

## Why a Subscription Model May Be Inevitable for Facebook

### Description

Ads are what keep **Facebook** (NASDAQ: FB) going and what allow users to avoid paying a fee to use the social media site, but there's always a chance that this could change in the future.

Privacy issues have been rising over the years. Whether they have involved data breaches or users' personal information, consumers are more aware than ever of what's at stake online: their data. That data allows advertisers to place ads to users based on their interests and any other information Facebook may have obtained from a user. Providing that information to advertisers becomes an issue, especially if it's not adequately safeguarded. It's a concern that regulators have been paying attention to.

### Fines are starting to mount

In July, Facebook was fined \$5 billion by the FTC for the Cambridge Analytica scandal. And **Alphabet**'s (NASDAQ: GOOG) (NASDAQ: GOOGL) Google faces a more modest punishment of \$170 million for YouTube's attempts at marketing to children.

However, there could be more to come for the popular search engine. According to *Forbes*, some allegations suggest Google is in violation of [General Data Protection Regulation \(GDPR\) laws](#) in the European Union, which could cost the company as much as [\\$5.4 billion](#). Tech companies as a whole are drawing the attention of regulators due to privacy and whether it's Google or Facebook, the fines could become more severe in order to ensure that companies are taking the issues seriously.

Facebook's fine and Google's unconfirmed fine are sure to draw the attention of investors and could lead to pressure for the companies to ensure that user information is more adequately protected. Although Facebook's \$22 billion in 2018 profit easily handles the fine, \$5 billion is large enough to put a dent in annual profitability.

### Why a pay model makes so much sense

Facebook's operating expenses have been rising more rapidly in recent years. Costs totaling \$30.9 billion in fiscal 2018 were a 51% increase from the prior year's operating expenses of \$20.5 billion. And those numbers were up 34% from 2016. Costs have been rising and that's likely to continue happening. In the company's most recent earnings results, it said that it had "agreed to implement a comprehensive expansion of our privacy program, including substantial management and board of directors oversight, stringent operational requirements and reporting obligations, and a process to regularly certify our compliance with the privacy program to the FTC." However, no specific dollar amount was provided as to the potential cost of all those governance changes.

Rising costs are going to be make things more challenging for the company's bottom line as well,

especially since its high growth rate has started to slide in recent years. Revenues of \$55.8 billion in 2018 were up 37%, which is well shy of 2017's growth rate of 47% or the 54% rise in sales that 2016 saw. It's likely that the company won't be able to combat rising costs by relying on a high growth rate, and that's why it's going to have to take the issues surrounding privacy more seriously. Many [advertisers have been upset with the company's practices](#) and although it's unclear how many have actually left, Facebook does admit that [some have pushed 'pause.'](#)

Depending less on ad revenue and more on subscription fees from users could not only reduce Facebook's costs (by decreasing the need to monitor ads) but also grow its sales. With 1.59 billion active users on its website, a price of \$3 per month would produce more than \$57 billion in sales for a year, which is more than the company made in 2018. That's much less than the cost of a **Netflix** ([NASDAQ: NFLX](#)) subscription, and in turn, users could enjoy an ad-free Facebook experience and not have to worry about whether they're seeing fake ads. Even a hybrid approach that allows some users to pay for ad-free accounts could help minimize the site's dependence on ads and its need to utilize user data.

## Takeaway for investors

Facebook may be in a bit of trouble when it comes to privacy issues, but the company has some flexibility. Whether for movies, video games, news sites, or even [Porsches](#), people have shown a willingness to pay recurring subscription fees. While a subscription model might not be on the horizon today, it's certainly an option for the [tech company](#) to explore should profits start to get squeezed. There are many ways the company can grow its revenues, and that includes offering users the option to pay to not see ads. While a subscription won't appeal to all of its users, even if some are willing to pay a fee for an ad-free experience, that will help lessen the company's reliance on advertisers and help strengthen its business by having another segment that can contribute to its top line.

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