

Pearlstein's Corner





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5 Things Everyone Should Know About Facebook

In just one week, Facebook lost \$50 billion in market value. That's about half the value of Royal Bank. What's going on?

Let's unpack this to gain some clarity for all stakeholders involved, including businesses and governments.

First, Facebook is entangled in an international data scandal which may have changed the course of the U.S. election, and perhaps Brexit. To compound the bad news, Mark Zuckerberg, Facebook's founder and CEO, was silent for five days as the situation unfolded. That was followed by an apology that many felt was lacking. The market acted quickly and the stock went down day after day.

Facebook's Privacy Settings Don't Protect User Profiles from Ad Targeting

What many users have learned the hard way is that their account privacy settings have little to do with how Facebook uses their information for advertising. For example, even when a user chooses the strictest privacy settings, all of their actions are still being monitored and the user continues to be targeted for advertising. That, in essence, is the Facebook business model.

However, the current controversy hinges on how personal data of about 50 million Americans was harvested by "a researcher" and then illegally sold to be used to influence voters in the U.S. election, not necessarily through advertising, but messages and articles fine-tuned to their actions and beliefs. In other words, Facebook made it relatively easy for the users' detailed information to be taken and misused.



Zuckerberg admitted the company made mistakes and apologized for a "breach of trust". But, if Microsoft's travails with European regulators, which stretched from 1998 through 2004 are any indication, it's unlikely Facebook's public relations issues are going to disappear anytime soon.

The Average Person Will Spend Five Years of Their Lives on Social Media

According to a 2017 study by influencer marketing agency Mediakix, the average person will spend more than five years of their lives on social media such as YouTube, Facebook, Snapchat, Instagram and Twitter.

Only television watching, at over seven years, beats it.

So, it's little wonder that advertisers are pouring money into social media. Margaret Wentz, columnist with the Globe and Mail, reminds us: "We conveniently forgot the first rule of marketing is that if the product is free, the real product is you."

In other words, Facebook's users are not its customers, but rather its advertisers.

Facebook Faces a PR Crisis but its Impact Will be Hard to Determine

For 2017, Facebook had sales of \$40 billion and profits of \$16 billion. The next company report is in early May.

In the meantime, most people are unlikely to unfriend Facebook (a recent Angus Reid poll indicated that 10% of the Canadian respondents would suspend or delete their account).

Continued on page 2.

Most advertisers will continue to use Facebook simply because of the sheer numbers and the ability to micro-target audiences. Still, when a company is facing a PR crisis, it's best to get in front of it and Facebook hasn't – yet.

When Equifax, a credit reporting firm, suffered a massive data breach last September, close to 143 million customers' information was hacked. It's estimated this will cost the company \$600 million, more than a year's profit. The stock lost close to one third of its value with no significant recovery.

Could Facebook suffer a similar decline? Possibly, but Facebook has a much wider economic moat – a sustainable competitive advantage – since it controls so much of the world's digital advertising.

Clearly, Facebook has the resources to do a better job of protecting its users' data. It would be better for the company to regulate itself rather than be regulated, but it may be too late for this.

Facebook's Relationship with U.S. Regulators is Now More Complicated

The company signed a consent decree with US Federal Trade Commission (FTC) in 2011. Among other requirements, that decree mandated that Facebook must notify users and obtain their permission before data about them is shared beyond the privacy settings they have established. The end result was Facebook signing this consent decree. It paid no fines for being lax about its users' privacy – seven years ago.

If it's determined the company violated the terms of its agreement, it could be subject to fines of \$40,000 per incident. That's potentially billions of dollars in fines. In the future, it's unlikely Facebook will get off with such a light regulatory touch. With billions of dollars of Facebook's profits up for grabs,

politicians looking to score some political points puts a target on Facebook's back. Meanwhile, the European Union is also following the money in another way.

Facebook May Be Impacted by a New European Union Digital Tax

This spring, The European Union will present its plans for overhauling tax rules for internet giants. This is aimed at making them pay in the countries where they earn their profits. Under EU law, companies like Facebook can choose to report their income in any member state, prompting them to pick low-tax nations like Ireland or Luxembourg. On average internet giants pay a tax of rate of 9% in Europe compared with an average rate of 23%. The proposed levy is 3% on revenues wherever they are earned.

The spoiler here for Brussels, and a temporary reprieve for Facebook, is all 28 member states have to agree to make this a reality.

Still, whether it's in the U.S. or Europe, one of Ronald Reagan's best quips summarizes what Facebook will likely have to deal with going forward as far as government oversight is concerned. "If it moves, tax it. If it keeps moving regulate it. And if it stops moving subsidize it."

What should you do about Facebook? It depends how the company's missteps affect you. If you are a network user or advertiser and think this will all blow over, do nothing. If you are dismayed with how Facebook's business model works, [here's a step by step guide to dial down your exposure](#). Finally, as a shareholder, if you are interested in either adding or reducing your holdings in Facebook, call me. Technology keeps changing how we connect. But paying attention to the price we pay for it is something also to keep top of mind.

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