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Social media

Facebook unfriended

SAN FRANCISCO

Russian meddling is only one challenge facing the social-networking giant

IN ITS early days Facebook embraced the motto "move fast and break things" to describe its engineers' strategy of rapid innovation. "Move slowly, and try not to break anything else" seems to be its new creed. In the last year Facebook has contended with several controversies, including charges that it helped spread false news, unwittingly facilitated Russian meddling in the 2016 election and fanned political polarisation (see briefing). After denials of responsibility and little action, Mark Zuckerberg, its boss, has talked of "fixing" Facebook in 2018. It will be a huge task.

Russia's alleged manipulation of Facebook users will harm the company. On February 16th special counsel Robert Mueller filed conspiracy and fraud charges against 13 Russians for interfering in America's 2016 election; Facebook was mentioned no fewer than 35 times as a place where Russian trolls swayed Americans through targeted political advertising and curated posts.

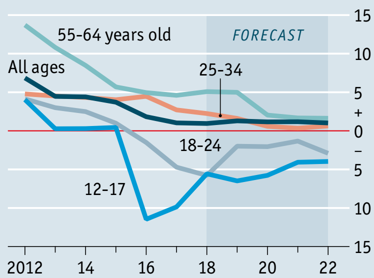
The indictment is also evidence that Facebook was not transparent in reporting the extent of activities that occurred on its platform. Last autumn it said it had determined Russian content reached around 130m Americans, and that Russian trolls had spent a mere $100,000 on ads during the 2016 election. Those figures seem too low. The Russian troll farm described in Mr Mueller's indictment probably had an annual budget of around $70m and would have spent heavily on Facebook ads and content. American politicians may press the social-media firm for more information and also haul executives before Congress again to give testimony, especially as concerns mount about foreign interference in upcoming elections in 2018 and 2020—big distractions for a firm contending with several other significant challenges.

Controversies around Russian meddling, fake news and hateful speech on social media have not yet dented Facebook's advertising revenues. But it seems likely that shrill and angry posts on the site, and bad press about social media, are playing a part in chilling usage of the core Facebook platform. Mr Zuckerberg's approach to fixing it has been to tweak what posts users see, prioritising "meaningful interaction" over "meaningful content", which has resulted in people seeing more of their friends' updates and fewer news stories.

Anti-social graph

United States, Facebook users by age group

% change on a year earlier



Source: eMarketer

But that does not go nearly far enough, says John Battelle of NewCo, a digital publisher.

Last month when Facebook reported earnings, it announced a decline in daily active users in America and Canada for the first time and estimated that, globally, users were spending around 50m fewer hours per day on Facebook. Such a drop translates into users worldwide spending around 15% less time on Facebook year over year, reckons Brian Wieser of Pivotal Research Group, an equity-research firm.

In America, Facebook is steadily losing users under the age of 25 (see chart). Youngsters are spending more time on other apps such as Snapchat, and Facebook-owned photo-sharing app Instagram, where their parents and grandparents are less likely to lurk. While Instagram and the two messaging apps that Facebook owns, Messenger and WhatsApp, help insulate the firm, "core" Facebook still accounts for at least 85% of the firm's revenue. Americans and Canadians are by far its most valuable audience, with an average revenue per user of $86, four times more than the global average. If users continue to engage less with Facebook's core network, it could cause advertisers to leave over time.

Yet most analysts and investors are still exuberant about future prospects for Facebook, which with a market value of $521bn is the world's sixth biggest publicly traded firm. They may be underestimating some of the risks the firm faces. One challenge, which has been highlighted by the Russia controversy, is its sloppiness. For a company whose sales pitch to advertisers is that it offers precision, targeting and transparency superior to traditional media, including television, it is remarkable that it has struggled to track the movement of ad dollars and content on its properties.

Either its algorithms have become so complex and opaque that executives have failed to keep up with them, or they have deliberately chosen to "slow walk" their ▸▸

audit of foreign spending on Facebook. Neither explanation is flattering. The company this summer will introduce a feature to allow users to see who is behind a political ad and also to view every ad a particular buyer has purchased. But that is around nine months after it was proposed.

A second challenge is that Facebook's costs are growing significantly. In 2018 expenses are expected to rise by around half, to $23bn, while gross revenue will grow by about a third, to $54bn, according to BMO Capital Markets, an investment bank. Today Facebook has around 14,000 workers overseeing security, safety, compliance and community operations, twice as many as a year earlier, and that figure is likely to rise as more countries require it to find and remove objectionable content.

Facebook is banking that future growth will come from luring more advertising spending away from television, but this will require investment in video content to the tune of billions of dollars. Meanwhile growth rates for digital advertising are bound to slow. This is particularly true in America, where digital's share of total ad spending—which today stands at 44%—outstrips the percentage of time people spend on digital versus traditional media.

A third risk, and the biggest, is new regulation. Politicians have hardened their attitudes toward Facebook. It has swallowed up smaller rivals and has few friends among the political elite. Regulators could scuttle new deals, impose new restrictions on data-sharing between Facebook's various apps, or fine it for anticompetitive behaviour and privacy violations. This is especially likely in Europe, but even at home watchdogs may get fiercer.

In the meantime Facebook will have to grapple with regulations that limit its ability to track consumers. In May a new data privacy law, the General Data Protection Regulation, comes into effect in Europe requiring firms to gain explicit consent from users to follow them around the web and share their information. The regulation could slow growth in digital advertising in Europe overall. It could also threaten some of Facebook's ad products, such as a tool that lets advertisers find their own customers on the social network.

Facebook has faced adversity before. Many doubted if Mr Zuckerberg could even build a business early on, and then whether he could manage the transition from desktop computers to mobile phones. He proved the naysayers wrong.

These days analysts and investors appear to have suspended doubts about his company. Support from the market may offer reassurance. Facebook's shares have fallen by only 8% from their peak at the start of February. But too many cheerleaders will not help it confront its biggest challenge, that of reinventing its core product, and repairing its reputation. ■

Corporate tax in America

The devilish detail

Tax reform is benefiting domestically focused firms most

"IT'S always a lot of fun when you win," President Donald Trump enthused after his tax package was approved by Congress in December. Company bosses nodded along. The centrepiece of the reform is a drastic cut to the corporate-tax rate, from 35% to 21%, taking it below the rich-country average. Although its impact is partly offset by some revenue-raising measures, the congressional Joint Committee on Taxation estimates that American business will gain around $330bn from the reform over the next ten years. Yet within that are sizeable variations in terms of which firms and industries benefit most.

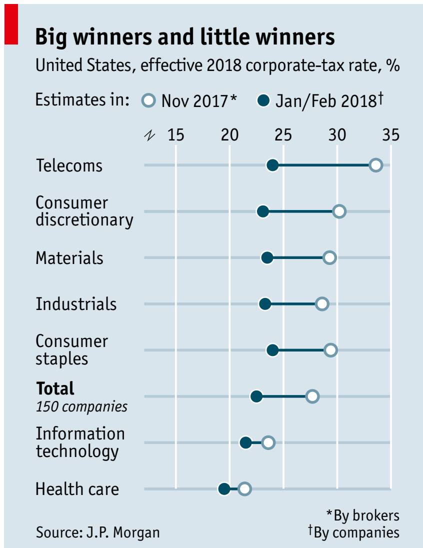
The biggest winners are more domestically oriented companies. These typically face higher effective tax rates than American companies with a big presence overseas, which do business in lower-tax countries. Bosses are also evaluating other new measures. So-called "full expensing", for example, helps those with big spending plans by allowing them to deduct investment costs up front. But using debt will become less attractive, as interest payments are no longer fully deductible.

Some firms experienced high volatility in their earnings for the final quarter of 2017 thanks to the treatment of so-called "deferred tax assets". These are past tax losses carried forward to set against future tax bills, and such assets have shrunk in value because of the lower corporate-tax rate. Other firms that hold deferred liabilities enjoyed big one-off gains.

Of the 150 S&P-listed companies that have so far released estimates of their effective tax rate for 2018, telecoms and consumer-focused companies (which often have a big American presence) expect to have gained the most, says Ramaswamy Variankaval of J.P. Morgan, an investment bank (see chart). AT&T, a telecoms giant, predicts a rise in cashflow of $3bn in 2018, or nearly a fifth of cashflow last year.

Multinational firms do benefit from a lower American headline tax rate. They will also pay a much lower tax rate, of 15.5%, on foreign cash that is repatriated. Yet while they were previously taxed only when the money was brought home, now they must cough up and pay tax on all of their $3trn stockpile of foreign cash over an eight-year period.

Other changes to the treatment of foreign income are more controversial. The new "base-erosion anti-abuse tax", or BEAT, applies to all big firms operating in



America and targets cross-border payments to foreign affiliates, such as royalties on intellectual property. Firms must now add such services back into their American corporate earnings, and pay a 10% tax (after 2018, until when a 5% rate applies) on this broader base—if it exceeds the standard calculation of 21% on a narrower base. Another new tax charge applies only to American firms that have "global intangible low-taxed income" or GILTI—returns on intangible assets, such as patents or software, parked abroad.

Both BEAT and GILTI were intended to prevent companies from dodging tax by stashing intellectual property and other intangibles in tax havens, notes Jennifer Blouin, from the University of Pennsylvania. But, as drawn up, they are much broader, she says, and could capture all foreign affiliates, even if they already pay high tax rates, such as those in Germany. That has irked some European firms.

With bureaucrats still transcribing the hastily drafted legislation into rules for business, firms cannot yet be sure of their total impact. But many technology and pharmaceutical companies, even though together they hold the most cash abroad, anticipate slightly lower tax rates as a result of the reforms, says Mr Variankaval. Even Apple, which booked a $38bn tax payment on its $250bn mountain of foreign cash (it has yet actually to pay it), expects a net benefit. In contrast, some other firms, such as IBM and General Electric, expect slightly higher tax rates in 2018 than they paid last year, as the wider tax base offsets the lower headline rate.

Unsurprisingly, the reforms appear to negate the benefits of "inversion", or setting up abroad for tax purposes. Valeant and Allergan, both drugmakers domiciled abroad, expect higher tax rates. It is too early to tell, though, if the tax changes will succeed in shifting supply chains and intangible assets back to America. ▸▸