



Economics, Planning & Finance Assignment

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1. Introduction

In line with the requirements outlined by the assessment brief, this paper examines what marketing plans Spotify has used in order to become a successful business. My research into the relationship Spotify has with its customers and contributors provided insight into how it has grown and developed over its years as a company. I have also considered the macro and micro economics of Spotify, its business model and company structure as well as the implications the recent pandemic has had on its finances. I reviewed the financial statement for Spotify for the year ending December 31st 2020 (Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934) which allowed me to consider the challenges facing the company in the future, and understand its income and expenditure. This paper will also examine the use of the Lean Start-Up method in contributing to the success of the Spotify name.

2. A Brief History of Spotify

Founded in 2006 in Sweden by Daniel Ek and Martin Lorentzon Spotify has fast become one of the largest audio streaming services of the 21st Century. Cashing in on the change in the way we consume music, Spotify was originally created to tackle the growing piracy issue within the music industry. At the turn of the 21st Century, the way in which we consume music changed dramatically - no longer were we spending money on physical copies, but changing to the ease of streaming music at our leisure instead. As well as the likes of Netflix, Spotify saw a gap in the market. Initially trials of the platform saw Ek and Lorentzon making videos available to users, but once they realised videos took up too much bandwidth the switch was made to audio. Ironically, the beta

version of Spotify was loaded with pirated music which was downloaded by its employees (Jones, 2017). Ek and Lorentzon wanted to make music accessible legally, but at no cost to its customers. As time went by and the popularity of streaming services grew, so did the concept behind Spotify. No longer did it seem like a viable business model to offer such a service for free, so after some time resisting paid subscriptions to the service were introduced. Now the company's mission statement envisions a cultural platform which allows professional creators to break free of their mediums constraints, and gives everyone the opportunity to enjoy an immersive artistic experience. But how does it achieve this?

Spotify operates as a platform business, or two-sided market as it brings together two types of user, in this case artist and listener. This model creates value by facilitating the exchange between consumer and producer, or connecting the supply to demand (Uenlue 2017). This model has been a success thus far for Spotify as it allows a business to create a large network of users, and products which can be accessed on demand. Unlike other business models, platform businesses don't create the product which they are selling, just market it cleverly to create a connection to their users. Other examples of a successful platform business are those such as Facebook, Youtube and Uber. Spotify negotiates directly with big record labels to set royalties for distributing music (Björkdahl & Holmén 2013). Offering two different levels of experience - a free, ad based package, and a premium option - Spotify's main source of income is generated through paid monthly subscriptions, whilst also benefiting from paid advertisements.

Since its inception Spotify has experienced a number of funding negotiations starting initially with a small amount in

2010 from Founders Fund. In June 2011 \$100 million was invested into the company despite it making a loss of \$4.4 million (Nylander, 2009) just two years earlier. Goldman Sachs Investment Partners invested \$626 Million between 2012 and 2015 and in March of 2016 a further £1 billion was invested by Dragoneer Investment Group (Goswami, 2021). Since 2013 Spotify's acquisitions have ranged from Tunigo, to Soundwave in 2016, Sonalytic in 2017 and The Ringer in 2020.

The Spotify we know today came about following negotiations between the founding president of Facebook Sean Parker - Parker approached Spotify and invested \$15 million to become a partner. It was Parker who negotiated deals with Warner and Universal and also engineered a partnership between Spotify and Facebook which allowed Spotify to incorporate a lot of social features into its service, such as sharing specific songs. In little over a year this venture helped to double Spotify's user base from 10 million to 20 million. In 2009 they offered an offline mode and expanded into an 'unlimited' option in May 2010. (Seufert 2013)

At the end of 2020 Spotify reported an average increase in monthly listeners of 29% year on year and 27% in subscribers year on year (Newsroom, 2020)

3. Economics

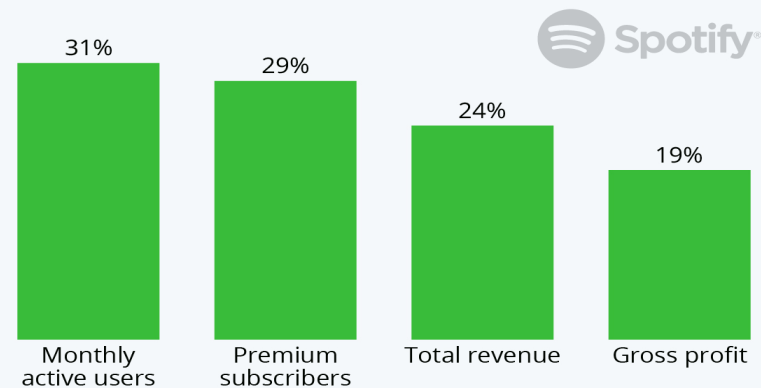
3.1 The Market

The global music streaming industry is estimated to be worth \$76.9 billion by 2027 (Grand Research View, 2020) with the compound annual growth rate expected to expand by 23.2% before 2026 (Businesswire, 2021). Furthermore, most streaming services saw a growth amidst the Covid global pandemic with Spotify reporting a Year on Year (Y/Y) growth of 31% of total revenue due to increased promotional activities

and price cuts in subscription models which came as people were no longer able to engage in outdoor activities. Music became much more important to people, especially those who

Growth Across the Board for Spotify in Q4

Year-over-year growth of selected KPIs for Spotify in Q4 2019



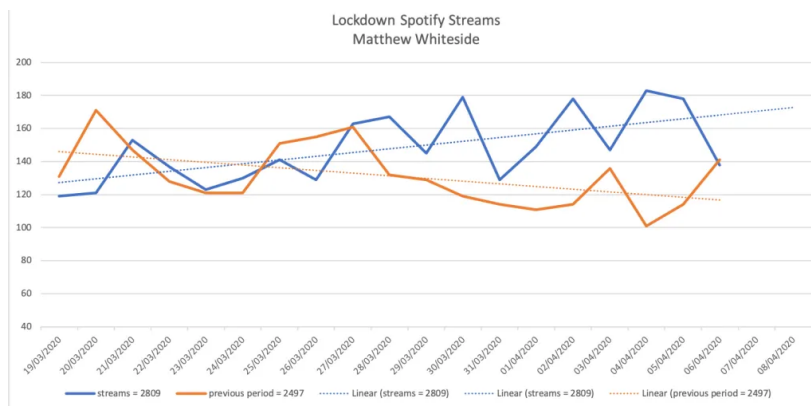
Source: Spotify



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create it as they suddenly found that they had to find new ways of promoting their material and engaging with their fanbase. The music industry had to adapt to the change in social climate and many streaming services saw an opportunity to increase their subscription numbers by offering special deals to NHS and frontline workers, extended free trials and even the option to 'share' your subscription with a loved one over the period leading to Valentine's day.

As far as supply and demand goes It could be argued that Spotify has not been receptive in terms of its elasticity in the changes to the economic environment, opting not to alter the fee for its premium subscription service but, behind the scenes Spotify has been working hard to ensure it can continue to justify its subscription fee. Although it recently removed a number of K-pop tracks from its catalogue, it recently peaked in the number of tracks uploaded adding 600,000 in just one day surpassing the 2019 figure by 50% (Ingham 2021). So, while Ek has hopes that the streaming service will host as many as 50 million creators by 2025 which can only further contribute to the number of content available



to users, perhaps it is more reasonable to consider that Spotify is elastic in its economics - continuing to offer more content, but not changing the price for its subscription.

3.2 Products, services & customer base

Spotify offers an interactive on-demand music streaming service, with the option of a freemium ad supported tier, and an ad-free premium tier for £9.99 per month. It's product strategy involves engaging with users through their freemium option, establishing regular use patterns and then enticing them with a free trial of the premium option. The premium tier also gives users the option to download songs, albums and podcasts which allows users to listen offline on mobile devices without it eating into precious 4G data. The premium option comes with a further 4 choices; Individual, Student, Duo and Family. With varying monthly fees, each package offers differing levels of discount most notably the Student package which affords the user with a 50% off subscription fee plus 4 years at a discounted rate. The Individual option does what it says on the tin - allows one person unlimited use, while the Family and Duo options are designed for use between more than one person.

Presumably, based on the subscription options, the customer base for Spotify is varied and perhaps has changed somewhat over the past year in response to the pandemic with more people finding themselves at home more often.

3.3 Pricing strategy

With four different subscription offers come four different prices with slightly differing benefits to each. The standard premium package comes at £9.99, with access to add free listening and 'unlimited song skips', the Duo package which is £12.99 is designed for two people living at the same address and comes with a playlist based on the tastes of both people. The family package, which is suitable for six people living under one roof costs £14.99 and comes with parental controls and access to the Spotify Kids app. Finally, the

student package costs £4.99 - or 50% the price of the individual package - and gives users access to the Headspace App at no extra cost. All packages are advertised as contract free with the option to cancel at any time.

In comparison to its competitors subscription charges - which we will discuss later - Spotify offers a fair price for a substantial service. It wasn't until 2014 that Spotify introduced its student and family subscription tiers (Hernandes, 2014) and since then very little has changed in terms of its pricing. Its business model has been criticised for focusing too heavily on acquisition and retention rather than monetisation sticking to what they know and not experimenting with different pricing tiers for features such as lossless quality. Their family package offers five users unlimited listening for less than the cost of the normal premium service per individual so has the potential to cause Spotify to lose more money. Having not ever increased their pricing, and focusing more on quantity of content available rather than quality, the announcement earlier on this year that they were increasing their increase in subscription fees in the US (Ronzon, 2021) to meet a change in service tax was not received well.

3.4 The Macro environment

Economists had previously complained that digital streaming platforms such as Spotify were causing them a headache because without a physical product to buy, there were some challenges in calculating GDP. The swap to digital download from physical CD meant that the consumer was paying less for the same product and therefore becoming better off financially. This was troublesome for the Bank of England as the extra wealth wasn't reflected in the macro data that it used to set interest rates. Over time, this changed and

recently The Bank of England's chief economist, Andy Haldane had encouraged economists to use Spotify to predict changes to the banks interest rate (Kaivanto, Zhang 2018). Following on from a study by Claremont Graduate University it was suggested consumers' states of mind were reflected in their listening habits and this could be used to gauge what people want to buy and how much they will spend, so it could be suggested that the relationship between economists and Spotify has come a long way.

In 2011 the UK unemployment rate dropped from 8.1% to a low of 4.4% in 2017 (Pitchspot, 2020). A low unemployment rate meant that consumers had more spending power and the confidence to pay for the premium services offered by Spotify. As the popularity of smartphones has increased so has the opportunity for Spotify to reach countries such as China and India and in February of this year they announced plans to expand into 80 new markets including Asia and Africa (Stassen, 2021)

Undoubtedly Spotify will have seen some changes in its users' listening habits due to the ongoing Covid-19 pandemic, with users being at home more and many finding they have more time to listen to music or Podcasts. However, the impact of the pandemic on the unemployment rate should be considered too - with the unemployment rate rising by 5.1% in December 2020 (King, 2021) some may find the £9.99 premium service an unnecessary expenditure.

With the use of Porter's Five Forces model it could be argued that Spotify is monopolistic which would imply that it has the monopoly on the streaming platform market and it would be difficult for anyone else to start up a new platform offering a similar service. As it already holds deals with the major labels, any start up would have to have substantial

negotiating techniques in order to be able to influence these relationships. Whilst Spotify's buyer power is large as there are so many alternatives - which we will discuss later in this paper - its supplier power is also large as its catalogue is exhaustive. However, if musicians, songwriters and record companies decided not to give Spotify access to their work this could potentially create massive problems and have huge implications for the level of service the streaming platform could provide. Of course, whilst this is speculative, the real current threat to Spotify comes from already established streaming services, new kinds of technology such as smart speakers, the low royalty payouts to independent artists.

The two sided business model Spotify has adapted poses limits too. The way in which it functions means that it has to continuously work on relationships and navigate agreements across a number of territories, all of which can be time consuming and costly. In order to continue to function responsibly and provide the service it does, Spotify must adhere to copyright laws worldwide. Whilst securing deals and negotiating contracts has proven to be a costly exercise for the streaming platform, the ramifications of not following intellectual property laws would be huge, and most definitely more costly.

Spotify has faced continued challenges surrounding its royalty payouts. There have been complaints that it doesn't do enough to democratize the music industry as 87% of its catalogue comes from the top four music labels. Interestingly economists have singled out Spotify as having a detrimental effect on measuring the economy (Felländer 2015, Bean 2016).

4. Finances

Whilst the story of Spotify is often hailed as one of success with vast numbers of users and numbers ever growing, it has yet to show a profit. Its losses have grown year on year faster than its turnover which means that the long term survival of the tech giant is dependent on further cash injections.

As of September 2020 it has 320 million monthly active users, 144 million of which are paid subscribers (Johnston 2020). In 2015 it was reported that the 25% of paid subscription users accounted for over 90% of Spotify's income (Dredge 2015). At £9.99 per month for a premium package, with such a massive number of active users, it might be surprising to discover that for almost a decade Spotify's ad free tier failed to turn a profit (Verbergt 2016).

However, the free subscription version was key for assisting in Spotify's growth. As of 2016, more than 70% of the hundred million active monthly users were happy to listen to ads in order to enjoy the service (Murgia 2016) and in 2017 Spotify's value was estimated at \$13 billion (Vonderau 2017). At the end of December 2020 Spotify was generating 91% of its revenue from its premium service and only 9% from its ad based subscription tier resulting in a revenue of €745 million (Johnston, 2021).

According to Spotify's financial statement it has reported a growth in gross profit year on year having more than doubled its profit in the last 4 years. At the end of 2020 its gross profit stood at a staggering 2308 million euros. However, it also reports that, since its birth in 2006 Spotify has incurred considerable operation losses, and has accumulated a deficit of 3290 million euros (December 31st 2020). It attributes these losses to the costs incurred to gain license content, including paying royalties to record labels and publishers and other

copyright owners. Spotify is wary of its future, stating that, if it cannot continue to earn revenue at the rate in which it exceeds operational costs, it is doubtful of its ability to achieve or sustain profitability on a sustained basis. (Section 13 or 15(d) of the Securities Exchange Act of 1934). Just before its 10th birthday in 2016, Spotify had \$1 billion in convertible debt and had lost money each year of the 10 years they had been in business (Aris et al. 2016). Despite the numbers of monthly paid customers, Spotify's income is vastly outweighed by its expenditures paying large amounts to Universal Music Group and Warner Music Group. Daniel Ek's solution to this problem is to continue to try to negotiate a deal between the labels that would see their check payments reduced by 50%.

5. Competition

According to the Spotify Financial report for 2020 it admits its competition comes in attracting and retaining users including predicting, recommending and playing content its users enjoy. It also reports that it may face challenges in monetizing its service on mobile devices, attracting and retaining qualified personnel in its international expansion, convincing advertisers to continue to use their service and the potential for software vulnerabilities amongst many other things.

As of October 2020 Spotify's monthly users stood at 286 million, with Apple at 60 million and Amazon at 55 million (Laker, 2020). Though it may have the monopoly, Spotify is not the only player in the global streaming service market. Its notable competitors come in the form of Deezer, Apple Music, Amazon, Napster and Tidal to name a few. In 2019 there were over 304 million subscribers to streaming platforms. Of this number, Spotify held the highest percentage at 36% with a

subscription revenue totalling \$1,663.9 million (Mulligan, 2020). It is interesting that, even though it holds the market share, its royalty payouts are often the lowest. With an average pay out of \$0.00437 Spotify requires 336,842 streams in order to meet minimum wage requirements. The debate about whether or not Spotify does enough to protect its artists has been ongoing for some time, notably with Taylor Swift removing her entire catalogue from their platform in 2014 amid accusations that Spotify underpays its artists.

Though Spotify is perhaps the most well known name in the music streaming market, it is not the only one. For the user the popularity of its platform of choice is not an issue; often the overall user experience is improved by the variety of content available and better app integration which is where competitors such as Apple or Amazon might have the upper hand. The following are the other main players in the music streaming market, all offering slightly different priced packages and marginally differing user experience.

5.1 Tidal

Self titled 'High Fidelity Music Streaming' Tidal offers a free 30 day trial with a £9.99 monthly subscription fee thereafter. Tidal boasts over 70 million songs, hand picked playlists and videos and livestreams and allows users to import playlists from other streaming services. The main thing that sets Tidal apart from Spotify is its sound quality with use of a HiFi 1141kbps system. Awarded The Best Music Streaming Service 5 years running by What Hi-Fi, Tidal also pays out more in royalties to its artists at \$0.01284 per stream (Ditto 2020). The main disadvantage of the platform as listed by What Hi-Fi is the ability to find some masters tracks, with some being difficult to locate.

5.2 Apple Music

Currently holding 18% of the market share (Iqbal, 2021) Apple also offers over 70 million songs with an ad-free option. Users can download tracks to play offline, access exclusive playlists and have the ability to listen across all devices. Unlike the other competitors, Apple has three live radio stations and lyrics view for songs. With the monopoly on a lot of tech, Apple utilises its influence by offering the option to use apple music across all of its devices including the Apple watch and CarPly. The platform offers three different subscription levels, not dissimilar to those offered by Spotify: Student at £4.99, Individual £9.99 and Family at £14.99. With a pay-per-stream price of \$0.00783 (Ditto 2020), Apple is not the worst paying, but certainly has room for improvement. The main con to Apple Music is that it's user interface seems to be aimed specifically at Apple users, so limits itself in terms of accessibility.

5.3 Amazon Music

Amazon offers its users a free 30 day trial and a £7.99 monthly subscription fee thereafter with the option to cancel anytime. Users also have unlimited access to songs, ad free, unlimited skips and a variety of podcasts. Again, Amazon offers four options; individual, family, student and a single device plan which is specific to Amazon devices and only £3.99 a month - the cheapest out of all packages across all platforms. The pay per stream rate it offers to the artists on its catalogue is estimated at \$0.00402 per stream (Ditto 2020). The disadvantages to the Amazon platform is the lack of free tier, unreliable interface and smaller catalogue of music available.

5.4 Deezer

Deezer has a free tier and a premium tier with the chance to try free for 3 months. Its premium access is split into individual, HiFi and student which it offers at a 50% discount to the £9.99 individual package. The HiFi option costs £14.99 and offers the user high quality flac sound as well as the ability to play on google supported devices. Deezer also has the option of an annual subscription which affords the user with a 25% discount. It works similarly to other platforms in that it boasts a catalogue of over 73 million songs, access to playlists and the ability to listen offline. Its pay per stream is higher than that of Amazon and Apple at \$0.0064 (Ditto 2020). The downside to Deezer is that it's rivals offer a better 'discover' option.

5.5 Napster - \$0.019 per stream

Finally, Napster offers a free trial and high quality audio with a monthly subscription fee of £10. On it's website it name drops links with Warner, Sony and Universal and is one of the better paying streaming platforms paying out \$0.019 per stream (Ditto 2020) to its artists. Aside from the initial legal hiccoughs with Napster I found it difficult to find any disadvantages with the streaming service and the service it currently provides.

A quick SWOT analysis of Spotify shows us that it's strengths lie in the quantity of content, it's brand reputation and it's agreements with the major record labels. In comparison to its competitors its weaknesses are in the value it places on its pay per stream, the quality of sound offered and limitations within its business model. In terms of opportunities Spotify has scope to diversify its online services which could create additional revenue streams. With its already impressive network of contributors Spotify could continue to work on new

partnerships which could create issues for its competitors. The main threat to Spotify continues to be the risk posed by its competitors. Companies with a global presence such as Apple and Amazon already hold the market share in many other markets. Additionally, continued legal disputes surrounding copyright and royalty payments would cause a further increase in expenses and may have the potential to damage the companies reputation.

6. The Lean Business Model

6.1 Theory

Invented in 2011 by author Eric Ries, the Lean Start-up model was a new and radical approach to the standard business model. Instead of a long and complicated process which involves a great deal of forecasts, target markets and expenses, the Lean start-up is a one page document aimed at increasing the success of a business by providing opportunity to continuously test and change things during the creation of a new product or service. The lean start-up argues that you should put something out, even if it is unfinished, to gauge a reaction. The model operates on a simplified loop of build - measure - learn, allowing businesses owners to examine whether or not their idea is viable. It also provides opportunity for feedback to be gained from potential customers, as well as scope for things to be tweaked or changed. To test the businesses viability, they first need what is known as a Minimum Viable product or MVP. The company tests their MVP - otherwise known as the build aspect of the model - on their customer base, the feedback is then measured, and from here the company can learn from these findings. At this stage the model proposes that the business or company owner can choose to adapt, pivot or persevere before continuing with the

process again. Over the years there have been many companies which have used this model to build successful companies - Dropbox and Uber are some notable ones now each with a net worth of \$9.3 billion and \$3.2 billion respectively.

6.2 Negatives

The lean business model has been criticized by some for being harmful, placing too much emphasis on incremental improvements, rather than future goals (Mollick, 2019). Perhaps the most notable issues with the Lean business model are the ability to gain effective feedback. Selection bias can be prominent in situations where companies ask its customers for feedback, as individuals can be influenced in a number of ways. For example, gaining feedback online restricts those who are not computer literate, and surveys could be more often filled in following a bad experience rather than a pleasant one. But how is this relevant to lean?

As the entire concept of the lean startup is based around the three principles of building, measuring and learning, there is a great deal of emphasis on the element of measuring in order to know what to change or improve. The model discusses the idea of pivot or persevere when establishing if something is working or not, so there is a certain amount of pressure that it placed on a company to ensure that they are obtaining their feedback from a fair selection of customers. An interesting example of this is the Bocconi Trial of 2018, which looked at companies with a turnover of more than 2 million euros. The study found that of 171 companies that embraced the Lean start-up, 2.7% found that they had better return on invested capital and 3.6% reported their net financial position was better. This is in comparison to the 3614

companies trialled which didn't use the lean method. From the offset, these figures could be interpreted in favour of the model, but how true could the sample be if they were not selected at random? It is also worth noting that a sample cannot be considered true until a large amount of sample has been selected, and as a start up may not have means of reaching such a wide audience there susceptibility to inaccurate information could be high. However, any amount of feedback could be useful if implemented properly and evaluated critically.

6.3 Positives

The biggest risk to any start up is investing time and money into something which no one likes. Implementation of the Lean method and the use of an MVP removes a great deal of risk from the process. However, it does mean that companies miss out on the 'big launch'. Perhaps the most notable positive of the lean business model is the opportunity for those with limited or no funds to test the waters with their ideas before investing great deals of money. The theory is a simple one, and gives startups free reign to continuously develop their idea. It allows a company scope to start up a business with only part of an idea and scraps the conventional 10 page business model.

6.4 Applying Lean to Spotify

Over the years there have been many companies which have used this model to build successful companies - Dropbox and Uber are some notable ones now each with a net worth of \$9.3 billion and \$3.2 billion respectively. This is a principle Spotify applied upon its start up in 2006. The lean startup applies a simple methodology of a Minimum Value

Product (MVP) - otherwise known as the beginning of an idea - which is released to a customer base who can provide authentic feedback. In the case of Ek and Lorentzon their MVP was a desktop app with one core feature: music streaming. It wasn't until later on that they implemented features such as the pay monthly add free option, which bought them time to confirm that their idea would work. Initially tried between their friends and family there is some irony as a lot of the initial content in the early days was pirated material. However, the general consensus was that this was an idea which could work and, within 5 months of its official launch, Spotify had already gained an average monthly user count of 1 million (Loeb, 2017). As discussed earlier, the continued development of the service, starting first with a partnership with Facebook and soon following social interaction, shows more evidence of the development of the idea of Spotify based on customer feedback.

7. Summary

Spotify has long been considered a market leader in the streaming platform industry, providing a friendly user interface, reasonable subscription charges, and brokering deals with key players early on. The platform responded to the outbreak of COVID-19 by marketing its packages more openly and the growth in subscriber numbers could be a sign of this being a successful strategy. Though the company has great potential for growth by offering a wider range of services or continuing to develop on its partnerships whilst they continue to haemorrhage money further investment into this kind of expansion may not be wise during the current climate. In the digital age where ease of access continues to be a major selling point, and technology continues to develop at a

rapid pace, Spotify may well have had it's 15 minutes of fame as it struggles to keep up with its competitors. The question as to its longevity still stands: can an enterprise which has yet to turn a profit continue to function long term as a legitimate business?

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