBooks and audiobooks. As with other digital services, there are often discounted deals to start with, meaning that many subscribers will churn when discounted periods end. Also, subscribers will tend to access the titles they wish, then cancel after that period; making a fresh stream of high-quality content essential.

• **Sports & eSports:** This area will be subject to many of the same issues as health and fitness and the other digitally delivered services, with users likely to churn after discounted initial periods have ended, or when the initial enthusiasm for services has waned.

• **Telecom & Mobile:** Telecom and mobile will have low rates of churn compared to other markets, given the long-term nature of many customer relationships in this space. However, mobile deals are highly commoditised in the present market, with users being very sensitive over costs, particularly as the cost of new devices rises. As such, competition on cost will be the most likely reason to churn, with bundling for add-on services, such as music subscriptions, also being a common reason for changing.

• **TV, Video & Gaming:** Subscriptions in this area are prone to churn, which has been seen in how some services have failed to sustain user growth over time. Users are likely to watch or consume the content they want, then drop the subscription. There have also been a lot of price increases in this market, as services move from the user acquisition stage, trying to increase their average revenue per user. These rounds of price rises are causing churn at a high level. The sheer number of services available also means that users are changing provider, as they just have so much choice and have increasingly limited budgets.

2.2 Introduction to Chargebacks

Juniper Research defines a chargeback as:

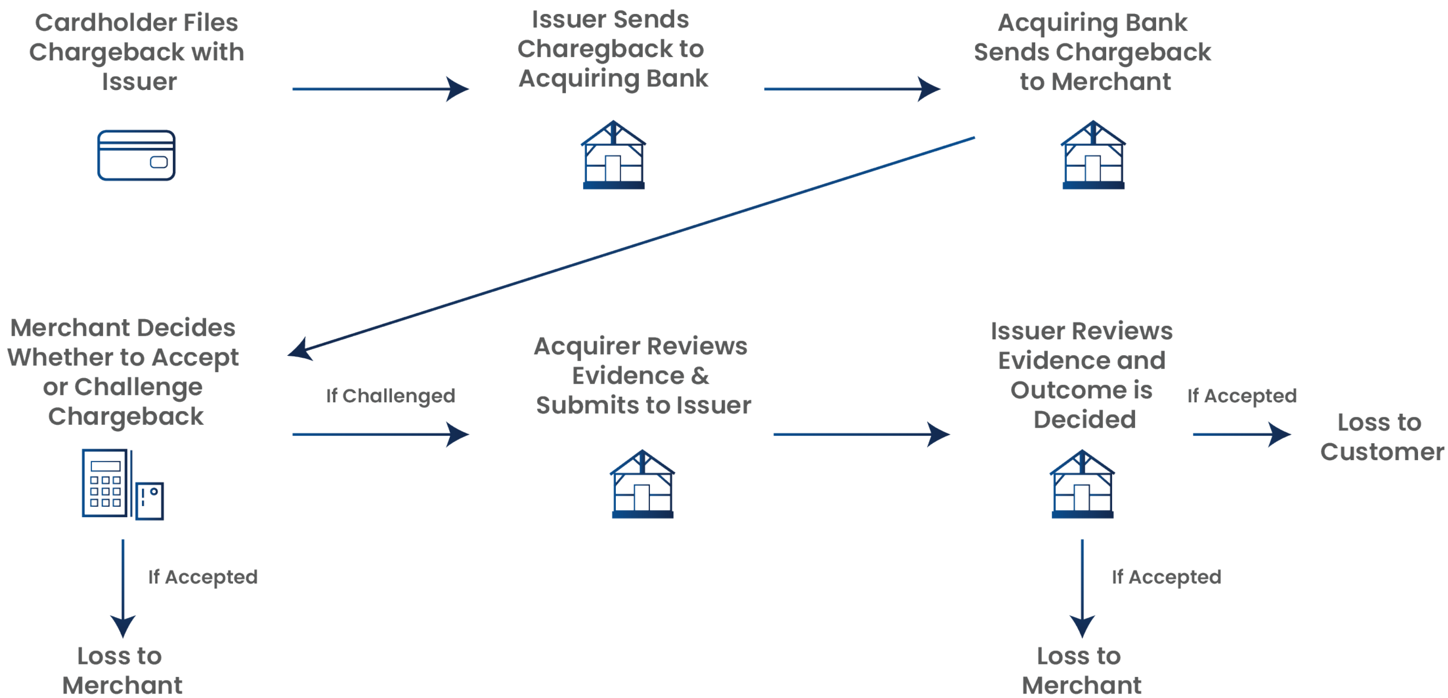
> A demand by a credit card provider for a retailer to make good the loss on a fraudulent or disputed transaction.'

Chargebacks may also be referred to as payment disputes. Chargebacks are fairly straightforward in principle - the issuer will charge back the amount of the disputed transaction to the merchant, returning the money to the cardholder without the merchant's approval.

When a cardholder disputes a charge, issuers review the transaction and, if the reason for the dispute is valid, provide a provisional credit to the customer's account while the chargeback claim is resolved. Chargebacks were created as a response to concerns about fraud. The chargeback process enables the cardholder to get refunds for fraudulent transactions directly from their issuing bank, letting the bank make decisions on how to handle the fraud claim.

Sometimes, a cardholder might dispute a charge because they had an issue with the merchant that was not resolved. Once a chargeback has been initiated, it will essentially go back and forth between the issuing bank and the merchant until one of them agrees to accept liability or until the card network must be called in to resolve the dispute.

Figure 2.11: Chargeback Process



Source: Juniper Research

Chargebacks are a persistent source of frustration and financial losses for merchants, as well as taking up significant resources from all parties involved.

2.3 Chargebacks in Subscription Services

Due to the fundamental nature of subscriptions, chargebacks are a major risk for businesses offering these services.

• Subscriptions can often be difficult to track, particularly given the fact that users often have numerous subscriptions to different services. With the number of subscriptions set to rise to over 4.2 billion in 2027 globally, based on Juniper Research data, this is an issue that is only going to accelerate. With users struggling to keep track of these subscriptions, payments going out serve as a reminder that the subscription is active. As such, users sometimes question these payments and raise chargebacks when they have not remembered to cancel, which causes an issue for merchants.

• The overall economic situation is uncertain at present, with inflation being very high across many markets. As such, personal finances are tight, with individuals looking to cut costs wherever possible. Therefore, there is greater incentive for users to question payments, given that the money is important, and we anticipate a higher level of chargebacks for the foreseeable future.

• A big issue with subscriptions is the nature in which most of these auto-renew, often with the end user being unaware of this. Where this renewal is monthly, this is not too noticeable, but this is very noticeable if the recurring payment is annual. As such, users are very likely to question large, unexpected payments, even if the terms and conditions did actually spell this out.

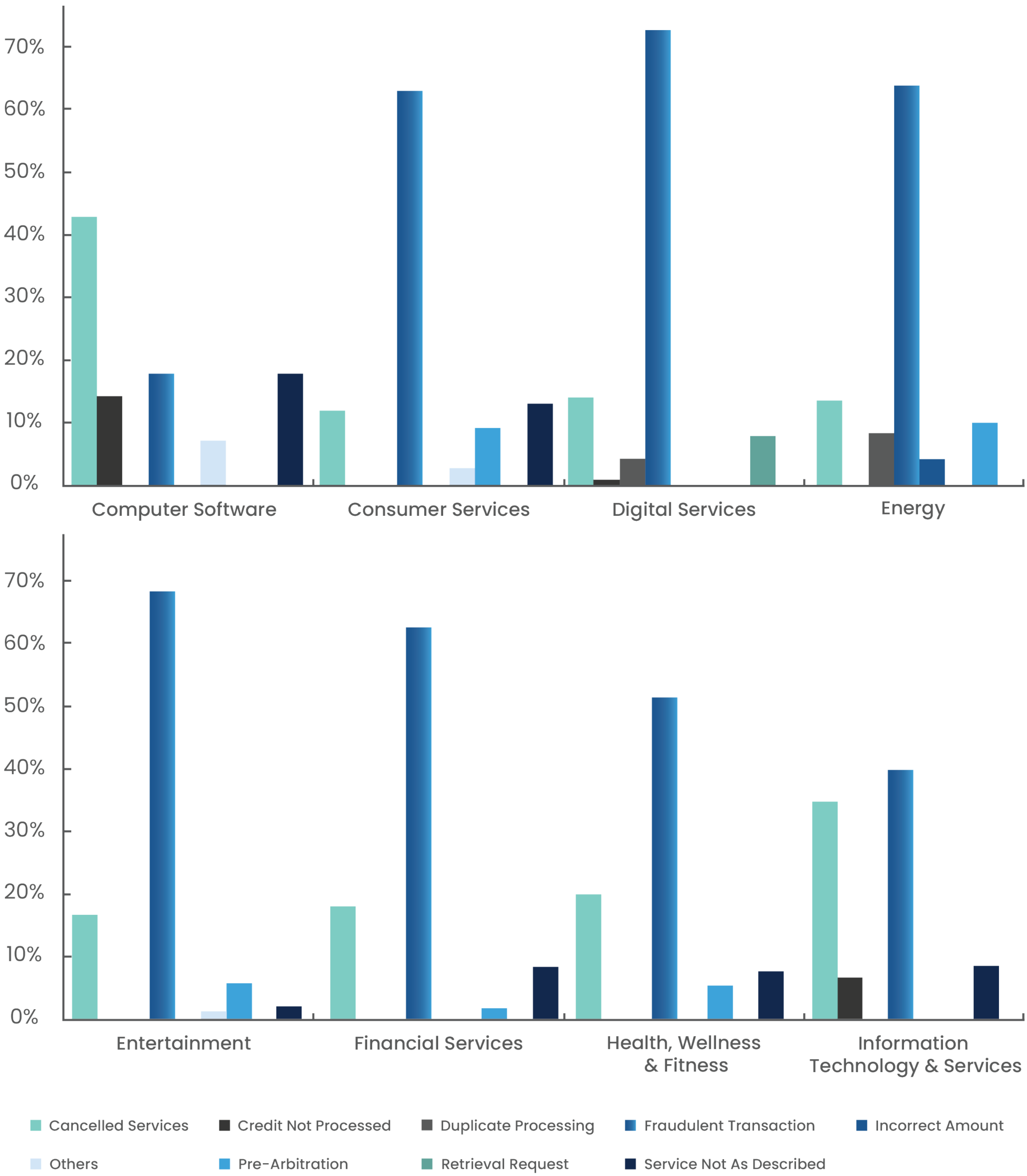
• 'Friendly Fraud', or First-Party Misuse, occur when the transaction was made by the actual user, but they still request a chargeback, potentially misrepresenting the situation with the merchant, if this means they recover their money. This often comes as the consequence of customer service issues. A common scenario is where the customer has tried to get a refund through customer service channels and this has not worked, so they request a chargeback, claiming that the services have not been provided. Another scenario can be where users simply bypass customer service entirely and go straight for a chargeback. These are both common in subscription services, where the customer misses the chance to cancel prior to autorenewal or does not see the value in what they subscribed to. In either scenario, the costs to the merchant are high in combatting these.

• Family fraud is another reason for chargebacks in the subscription area. Given the easy nature of taking out subscriptions, particularly for digital subscriptions where card details are saved already, there is potential for subscriptions to be taken out by family members without the cardholders' knowledge. While these chargebacks can be fought, this takes time and money for merchants.

2.3.1 Top Chargeback Reasons per Industry

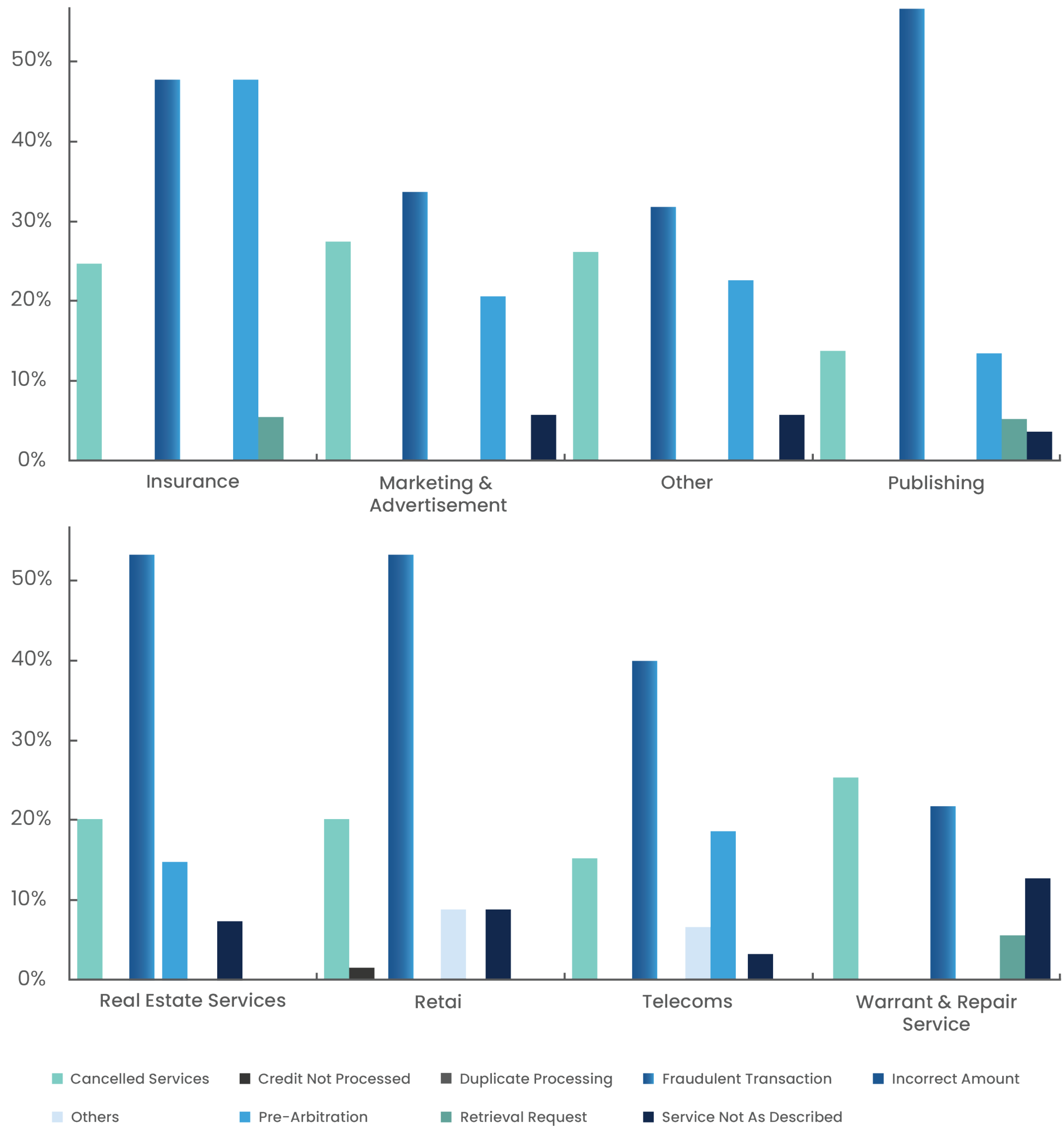
The below graphs give insights into the reasons behind chargebacks, which is varied across markets.

Figure 2.12: Top Chargeback Reasons per Industry, Selected Industries, 2021



Source: Chargeback Gurus

Figure 2.13: Top Chargeback Reasons per Industry, Selected Industries, 2021, Continued



Source: Chargeback Gurus

i. Chargeback Analysis

There are a few important key takeaways from this chargeback data to consider:

• Fraud is the leading chargeback reason stated, accounting for over 52% of all chargebacks logged.

• Cancelled Services was the second most common reason code, at 18.4% of chargebacks. Given that in many cases users should still be obligated to pay for the service, depending on the terms and conditions they agreed to, there is significant opportunity to fight these chargebacks.

• Pre-Arbitration was the third most common reason code, at 18.1% of all chargebacks. Pre-arbitration occurs when a previously reversed chargeback is being challenged. This is another reason why chargebacks are complicated and having the right platform to manage them can be important.

Diving into the industries more deeply, a few important points become clear:

• **Computer Software:** Cancelled Services is the top reason at 43% of chargebacks, with Fraudulent Transactions in second at 18% and Service Not As Described in third at 18%. This indicates that in the computer software industry, chargebacks are being used in lieu of a customer service process, which is a major challenge.

• **Consumer Services:** Fraudulent, Service Not As Described and Cancelled Services were the top reasons here, with fraud being particularly high at 63% of chargebacks,

• **Digital Services:** Digital services had the highest rate of Fraudulent Transaction claimed at 73%, far higher than the average, indicating that fraud, or at least claims of fraud, are the major issue here.

• **Energy:** Pre-Arbitration was third in energy, indicating that disputes in this market are less likely to be accepted by either party.

• **Entertainment:** Fraudulent Transaction was also very high in entertainment, at 72%, indicating significant issues with fraud, or transactions being reported as fraud. Cancelled Services was also a high priority concern at 18% in second.

• **Financial Services:** Again, Fraud was very high in this market as a reason, at 66%, with also 19% being categorised as Cancelled Services.

• **Health, Wellness and Fitness:** Services Not Provided appeared in the top three here at 10%, indicating that this is a significant issue.

• **Information Technology and Services:** This sector had the second highest rate of Services Cancelled, at 37%, showing that there are major issues in this particular area of subscription management that need to be handled carefully.

• **Insurance:** Pre-Arbitration and Services Not Provided both featured at 11% here Confusion over policy terms can often lead to disputes in this industry. However, to avoid losses outside of regular customer services channels, focus will need to be brought to bear on chargebacks.

• **Marketing and Advertising:** This area also had high rates of Pre-Arbitration and Services Not Provided, at 21% and 12% respectively. Because the customers in this industry tend to be businesses, they frequently refuse to accept an overturned dispute.

• **Real Estate Service:** This sector had relatively high rates of Pre-Arbitration and Services Not Provided, at 18% and 10% respectively. Customer Satisfaction is often an issue driving disputes in this industry.

• **Retail:** Retail had a high rate of Fraud at 63%, as is to be expected, given the long-standing nature of fraud related to physical items that can be resold.

• **Warranty & Repair Services:** This was the only market where Fraudulent Transaction was not the top code, with Cancelled Services being the top one at 30%. These services often have subscription terms of a year or more, and the surprise of a recurring charge may lead customers to realize they never used the service.

MANAGING CHARGEBACKS IN THE SUBSCRIPTION ECONOMY

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3. Handling Chargebacks Effectively

3.1 Best Practice for Chargeback Management for Subscription Billers

There is no doubt that chargebacks present a serious challenge to subscription merchants. However, with the right tools & services, merchants can improve their performance with chargebacks and ultimately retain more of their hard-earned revenue. Below are some of our recommendations for best practice in this difficult space:

3.1.1 Embrace Data Analytics

By leveraging a platform that features analytics capabilities, merchants can identify hidden trends in their chargebacks, reducing their workload and their revenue loss. In an increasingly crowded subscription environment, this can give merchants an advantage over their competition.

3.1.2 Choose a Partner Who Knows Your Industries

As we have seen in the data presented within this whitepaper, the situation across industries can be very different, with some sectors facing much higher chargebacks and declines than others. As such, it can be advantageous for merchants to choose a partner that understands their industry.

For geographically diverse merchants, this also stretches to knowing different regional markets, where trends in terms of churn, declines and chargebacks can be highly variable.

3.1.3 Know When to Represent Chargebacks

In order to fight chargebacks effectively, it is important for merchants to be able to differentiate between legitimate chargebacks, such as those caused by true fraud, and illegitimate chargebacks. This avoids wasting resources fighting a dispute that will not be overturned. Both data analysis and review by experts can be valuable tools to help merchant make these determinations.

3.1.4 Build Processes to Best Fight Your Case

Merchants need to be able to bring the evidence to bear to challenge incorrect chargeback cases and do so in a timely manner. Having the correct business practices in place to handle this task is of the utmost priority.

To ensure the right chargebacks are being fought, the right evidence is being presented, and the right processes are being followed, it is often worthwhile for merchants to consult experts in chargeback management. The right expert can audit your chargeback strategy, provide industry benchmarks, and make recommendations for process improvements.

3.1.5 Be Clear in Customer Communications to Reduce Confusion

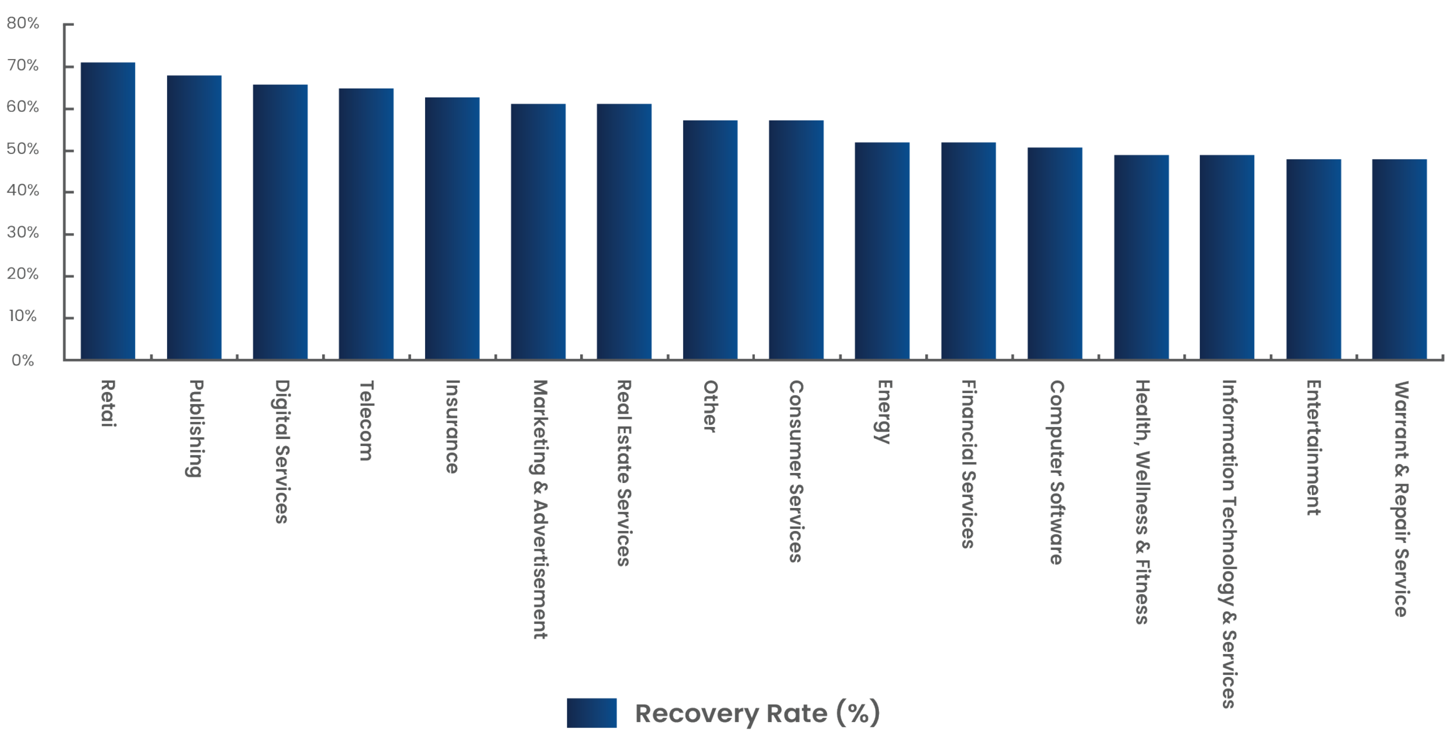
A big issue around subscriptions and churn is customer confusion – this is especially common when dealing with free trials or promotional periods, which can be a major source of customer frustration. Where users are unaware of relevant terms, they are likely to get very frustrated by unexpected charges.

This is where subscription billers improve their processes, by being very clear and transparent around how these processes work. The clearer processes are to the user, the less confusion there is and the less chance of chargebacks there is.

3.1.6 Recovery Rates by Industry

The below graph shows the recovery rates for chargebacks in sectors where Chargeback Gurus operates, with some interesting results.

Figure 3.1: Chargeback Recovery Rates, 2021, by Sector (%)



Source: Chargeback Gurus

• Retail had the highest recovery rate at 71%, with warranty and repair services joint lowest at 48% with entertainment.

• The sheer level of variability is notable here, with industries showing radically different recovery rates. There will be different reasons for this in each of these markets.

• The high success rate of the insurance industry may be attributable to the fact that many disputes are related to the insurer denying coverage in accordance with the terms the customer agreed to.

• Marketing and advertising also had a relatively high recovery rate, which is impressive, given that many marketing arrangements will have uncertain outcomes that are prone to being disputed.

• Although financial services had a slightly below average recovery rate at 52%, this still represents an enormous amount of revenue, given the size of many financial transactions.

3.1.7 Preventing and Fighting Chargebacks in Recurring Billing

The experts at Chargeback Gurus provided some advice for preventing and fighting chargebacks within recurring billing.

i. Prevention Tips

• Make sure your sign-up, billing, and cancellation policies are compliant with card network requirements.

• Provide customers with an easy, accessible, online mechanism for cancelling their subscription.

• Make your cancellation policy no-strings-attached, and consider offering a prorated refund for unused time.

• Process cancellation requests immediately and send the customer a notification that you have done so.

• If a customer incurs additional charges after cancelling a subscription, obtain and authorize their payment method again, if possible, rather than automatically charging the card on file.

• Send a notification a few days in advance of a recurring billing charge via the customer's preferred communication channel.

• If your subscription prices are increasing, notify the customer ahead of time and request a new payment authorization.

• Use a clear and recognizable merchant descriptor for cardholders' billing statements. Include a phone number, URL, and any other pertinent information you can fit in.

ii. Evidence to Provide in Representment

• A copy of your subscription agreement or cancellation policy, which should clearly indicate that the cardholder agreed to the billing terms.

• Proof that the cardholder did not attempt to cancel their service in accordance with the subscription agreement.

• Proof that the cardholder continued to use and derive benefit from your services during the billing period under dispute.

• Proof that you have already refunded the cardholder for the disputed payments (If any).

• Transaction copy of the parent order (first transaction) with AVS and CVV match.

• A copy of all transactions by the same cardholder which are not in dispute.

MANAGING CHARGEBACKS IN THE SUBSCRIPTION ECONOMY

4. Chargeback Gurus' Vendor Profile

4.1 Chargeback Gurus

CHARGEBACK GURUS

Chargeback Gurus helps businesses protect and recover revenue by providing effective chargeback management solutions, AI analytics and insights powered by our proprietary **FPR**ONE™ platform.

By understanding our clients' needs and fully aligning with their goals, we help them reduce chargebacks and increase recovery rates to maximize revenue retention. Our technology solutions use powerful data science and AI analytics—combined with deep industry expertise—to deliver hundreds of millions of dollars in recovered revenue to our clients.

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