ESG Now Podcast

“Big Tech is Knock Knock Knockin’ on the GDPR’s Door”

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Bentley Kaplan:

Hello and welcome to the weekly edition of ESG Now, the show that explores how the environment, our society and corporate governance effects and are affected by our economy. I'm Bentley Kaplan, your host for this episode. On today's show, we are going to get into the private parts of your data, or rather the companies that are getting into and using the private parts of your data. First, we'll be looking at the business models of some of the world's biggest tech firms and how their revenue center on the collection and use of personal data, and then we'll dig into how the EUs big bad privacy law is creating some very hard edges for these business models. Thanks for sticking around. Let's do this.

I wanted to start the show with a personal confession. So gather round. Here it is. I am a serial browser. Before online shopping got so big, I had become an expert at deflecting salespeople with a deft thanks, but I'm just looking. And now life is all about the online browsing before actually buying anything, whether it's running shoes or coffee grinders or proofing baskets or headphones, I spend agonizing hours building up a use case. My search history is listed with terms that start with is X worth it? Or 10 ways that X will improve your life. Or even my friends say, X sucks, are they right? My current browsing obsession is that pinnacle of middle class pride: an air fryer. An appliance that I have found is like a starters pistol for conversation with some surprisingly passionate advocates and detractors, but I digress. You see, historically I've been pretty good at holding off on actually buying something if I can't see how it's actually worth the money or if I don't think it will fit into a life that is currently squeezed between two dogs, two kids, and a side hustle as a podcaster.

Or I used to be very good at holding off, because the Internet, capital I, is getting very good at dangling temptation at me and in all sorts of unexpected places. And I'll suddenly find digital news articles littered with adverts for air fryers of all shapes and sizes. And the same goes for YouTube videos, online searches, and a range of webpages. And as Yoon Young Chung, out of our Boston office, told me, "That's kind of the whole point." Focusing on two giants of the tech platform world, Alphabet and Meta, Yoon Young outlined the link between my personal data and their revenue.

Yoon Young Chung:

Digital online platform players generate revenue by collecting and monetizing user data. Your online activity tells parts of your life or who you are. Alphabet and Meta keep track of every activity you perform on their web browsers, social medias and apps while you search and use the internet and social medias. Whenever you do a search, watch your video or make an online purchase, Alphabet collects and stores the information. For Meta, Facebook collects information about people, account, hashtags and Facebook groups and pages you're connected and how you interact with them. Both Alphabet and Meta make money mostly from their advertising businesses. Digital advertising marketers can target specific category of users based on various factors such as location, age, gender, and behaviors on Meta's Facebook and Instagram.

Bentley Kaplan:

Okay, so at this high level it's pretty simple. When I'm going into Google and slapping down my endless and nitpicky questions about price ranges or recipes or the electricity consumption of air fryers per cubic centimeter of potato wedge, all of that information is being collected. And I'm not exactly posting pictures of my favorite air fryers on Instagram or joining air fryer groups on Facebook. But if I was, then that data is all being collected too. And for all the fun of talking about air fryers, I don't want you to lose sight of the huge range of personal data that is potentially being collected – data that you might feel much more protective over, personal things like your religious affiliation, political preferences, or sexual orientation… the people you're contacting, and who are contacting you, or even something as personal as your medical history. And all of this data, while very personal, doesn't have value in isolation. But if you're say someone who's interested in selling air fryers or you're trying to place adverts that get in front of the right person at the right time, well then jackpot. And as Yoon Young explains for companies like Alphabet and Meta, their capacity to collect personal data underpins their advertising segments, which in turn account for the lion's share of their revenue.

And this dependence on personal data is something that we look at in our ESG ratings model. And not just for tech companies. Some sectors like healthcare or even telecoms and insurance, collect large quantities of personal data often by necessity. And holding this personal data creates risks for these companies, especially if it's poorly handled, accidentally leaked or used for secondary purposes. In our model, we weigh this risk, in this case the extent to which companies depend on and collect personal data, with the extent to which they are positioned to manage this risk. In the context of tech and social media, Yoon Young highlighted some key practices that would help companies manage risks related to their collection of personal data.

Yoon Young Chung:

We capture how companies handle personal data by third parties with their practices and content requirements. We see the best practice as a company that does not rent, sell, or provide personal data for secondary purposes. Alphabet provided users with an option for opting in for providing personal data for secondary purposes. When you use the Google search engine, you can choose to offer or opt in your consent for providing your personal data to be processed for secondary purposes. In the meantime, we found no evidence if Meta provided users with an option for opting in or opting out of providing personal data for secondary purposes.

Bentley Kaplan:

Right. So there is a key point here. Meta and Alphabet both have the capability of collecting all kinds of personal data while you're on their platforms and websites and apps and even hardware. And that data holds huge potential value for "secondary purposes". Like trying to target me with adverts for air fryers. But as of the time of recording, if you're using something like Google, it's a lot easier to prevent your data from being used for these secondary purposes, whereas as Yoon Young told me, for Meta, this is not quite the case. Now, if like billions of other people who are using these platforms, you might have mixed feelings about your data being collected. And while mixed user sentiment is definitely something that tech companies will take into consideration, there's actually a much bigger stick that's being wielded at the moment in the form of regulation.

And the regulation I'm talking about here is the EU's General Data Protection Regulation, or the GDPR, which came into effect in 2018. We have talked about it on the show a few times before, and it's arguably one of the most significant pieces of legislation governing the collection and handling of personal data. Companies that are found to be violating the law can be fined up to 20 million euros or four percent of their global turnover, which can be a big chunk if you're a multi-billion dollar company. And to illustrate that, in May this year, Facebook received a 1.2 billion euro fine over mishandling user data and was ordered to suspend the transfer of this data from the EU to the US.

And that at least gives you an indication of how costly things can get. And maybe another reason why the GDPR is so key is that it basically looks at this idea of companies being able to collect personal data as long as they're super careful with it and takes a step back to the idea that data privacy is a fundamental right and that this right can only be violated under very specific circumstances. Andrew Young, out of our London office took me through the conditions under which companies like Meta and Alphabet might be able to collect or use this data in the EU.

Andrew Young:

So like you said, the GDPR recognizes privacy as a fundamental right, and so the regulation says that companies need a good reason to use someone's personal data. Reasons like in the public interest or to protect someone's life. But for the purposes of advertising business, the GDPR offers three reasons. One is contractual necessity. So this is where Amazon needs your credit card, your address, your phone number to deliver your air fryer. Another is a company's legitimate interest, which can include operating a profitable business, but a company's legitimate interest cannot override an individual's fundamental rights and freedoms. This is an area where courts are beginning to weigh in. The final reason is consent, and the key tenet here is that consent must be freely given. It cannot be bundled with a terms of service or coerced in any way.

Bentley Kaplan:

Right. So I'm very glad we have Andrew here for this, because translating regulation into a podcastable language is no mean feat. Basically, for social media companies to be able to collect personal data in the EU, they can try three doors. Behind the first is something called contractual necessity. These are details a company has to have to be able to offer its service to you. If Amazon doesn't know where to deliver my air fryer, that makes things a little tricky. Behind door number two is legitimate interest. So a company doesn't have to have this data, but they can potentially make their case for it. Crucially, this interest is outranked by individuals' right to privacy and behind door number three is consent, which means you will need contractual necessity or legitimate interest as long as this consent is uncoerced and unbundled. But let's put a pin in consent for now, because it's the only thing standing between this train of thought and a very aggressive tangent. Now through 2023, Meta has kind of been knocking on all three of these doors, which is something that Andrew has been watching.

Andrew Young:

So I guess the reason we're talking about privacy in Europe now, is because of some potentially consequential decisions made by privacy authorities and the courts in Europe this year. I say potentially, because the decisions are subject to appeals processes, but essentially contractual necessity, that's Amazon collecting your address and credit card info to deliver your air fryer, was not considered an appropriate legal basis for personalized advertising by Europe's privacy regulators. So Meta or other social media's terms of services, don't give them the right to serve their users personalized ads, at least based on third party data. But as I said, it's technical and subject to appeal. However, if it holds, that leaves only legitimate interest and consent as the basis for social media platforms to process personalized data for advertising. A recent decision by the Court of Justice of the European Union said that users of social media platforms cannot reasonably expect data collected from third party sources to be used to serve them ads. This decision then appears to limit the legitimate interest reason for processing personal data.

Bentley Kaplan:

Right. So Meta tried contractual necessity as the reason why it serves personalized ads in the EU, but no dice. The company was fined 390 million euros in January this year by the Irish Data Protection Commission or the DPC, which involved separate fines for Facebook and Instagram. Incidentally, the DPC is Meta's main data protection regulator in the EU, as the company's European headquarters are based in Ireland. But then in July, the company started to really run out of wiggle room, and it was on the wrong end of a ruling from the Court of Justice of the EU that found that using legitimate interest as a reason to serve personalized ads also fell short of the mark. And if you'll remember, there were three main justifications that social media or tech companies could use to serve these ads. And with two down, there was just one to go.

Andrew Young:

I also wanted to mention the last reason offered by the GDPR for processing personal data available to social media. And that is consent. The recent decision by the Court of Justice of the European Union raised the question of whether consent can be freely given to a social media platform that has a dominant market position. This links together privacy and antitrust concerns, an additional consideration for the really big social media companies. Again, there is undoubtedly more of the story to be hashed out, but overall, in 2023, social medias have rarely seen their core business of delivering personalized ads come under some level of threat.

Bentley Kaplan:

Right. So the EU Court of Justice pointed to the difficulty of separating consent from the near monopolies that companies like Alphabet and Meta have over the digital marketplace and social media. Because given the relatively limited competition in terms of social media or search, there is an argument that users who don’t want their data to be collected by a company like Meta, or Alphabet don’t really have many alternatives. And that a dominant market player asking for consent might be a bit of a hollow gesture. Which is not to say that there's no route forward for Meta and Alphabet and their peers as they look to defend their revenues from personalized advertising. They may have difficulty using either contractual necessity or legitimate interest. But the question of consent, at least seems open for now. But it does look like life is going to get a little more complicated, and that the onus will be on these companies to show how users have given their consent freely in spite of their dominant market positions.

As Yoon Young told me, Alphabet's European revenue in 2022 was 29% of its total. And for Meta it was 23%. Now, not all of that is going to be coming from advertising, but certainly enough for investors to sit up and take notice. And as Andrew told me in a longer recorded interview, the GDPR doesn't look to be going anywhere anytime soon. As a principle-based law it potentially has a long shelf life with room for adjustments, a key attribute for regulating a sector that evolves so quickly. And as for me, well, I still haven't chosen an air fryer, but if I've learned anything from this, I can probably expect those ads to keep coming thick and fast at least while I'm browsing outside the EU.

And that is it for the week. A massive thanks to Yoon Young and Andrew for their take on the news with an ESG twist. I'd also like to give a shout-out to Gabriela de la Serna, who produced this episode, and let me swoop in to take all the glory at the last minute. We are gradually building out our little podcast family here at ESG Now, so do expect to see some new talent and fresh faces cropping up over the next few months. I'm excited, and you should be too. Thank you as always for tuning in. Don't forget to rate and review us wherever you're listening to the show all and any feedback is great and helps us get better and to get you what you really want to hear. Thanks again, and until next time, take care of yourself and those around you.

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