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Facebook, tech peers, face ad crunch from European rules

By Paula Schaap

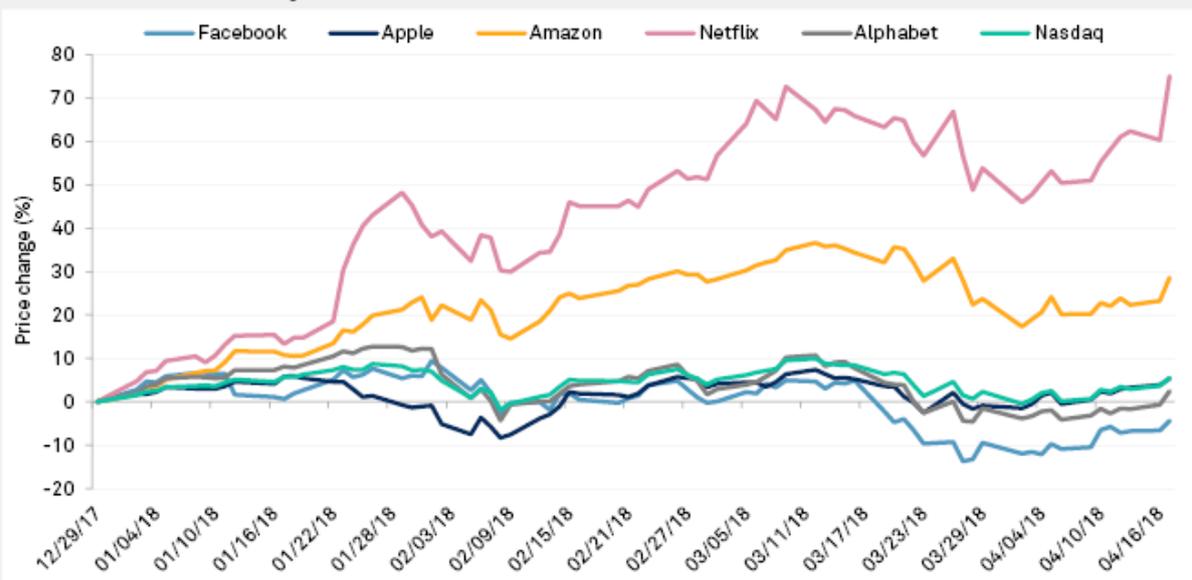
When, during the hearing over the harvesting of data by Cambridge Analytica, a U.S. senator asked Facebook Inc. CEO Mark Zuckerberg how his company could continue to offer services for free, the 33-year-old, already one of the richest men in the world, had a succinct response: "Senator, we run ads."

People laughed, perhaps unfairly. Even though Orrin Hatch's question was preceded by remarks which showed he knew how Facebook made money, Zuckerberg was widely thought to have gotten the better of the [Wall Street Journal](#) exchange. But the assurance with which the self-made billionaire pronounced his words was supported by a business model set to face its most fundamental challenge yet.

The implicit charges levied by technology companies on hundreds of millions of people around the world for posting family snaps, using search engines or keeping up with friends via email are set to be laid bare by landmark European legislation, potentially dealing a billion-dollar blow to a lucrative trade in third-party data and slashing advertising revenues.

The

FAANG stock moves year-to-date



Source: S&P Global Market Intelligence

European Commission's General Data Protection Regulation, which will be enforced from May 25, will require companies to gain users' consent before using their data and selling it on to advertisers, or face potentially enormous fines.

They will have to tell them what it is going to be used for, and the consent, which the EU wants to lapse after a year, can be withdrawn at any time.

While predicting how consumers will react is tricky, two marketing professors who have looked at the impact of expiry dates on cookies — the data trackers which websites download onto computers and can be used to monitor a user's every click — expect a big impact from this measure alone.

Cookie expiration could cost publishers, including Facebook and Google parent Alphabet Inc., 8.1% of the €10.6 billion in annual cookie-based display ad revenue, Klaus Miller and Bernd Skiera, from Goethe University in Frankfurt calculated. If the expiration period is set at two years, as the industry has lobbied for, this loss is reduced to 1.4%.

Cookies are more valuable if they last longer because ad marketers learn more about the users attached to specific cookies over time, Miller said in an email.

"Essentially, this revenue loss stems from the lost value buildup over time that we would lose once cookies are set to auto expire," Miller said.

Fines

While the U.S. and Canada still accounted for the largest share of Facebook's revenue in 2017 — \$6.3 billion, as compared to \$3.2 billion for Europe — the rate of revenue growth was higher in Europe, at 31% compared to 28%. Average revenue per user also increased more quickly in Europe than elsewhere, jumping by 41%, versus 36% in the U.S. and Canada, 22% for the Asia-Pacific region and 33% in the rest of the world. Facebook counted 277 million daily active users in Europe by the end of 2017.

While the cost of complying with GDPR will be significant, the cost of noncompliance would be higher. A first level of fines can run to the greater of €10 million or 2% of total revenue, and major violations can cost the higher of €20 million or 4% of total revenue.



Facebook CEO Mark Zuckerberg prepares to be interrogated.

Source: Associated Press

May."

In a Q&A posted on the Facebook website, Zuckerberg said that the company intended to make the same controls and settings needed to comply with GDPR available everywhere, though he noted that it might not be in the same format in all jurisdictions. "We need to figure out what makes sense in different markets with the different laws and different places," he said.

Paid content

That was a couple of months before the Cambridge Analytica news broke. Facebook stock dropped on the news and had lost 10.5% during 2018 to \$157.93 by the close on April 9, the day before Zuckerberg started his two days in the Congressional hot seat. It has since recovered, standing at \$168.66 by the close on April 17.

The share prices of other big tech companies, including Alphabet, [Twitter Inc.](#) and Snapchat-owner [Snap Inc.](#), also tumbled on fears that the revelations that Facebook data might have been used to help campaigns in favor of Donald Trump and Brexit, coupled with previous scandals over fake news and extremist content, might prompt U.S. authorities to [impose GDPR-like rules](#), crimping advertising. Facebook has even approached conservative groups for help in fending off such legislation in Washington, Politico reported.

Some of these companies have made tentative moves toward straight-up charges for their services, such as when, in 2015, Google launched YouTube Red, which allows subscribers to watch videos uninterrupted by ads and provides original content for those willing to pay. But advertising remains the bedrock of their businesses, with Google reporting a 22% jump in fourth-quarter advertising revenue to \$27.2 billion in the fourth quarter of 2017. While other revenue was up

This is a major step up from the previous punitive regime governing electronic information. London-based TalkTalk Telecom Group plc was fined only £400,000 for the data breach of its 157,000 customers, noted Phil Beckett, a forensic technology expert with consultancy firm Alvarez & Marsal. Last year, Spain's privacy watchdog said it was fining Facebook €1.2 million for its use of cookies. Facebook is appealing that decision.

"While GDPR may be an initial burden on the balance sheet, firms need to consider the fines and reputational damage that could be incurred if something were to go wrong," Beckett said, adding that managing GDPR compliance may cost most companies "upwards of six figures" as well.

Facebook declined to speak about GDPR's potential effect on ad revenue. A person familiar with the company said while it did not comment on forward-looking revenue questions, Facebook was going to share more information on GDPR in the coming weeks.

Facebook COO Sheryl Sandberg reassured investors on a fourth-quarter conference call that "the Facebook family of apps already applies the core principles in the GDPR framework, which are transparency and control. And we're building on this to make sure we're ready to fully comply by

38%, it only came to \$4.7 billion.

Google CEO Sundar Pichai said on a fourth-quarter earnings call that the company was committed to complying with GDPR for all services provided in Europe. Google did not respond to an emailed request for comment.

"We've seen this movie before, especially in print and audio," said Laura Beaudin, a partner with consultancy Bain & Co., referring to the crises which struck the newspaper and music industries when they struggled to find ways to make people pay for online content.

"It's been really hard for any company to survive with just an advertising model," she said.

But, so far, Facebook seems to be doing just that. Its fourth-quarter revenue from advertising was up 48% to \$12.8 billion year over year, while payment and other fees accounted for only \$193 million, an increase of 7%.

And at the hearing, Zuckerberg indicated that advertising was likely to remain central to his company, telling Sen. Hatch "There will always be a version of Facebook that is free."

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