

Performance Evaluation of Machine Learning Algorithms for Real-Time Credit Card Fraud Detection

Shweta Gangurde¹, Shruti Niphade², Rutuja Gholap³, Nikita Dargude^{4, 5}

¹²³⁴Student, Computer Engineering, Matoshri College of Engineering and Research Centre, Nashik, Maharashtra, India.

⁵Assistant Professor, Computer Engineering, Matoshri College of Engineering and Research Centre, Nashik, Maharashtra, India.

ABSTRACT

The rapid growth of digital payment systems has significantly increased the risk of credit card fraud, resulting in major financial losses for banks, businesses, and customers. Traditional fraud detection systems often fail to identify complex and evolving fraud patterns in real time. This research presents a comparative study of multiple machine learning algorithms for detecting fraudulent credit card transactions. The study evaluates Logistic Regression, Decision Tree, Random Forest, and XGBoost models using a publicly available transaction dataset. Data preprocessing techniques such as normalization, missing value handling, and class imbalance treatment are applied to improve model performance. The models are evaluated using accuracy, precision, recall, and F1-score metrics. Experimental results show that ensemble learning methods outperform traditional classification models in fraud detection. This research helps identify the most efficient algorithm for real-time financial transaction monitoring.

1. INTRODUCTION

In today's digital world, online payment systems and card-based transactions have become a crucial part of daily life. However, the increase in online financial transactions has also led to a significant rise in credit card fraud. Fraudulent activities can cause financial losses to customers, banks, and businesses.

Traditional fraud detection methods are mostly rule-based and struggle to adapt to changing fraud techniques. Machine learning provides an intelligent solution by learning transaction patterns and identifying suspicious activities automatically.

Conventional fraud detection systems are primarily rule-based, where predefined conditions are used to identify suspicious transactions. Although these systems can detect known fraud patterns, they often fail to adapt to new and evolving fraud techniques. Rule-based systems may generate a large number of false alerts, increase operational costs, and reduce the efficiency of fraud investigation teams. Therefore, intelligent and adaptive fraud detection mechanisms are required to identify fraudulent transactions accurately and in real time.

Machine learning has emerged as a powerful technology for solving fraud detection problems. By analyzing historical transaction data, machine learning models can identify hidden patterns, detect anomalies, and classify transactions as legitimate or fraudulent. These models can continuously improve their performance as new data becomes available, making them highly suitable for dynamic financial environments.

This research focuses on the comparative analysis of multiple machine learning algorithms for credit card fraud detection. Algorithms such as Logistic Regression, Decision Tree, Random Forest, and XGBoost are implemented and evaluated to determine their effectiveness in identifying fraudulent transactions. The models are trained using real-world transaction datasets and evaluated using performance metrics such as accuracy, precision, recall, and F1-score. The main objective of this research is to identify the most efficient machine learning model for developing an accurate, scalable, and real-time fraud detection system.

Due to the highly imbalanced nature of fraud datasets, where fraudulent transactions represent only a small percentage of total transactions, special data preprocessing techniques and model optimization strategies are essential. This study also explores the impact of data balancing and feature engineering on model performance. The findings of this research can help financial institutions improve fraud detection systems, reduce financial losses, and provide better security to customers in digital payment environments.

1.1 LITERATURE SURVEY

2025: Sharma et al. proposed an XGBoost-based fraud detection model for financial transactions and achieved high detection accuracy with reduced false positives.

2024: Khan et al. developed a machine learning framework using Random Forest and Decision Tree models for transaction fraud analysis in banking systems.

2023: Das et al. performed a comparative analysis of supervised machine learning models for fraud detection and found ensemble methods to outperform traditional classifiers.

2022: Singh et al. implemented real-time fraud detection using Random Forest and boosting algorithms on transaction datasets.

2021: Reddy et al. explored deep learning and machine learning approaches for detecting complex fraud patterns in online payment systems

2. PROBLEM STATEMENT

Problem Statement:

Credit card fraud detection is challenging because:

- Fraud cases are very rare compared to legitimate transactions.
- Fraudsters continuously change their strategies.
- Real-time decision-making is required.
- Traditional systems produce high false alerts.
- Therefore, an intelligent machine learning-based system is needed to accurately identify fraudulent transactions.

2.1 OBJECTIVES:

- To study different machine learning algorithms for fraud detection.
- To preprocess transaction data for better model performance.
- To compare the performance of multiple classification models.
- To identify the best algorithm for real-time fraud detection.

2.2 DATASET:

The dataset used in this research is the Credit Card Fraud Detection Dataset, obtained from the Kaggle machine learning repository. This dataset contains real-world anonymized credit card transaction records collected from European cardholders over a specific period. It is widely used in fraud detection research because it represents realistic financial transaction patterns and includes both legitimate and fraudulent transactions.

The dataset contains a total of 284,807 transaction records, out of which 492 transactions are identified as fraudulent, while the remaining transactions are legitimate. This creates a highly imbalanced dataset, where fraudulent transactions represent only a very small percentage of the total data. Handling such class imbalance is one of the major challenges in fraud detection systems.

The dataset consists of multiple input features, including Time, Amount, and 28 transformed numerical features (V1 to V28) generated using Principal Component Analysis (PCA) for privacy and security purposes. The target variable is Class, where:

Class = 0 represents legitimate transactions

Class = 1 represents fraudulent transactions

The Time feature represents the time elapsed between each transaction and the first transaction in the dataset. The Amount feature indicates the transaction amount, which helps in analyzing unusual spending behavior.

3. SYSTEM METHODOLOGY:

These are not the only challenges in implementing a real-world fraud detection system. In practice, the enormous stream of payment requests must be scanned rapidly by automated tools that decide which transactions to authorize. Machine learning algorithms are then applied to analyze the authorized transactions and flag any suspicious activity. The flagged transactions are further investigated by professionals, who reach out to the cardholders to verify whether the transaction was legitimate or fraudulent.

Handling Missing Values

- Fill or drop incomplete records.
- Data Cleaning
- Remove outliers or noisy entries.
- Feature Engineering
- Create new features like transaction frequency, average transaction value, etc.
- Scaling and Normalization
- Standardize numeric features to avoid biases.
- Dealing with Class Imbalance
- Techniques:
- Resampling: oversampling (SMOTE), undersampling.
- Class weighting in algorithms.
- Anomaly detection approaches..

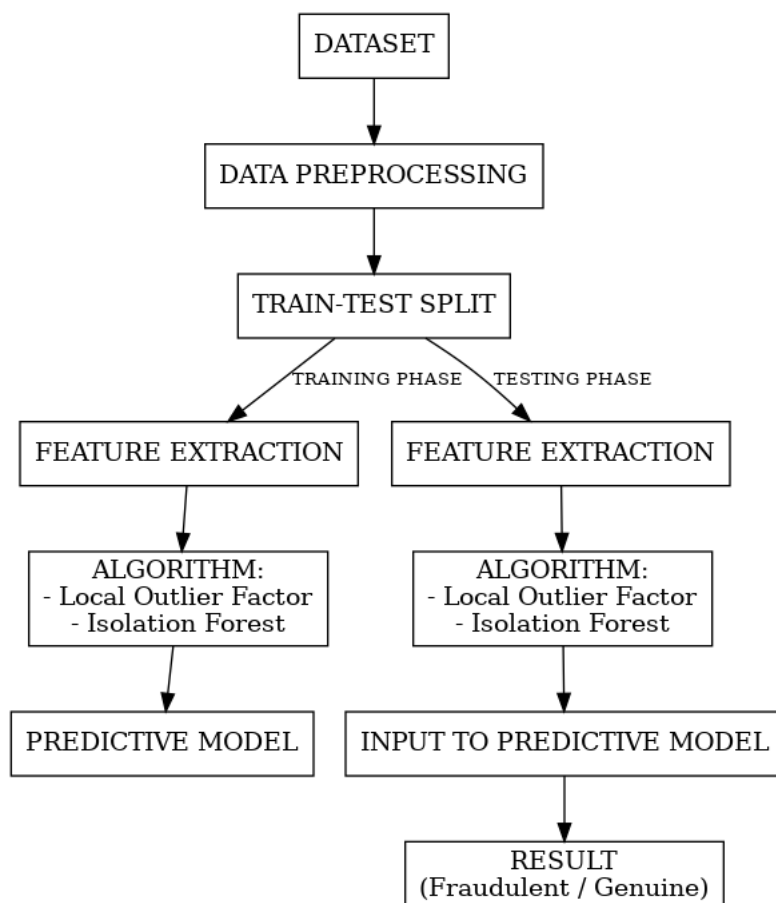


Fig 3.1 :- Workflow Diagram of Credit Card Fraud Detection

4. ALGORITHMS USED

4.1 Logistic Regression

Logistic Regression is one of the most widely used supervised machine learning algorithms for binary classification problems such as credit card fraud detection, where the goal is to classify a transaction as either legitimate or fraudulent. Unlike linear regression, logistic regression uses a sigmoid function to transform predicted values into probabilities ranging between 0 and 1. Based on this probability, the transaction is classified into one of the two classes. In fraud detection, the model analyzes transaction-related features such as amount, transaction time, user behavior, and other patterns to determine the probability of fraud. Logistic Regression is computationally efficient, easy to implement, and provides interpretable results, making it a suitable baseline model for comparison. However, it may struggle to capture highly complex or non-linear fraud patterns in large datasets.

4.2 Decision Tree

Decision Tree is a supervised machine learning algorithm used for both classification and regression tasks. In credit card fraud detection, it is mainly used as a classification model to separate fraudulent and non-fraudulent transactions. The algorithm works by splitting the dataset into smaller subsets based on the most important features, creating a tree-like structure of decision rules. Each internal node represents a decision based on a feature, each branch represents an outcome, and each leaf node represents the final classification. In fraud detection, the model may split transactions based on features such as transaction amount, location, time, or unusual behavior patterns. Decision Trees are easy to understand, interpret, and visualize, making them useful for analyzing fraud patterns. However, they can sometimes overfit the training data, which may reduce performance on unseen transactions.

4.3 Random Forest

Random Forest is an ensemble machine learning algorithm that combines multiple decision trees to improve prediction accuracy and reduce overfitting. It works by creating several decision trees during the training phase and then selecting the final prediction based on majority voting. In credit card fraud detection, Random Forest analyzes transaction data across multiple decision trees, allowing the system to detect complex fraud patterns more accurately than a single decision tree. This algorithm can handle large datasets, missing values, and class imbalance effectively, which are common challenges in fraud detection. Because fraud cases are rare compared to legitimate transactions, Random Forest helps improve model stability and detection accuracy. Its ability to reduce variance and improve generalization makes it one of the most reliable algorithms for financial fraud detection systems.

4.4 XGBoost

XGBoost, which stands for Extreme Gradient Boosting, is an advanced ensemble machine learning algorithm designed for high-performance classification and prediction tasks. It builds multiple weak learners sequentially, where each new model attempts to correct the errors made by the previous model. In credit card fraud detection, XGBoost is highly effective in identifying subtle and complex fraud patterns hidden within large transaction datasets. The algorithm uses gradient boosting techniques along with regularization methods to improve accuracy while preventing overfitting. XGBoost can efficiently handle missing values, feature interactions, and imbalanced datasets, making it particularly suitable for fraud detection applications. Due to its speed, scalability, and superior predictive performance, XGBoost is widely used in banking, cybersecurity, and financial risk management systems.

5. FUTURE SCOPE:

- Use deep learning models.
- Deploy on cloud systems.
- Integrate blockchain security.
- Use live banking transaction data.

6. PERFORMANCE TABLE AND RESULT:

Algorithm	Accuracy	Precision	Recall	F1-Score
Logistic Regression	96.8%	82%	78%	80%
Decision Tree	97.5%	85%	83%	84%
Random Forest	99.2%	92%	89%	90%
XGBoost	99.4%	94%	91%	92%

RESULTS AND PERFORMANCE ANALYSIS

The performance of different machine learning algorithms was evaluated using accuracy, precision, recall, and F1-score metrics. Experimental results show that XGBoost achieved the highest overall performance among all tested models, followed by Random Forest. Logistic Regression and Decision Tree also produced satisfactory results but showed comparatively lower performance in detecting complex fraud patterns.

7. CONCLUSION

In this research, a comparative analysis of multiple machine learning algorithms for credit card fraud detection was performed. The increasing use of digital payment systems has made fraud detection an important challenge in the financial sector. To address this issue, machine learning models including Logistic Regression, Decision Tree, Random Forest, and XGBoost were implemented and evaluated using a real-world credit card transaction dataset.

The experimental results demonstrated that different algorithms show different performance levels in identifying fraudulent transactions. Among the evaluated models, ensemble learning algorithms such as Random Forest and XGBoost achieved better accuracy, precision, recall, and F1-score compared to traditional classification models. These algorithms successfully identified fraudulent patterns while minimizing false predictions.

This study concludes that machine learning can significantly improve fraud detection systems by providing faster, more accurate, and intelligent decision-making. The findings of this research can help financial institutions build secure real-time fraud monitoring systems and reduce financial losses caused by fraudulent activities.

8. REFERENCES

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