‘Wake-up call’ jolts Facebook shares

$100 BILLION DROP IS WALL STREET RECORD Market punishes privacy errors, stagnation in users

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The cost of years of privacy missteps finally caught up with Facebook this week, sending its market value down more than $100 billion Thursday in the largest singleday drop in value in Wall Street history.

Worries about the rising costs of privacy regulations and controversies, along with declining growth in users and revenue played a key role in a major Wall Street sell-off that started Wednesday night after Facebook reported earnings. Facebook’s stock closed down 19 percent Thursday, at its lowest level in nearly three months.

The steepness of the decline suggests investors are reevaluating the viability of Facebook’s core business — collecting extensive data on users so that they can better target them with advertisers — in a world in which public pressure is mounting for stricter privacy protections.

“This is a privacy wake-up call that the markets are delivering to Mark Zuckerberg,” Jeffrey Chester of the privacy advocate Center for Digital Democracy said of Facebook’s chief executive.

Long-simmering privacy concerns, dating nearly to the birth of the company in a Harvard dorm room in 2004, have in recent months taken more concrete form than ever. In May, the European Union imposed a strict new regulatory regime. U.S. officials, meanwhile, have begun scrutinizing Facebook in a multiagency investigation related to its handling of the recent data scandal involving political consultancy Cambridge Analytica, which improperly accessed information from 87 million people.

Facebook’s bad day on Wall Street raises questions about the fate of other big technology firms, such as Twitter and Google, which like Facebook have been grappling with rising privacy concerns and con-
gressive demands to more aggressively combat the flow of disinformation on their platforms.

Twitter’s share price declined sharply after The Washington Post reported three weeks ago that the company was suspending fake and suspicious accounts at a record pace and might see a decline in its monthly users. The company is expected to report its second-quarter earnings on Friday.

But analysts noted that Google’s parent company, Alphabet, saw shares surge Monday after reporting strong earnings despite the new European regulations and a recent $5.1 billion fine for antitrust violations, suggesting that investors have specific concerns about Facebook and its recent bout with scandals.

The public mood regarding Facebook also has arguably soured amid the privacy controversies and revelations about the platform’s role in spreading Russian disinformation during the 2016 presidential election. Calls to #DeleteFacebook have spread on Twitter, and some prominent people have announced that they were stepping away from their heavy use of social media.

In terms of measurable impact on Facebook, the new European rules, called GDPR for General Data Protection Regulation, led to a decline of 3 million users on that continent, company officials revealed in an earnings call on Wednesday. Facebook said the changes would continue to hurt revenue as more people opted out of ad targeting in the months ahead.

The company also said it would lose money because its advertiser partners had been affected by GDPR and because of other privacy changes to come.

But Facebook, like some other technology companies, has rolled out the user protections worldwide, meaning the consequences for the company are likely to be global. Chief Financial Officer David Wehner said in an earnings call Wednesday that expectation of declining earnings growth is “really a combination of kind of how we’re approaching privacy as well as GDPR and the like.”

Problems for the company have not been confined to privacy issues. Signs of trouble have been growing for nearly two years, since the aftermath of the 2016 presidential election when Zuckerberg dismissed the possibility that the rampant spread of phony news reports on the platform affected the vote. He called the notion “a pretty crazy idea” but later apologized for the comment.

What followed was a major public reckoning, rare for highflying technology companies. Facebook eventually disclosed aggressive Russian manipulation on its platform and had to answer pointed questions about it on Capitol Hill. Then, news reports in March detailed how Cambridge Analytica had siphoned away the data of Facebook users for campaign targeting. This prompted another round of questioning on Capitol Hill, this time of Zuckerberg himself.

But Facebook long had a knack for navigating privacy controversies related to its collection of user data. Its stock price proved resilient throughout these controversies — aside from a dip after the Cambridge Analytica news — even as Zuckerberg warned that addressing issues such as privacy and disinformation on the platform would involve costs for the company, such as the hiring of tens of thousands of new content reviewers. That three-year
The impact of data privacy and GDPR seems to have had a greater effect on their business than many had appreciated,” said Christopher Rossbach, chief investment officer at J. Stern & Co. GDPR gave users more elaborate notices about how their data was being collected and used, and it required explicit approvals.

The earnings report suggests broader worries that a company that has grown at a furious pace for years may finally be seeing its growth easing, especially among younger users opting for such social media alternatives as Snapchat or Instagram. The latter company, along with the globally popular WhatsApp messaging service, is owned by Facebook, but neither has been as effective as the parent company at generating advertising revenue.

Morningstar issued an analysis Thursday afternoon, noting the slowing growth and lowering its estimated value of Facebook stock. The report declared that this week’s decline was “Not a Buying Opportunity.”

Yet it’s the privacy issues and cascade of recent scandals that dominated commentary about Facebook on Thursday, as investors tried to make sense of Facebook’s tumble.

“If Cambridge [Analytica] had never happened, I don’t think the worries would be as pronounced. Cambridge has thrown in a whole host of worries around confidence for users, advertisers, and regulators. It creates a murkier picture,” said Daniel Ives, chief strategy officer and head of technology research at GBH Insights.

The U.S. investigations, first reported by The Washington Post this month, have two major areas of inquiry: The Federal Trade Commission is probing whether Facebook violated a 2011 consent decree with the agency governing its privacy practices when it shared data with Cambridge Analytica and other companies. And the Justice Department and Securities and Exchange Commission are examining whether Facebook’s portrayals of its actions with regard to Cambridge Analytica have been timely and accurate.

Facebook has said it is cooperating with these investigations. It has portrayed Cambridge Analytica and people working for the company as acting inappropriately in collecting data on its users.

The broader political atmospherics surrounding the company also have darkened amid these controversies, with both Republicans and Democrats calling for possible new regulation of the tech industry and social media in particular.

“It takes a while for opinions to begin to settle, and I think the cumulative effect of months on end of scandal has shown that this is not something they are capable of fixing in any meaningful way — on their own,” said Sarah Miller, spokeswoman for Freedom From Facebook, a nonprofit coalition of progressive groups calling for Facebook to be broken up.

Analysts on Thursday morning began debating whether Facebook’s tumble signaled the likelihood of long-term stagnation or merely was a stumble — and hence an opportunity to buy a fundamentally strong stock before it continues rising again.

“We were pretty stressed out during Facebook’s Q2 2018 conference call and could sense the fear/panic in investors’ voices afterwards,” wrote Richard Greenfield of BTIG. “But as we sat back and reflected on why we believe in Facebook, the core tenets of our investment
thesis are unchanged. ... Mobile is eating the world, and Facebook is a core holding to benefit from that shift.”

What remains less clear is whether the push for tougher privacy regulations has peaked or is still building. The fate of Facebook — and many other tech companies — probably depends on the answer to that question. More at washingtonpost.com/news/technology