



Spotify

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Abstract

This paper analyses how Spotify became the market leader in music streaming. Financially, the company has been supported by various external investors but really improved funding after their IPO. The research demonstrates how the company engages with their subscribers by constantly improving their customer experience. They do that by extensive R&D, creating personalised playlists, and adding more songs and podcasts to their library. The competitor analysis suggests that there is pressure in increasing subscription prices but also that Spotify offers more benefits such as better sound quality compared to other platforms that are dominating the market. The music streaming business has also been adopting techniques from the Lean Start-up method to test and improve their service. One way they are doing that is by assigning different new ideas to small teams globally that would develop and test new features, as well as tailor them if needed.

Table of Contents

Introduction	3
History	3
Finance	4
Short-Term Financing	4
Long-Term Financing	5
Investment Activities	6
Alternative Financing Method	6
Business Economics	6
Macro Environment	6
Political	7
Economic	7
Social	7
Technological	8
Legal	8
Environmental	8
Market Characteristics	8
Products, Pricing Strategy and Customer Base	10
Competitors	12
The Lean Business Model	16
Theory	16
Drawbacks of Lean Start-up	17
The Lean Start-up and Spotify	18
Conclusion	19
References	20

Introduction

This report is focused on the leading global music and podcast streaming service Spotify. It provides the reader with a brief historic outline of the company, as well as a review of its business structure and financial status. The micro and macro-economic environment of the music platform is then analysed, followed by a competitor analysis. The Lean Start-up model and its limitations are discussed, applying the framework to Spotify by suggesting how their operations could be improved.

History

Spotify was founded in 2006 by Daniel Ek and Martin Lorentzon in Stockholm, Sweden with the ambition to battle music piracy, which exponentially grew when the WWW (World Wide Web) was born. In an interview in 2010 for The Telegraph, Ek said that the only way to solve the piracy problem was to “create a service that was better than piracy and at the same time compensates the music industry” (Neate, 2010). The streaming service launched on October 7, 2008, while initially limiting the free sign-up to invite-only. The paid subscription option was made available as well, however, the company reported \$4.4 million loss in 2008. Spotify was first available in Scandinavia, the United Kingdom, France and Spain. In the UK, the free sign-up option was not available until 2009.

In 2009, Spotify launched on the Apple App Store escalating its growth, as it provided an online alternative to downloaded and pirated music. This was a big step in expanding their popularity and making the service more accessible. In 2011, the company received a \$100 million investment that was used for their launch on the US market. A key event was when Sean Parker, the co-founder of the file-sharing website Napster, joined the company to create valuable relationships with the major record labels. In 2012, Spotify was made available on Android smartphones, broadening their reach.

2015 was a year in which the business was rebranded as music videos and clips were added, improving the user experience to a more visual one. In April 2017, Spotify for Artists was launched. It is a platform for artists and managers giving access to tracks streaming data such as listeners demographics, as well as making it available to customise one’s artist page.

After negotiations in 2017, it was established that all new albums by artists signed to Universal Music Group will only be available to the premium users for the first two weeks after release. That way, regular users would be more likely to switch to the paid version.

Spotify had an initial public offering (IPO) on 3 April 2018 on the New York Stock Exchange and opened at \$165.90, which was more than 25 percent above its reference price. On 14 November 2018, Spotify announced a total of 13 new markets in the MENA region (Spotify, 2018). Today, the streaming service is available in 170 markets with, as recorded on 31 December 2020, 155 million subscribers (premium users) and 345 million monthly active users. Furthermore, the platform now has over 70 million songs and 2.2 million podcast titles in its catalogue (Spotify, 2021).

Over the years, Spotify has acquired 19 companies, the first one being the Swedish music discovery app Tunigo in 2013. Some of the more significant acquisitions are Preact (a service which assists companies to acquire and retain subscribers) in 2016; the blockchain startup Mediachain Labs in 2017 to help solve the attribution issue in music; in 2017, Niland – an AI startup to improve personalisation and recommendation; and Loudr in 2018 to facilitate the identification, tracking, and royalty payments to music publishers. Since 2019, Spotify have been buying podcast companies such as Parcast, Anchor, Gimlet Media and Megaphone (for \$235 million) with the ambition to grow in that area of podcasting.

Finance

Short-Term Financing

Spotify's major short-term financing is external investors. Over the years, they have raised a total of \$2.6 billion in funding over 21 rounds. When they received the \$100 million to support the US launch the company was valued at \$1 billion. In November 2012, funding lead by Goldman Sachs raised around \$100 million again, valuing the company at \$3 billion. In 2015, The Wall Street Journal announced Spotify was seeking \$400 million. In the end, the streaming business raised \$526 at a \$8.53 billion valuation (Crunchbase, 2021). The latest funding was on 8 January 2018 from a Corporate Round.

Initially, investors are a good method of gaining capital since “any company that can attract investors achieves the image of success” (Duff, 2021). Furthermore, they often provide contacts and financial advice, which could be beneficial to the company’s growth in the long run. The company is funded by a total of 49 investors, SharesPost Investment Management and EquityZen being the most recent ones (Crunchbase, 2021).

Long-Term Financing

Spotify has two types of long-term financing – from shareholders and on platform revenue from the Premium Subscription, as well as advertisers. In the fourth quarter of 2020, Spotify generated \$2.2 billion from the premium subscription and \$336 million from ads on the free version. Thus, demonstrating a 17 percent growth in total revenue compared to the previous year. The exponential growth of revenue over the years is illustrated on the graph below (Figure 1).

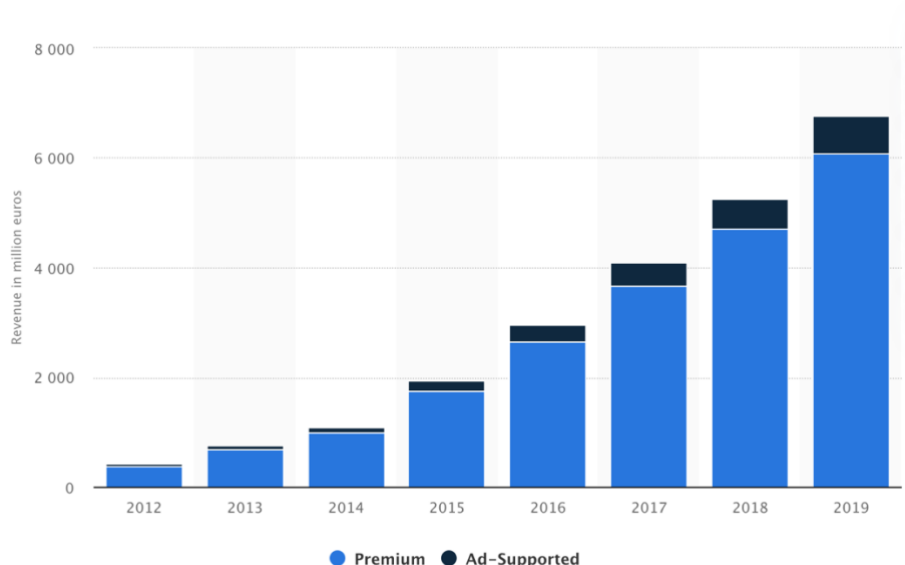


Figure 1. Spotify’s revenues from 2012 to 2019 by segment (Statista, 2021)

The other long-term financing method for Spotify is through the stock exchange. The current stock price fluctuates around \$280 (MarketWatch, 2021). Spotify has six top institutional shareholders that hold the majority of the shares at about 55-57% of total shares outstanding which are 189.59 million. The company’s market cap is about \$60.6 billion (YCharts, 2021). It is important to note that in 2020 the business had a net loss of

\$740.5 million and revenue of \$8.5 billion, demonstrating the tremendous costs Spotify have to take care of.

Investment Activities

When it comes to the business' investment activities, five investments have been made. The most recent one was on 10 March 2020 in Sounder.fm (a platform that facilitates the management, marketing and measurement of creators' audio content) raising \$1.8 million. The company has also invested in Artory (2019), Distrokid (2018), Tencent Music Entertainment (2017), and Soundtrack Your Brand (2015). Artory is a public registry for art and objects, utilising blockchain technology. Distrokid is an online music distributor, while Tencent Music Entertainment is the operator of music streaming and download services. Soundtrack Your Brand is a background music streaming service with curated soundtracks for business purposes. It could be observed that Spotify only invests in companies that are directly connected to their business. This way, the good performance of these corporations will directly benefit Spotify.

Alternative Financing Method

Spotify have already taken advantage of most of the major financing methods such as angel investors, venture capitalists, going on the stock market and directly gaining revenue from their service. One alternative way of financing is crowdfunding. This method, however, would be more effective for smaller businesses that are just starting out or do not offer a paid service. People would most likely not be willing to invest in such a large company without getting anything in return, hence probably why Spotify has not tried crowdfunding.

Business Economics

Macro Environment

The Macro Environment of Spotify is discussed by implementing a PESTLE analysis.

Political

A political challenge facing Spotify is the inability to join the Chinese market due to the strict government system in the country for foreign companies to enter. China is a compelling market due to the high population. This is why Spotify solved this problem by creating a joint venture with Tencent that develops music streaming for the Chinese Market. Since Spotify became available in India in 2019, they have been worried by the extensive piracy in the country. In a 2019 International Federation of the Phonographic Industry (IFPI)-Indian Music Industry (IMI) report, it was stated that piracy “makes up for 67% of the market – the global piracy average being 27%” (Economic Times, 2020). This conveys that the world’s largest markets based on population are restricting the growth of multinational companies due to their political regulations, or their inability to regulate their market.

Economic

A recent economic factor that could have damaged Spotify’s growth is COVID-19. However, despite the global economic crisis, the streaming platform saw growth in 2020. This demonstrates that while such services could be considered as non-essential items, consumers chose to invest their limited capital in entertainment. One could argue that by being the global leader and operating in a market that always has high demand, Spotify has a stable income stream.

Social

Spotify has the potential of becoming a leader in podcasting that would contribute to society. The fact that they have been investing in such companies shows that Spotify will allow podcasters all over the world to capture local topics and issues and attract more listeners.

Technological

There are two major technological developments affecting the company's operations – 5G and voice technology. 5G wireless technology provides “more reliability, network capacity, increased availability and a more uniform user experience” (Qualcomm, 2021). This is why 5G would facilitate everything from the user experience to the distribution of tracks and royalties, and the general company operations. Spotify has developed a technology that analyses the subscriber's voice and suggests songs based on “emotional state, gender, age or accent”. That way, they can play music based on “mood or even social setting – e.g. alone, small group, party” (Savage, 2021), showing that user privacy is a thing of the past.

Legal

Each country has different regulations that the company has to take into consideration and conform to. This is why Spotify has many offices worldwide and employees that are responsible for different regions. Royalty distribution and copyright are some of Spotify's biggest responsibilities from a financial and bureaucratic point of view that fall under the “legal” category. This is why well-functioning relationships with distributors and collection societies is important.

Environmental

Spotify's operations are solely technological, so there is no direct environmental waste like some businesses have from production or manufacturing. However, any waste should be reduced, and it is recommended that day-to-day operations adopt reusing and recycling.

Market Characteristics

Music streaming was born in 2005 when the streaming service Pandora was launched. It offered new music based on user listening history, inspiring services including Spotify. One could argue that streaming became reality when YouTube was launched in 2005. Today, more than fifteen years later, streaming is dominating the music industry. The global music industry saw a growth of 8.2 percent in 2019 due to the engagement with

streaming. This was the fifth consecutive year of international growth. Revenues increased in nine of the global top 10 markets. As stated in IFPI, the total value of the recording industry in 2019 was \$20.2 billion and digital revenues account for more than half of the recorded music market in 42 countries. Furthermore, it was discovered that \$5.8 billion is invested in A&R and marketing by record labels annually (IFPI, 2021). This shows that labels are relying on income streams such as music streaming and royalties generated on them to get a return on that investment.

There has been a 24.1 percent growth in paid streaming revenues in 2019 with a total of 341 million paid streaming accounts globally, demonstrating that the willingness to pay for a catalogue of music every month is spreading. The diagram below shows that 56.1 percent of the global industry revenue comes from streaming (Figure 2).

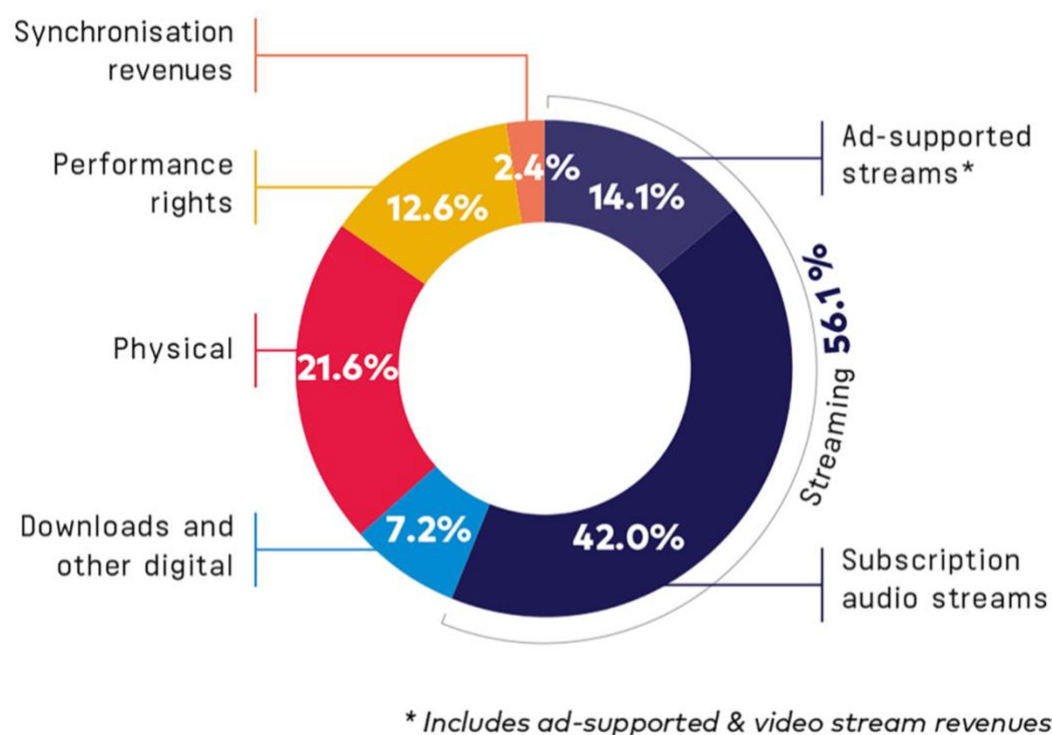


Figure 2. Global recorded music revenues by segment 2019 (IFPI)

An IFPI report published in September 2019 examined listener engagement across 21 of the world's biggest music markets. It was discovered that respondents spend 18 hours per week listening to music, which is the equivalent of 52 three-minute songs daily. 54 percent of them stated that they "love" music or are "fanatical" about it. It was also

discovered that older groups are now embracing streaming services. The highest growth rate in engagement is in the 35-64-year-old people, with 54 percent of them using a music streaming service in the past month when they were being interviewed.

One challenge still hovering over the music industry is copyright infringement. More than 27 percent of the respondents in the listener engagement report used unlicensed methods to listen to music. 23 percent used illegal stream ripping services, which is “the leading form of music piracy” (IFPI, 2019).

Products, Pricing Strategy and Customer Base

The products Spotify offer are musical works and podcasts to stream online or download for offline access available to the Premium Subscribers. Spotify’s customer base in 2020 was recorded to be 144 million premium subscribers in 92 countries worldwide of people of various ages and gender.

When it comes to the Premium Subscription, Spotify has four pricing strategies: ‘Individual, Duo, Family and Student. All four options offer a one-month free trial. However, the one-month free trial cannot be used if one has already tried Spotify Premium. The ‘Individual’ subscription is \$9.99 a month, where the customer can listen to ad-free music, play anywhere (including offline) and have access to on-demand playback (Spotify, 2021). The remaining three options offer the same as a basis. The ‘Duo’ offers two premium accounts for a couple under one roof and Duo Mix – a playlist for two, updated with tracks both would enjoy. It is priced at \$12.99 a month. The ‘Family’ option is priced at \$14.99 a month for six accounts living under one roof. This pack blocks explicit music, gives access to Spotify Kids, which is a separate app exclusively for children, and creates a Family Mix playlist. Finally, ‘Student’ is the cheapest option at \$4.99 giving access to an ad-supported Hulu plan and subscription to SHOWTIME (a CBS network).

Based on a survey of 7,458 US Spotify Free and Premium Members, the median willingness to pay (WTP) for Spotify customers is \$10.04, which is only \$0.05 from the actual individual subscription (Figure 3). The range for WTP, however, is much wider, as some are willing to pay \$5, others \$15 per month.



Figure 3. Overall Price Sensitivity (Profitwell)

The student plan may seem too cheap, but that demographic is much more prone to paying more compared to some of the older groups (Figure 4). This way, once students graduate, they would not mind paying the regular fee, as they would be used to Spotify. This is an example of acquisition and retention strategy. Whereas the group 26-35-year-olds would be willing to pay the least, as they are the generation that grew up with piracy and platforms such as Napster and Limewire. They are the only generation “unwilling to pay for music” (Campbell, 2018). Younger generations grew up with streaming services, older ones bought CD’s and vinyl, so the “illegally downloading” music generation could take the blame for why Spotify’s price is so low for a catalogue of over 50 million songs.

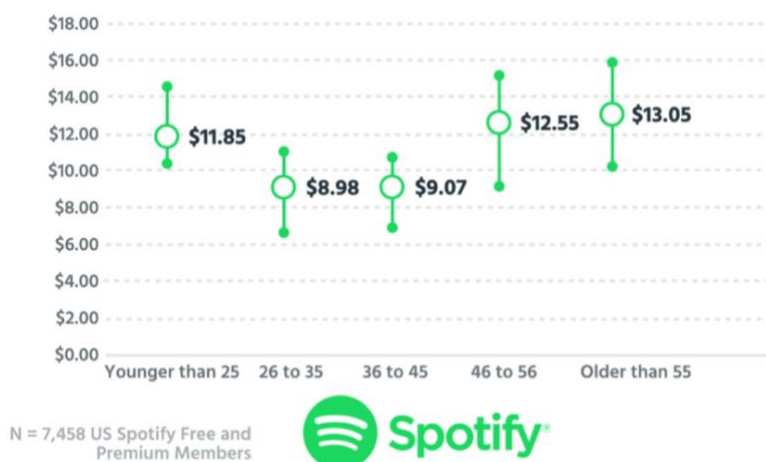


Figure 4. Price sensitivity by age (Profitwell)

It could be argued that Spotify is losing money on their Family Pack, because out of the sample survey it could be deduced that people are willing to pay 18.96 for a subscription for up to 5 users (Figure 5). The median WTP is \$4 above the current price, however Spotify is not raising the price. Their strategy is that the low price would bring people in, just like with the student plan again relying on acquisition and retention.

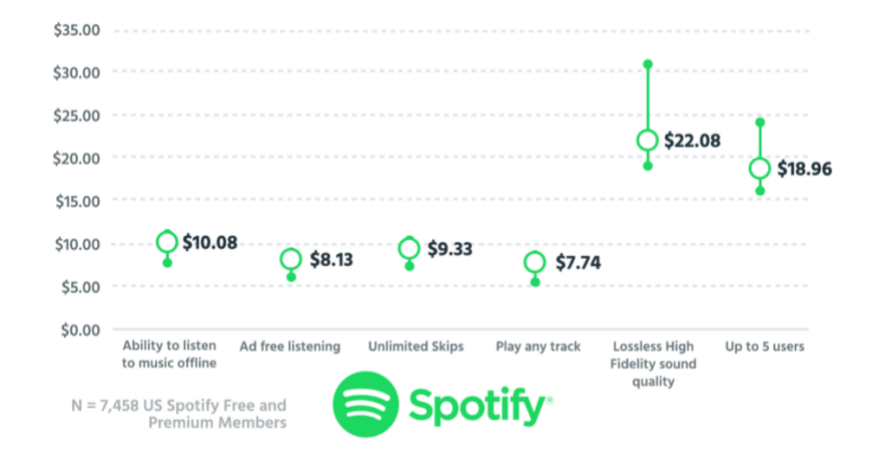


Figure 5. Price Sensitivity by Feature (Profitwell)

Spotify could experiment by offering a lossless sound quality option and raise the Family Pack prices to increase their monetisation.

Competitors

The Five Forces Analysis is a useful tool because it helps determine a firm's competitive environment, which in turn affects profitability (Table 1).

The intensity of rivalry in the music streaming industry is high because there are a lot of services on the market. There is pressure put with price because all are following the industry standard of \$9.99 a month, so platforms are equally as attractive to customers pricewise. However, the threat of new entrants is low. The reason is that currently the market is an oligopoly because there are a few main companies people are subscribing to. Innovation is difficult in the streaming market because most competitive advantages have already been explored. The threat of substitutes for Spotify is high because there are

numerous other businesses that offer the same service at the same price. This is why Spotify is focused on creating better playlists, improving personalised suggestions and popularising podcasts. The bargaining power of customers is low because the current subscription price is an industry standard. Even if the services decide to raise fees, listeners would be willing to pay because they are used to streaming music. The bargaining power of suppliers is high because major record labels determine the distribution of most popular artists' songs, so they are prone to having higher demands such as high placement on big playlists or larger royalty shares.

Table 1. Five Forces Analysis

	Related Factors	Assessment
Intensity of rivalry	- Competitive industry - Many music streaming services - 4 main competitors: Apple Music, Amazon Music, YouTube Music, Pandora based on subscriber count operating on a global level - Pressure put with price - No potential substantial competitive advantage	High
Threat of new entrants	- Rigid oligopoly - Not possible for new entrants without economies of scale - Not enough space for innovation of streaming services	Low
Threat of substitutes	- Multiple substitutes - Offering the same service, so having a competitive advantage to customers is difficult	High
Bargaining power of customers	- Streaming companies dictating the music market - The standard price is already accepted by users - They offer a service music fans need anyway, so customers have little to no bargaining power	Low
Bargaining power of suppliers	- Very high bargaining power from record labels due to having a larger cut of major artists' recordings	High

Spotify has numerous competitors, the top 10 being Apple Music, Amazon Music, YouTube Music, Google Play Music, Pandora, SoundCloud, Deezer, Napster, Tidal and Bandcamp. As of the first quarter of 2020, Spotify dominates the world's music streaming market with 30 percent, followed by Apple Music, Amazon Music, YouTube Music and

Pandora, all to be further discussed (Figure 6). Spotify has a catalogue of 70 million songs, more than 2.2 million podcasts and is available in 170 markets. Out of the five companies, Spotify has the highest bitrate of 320Kbps, demonstrating they offer the highest sound quality.

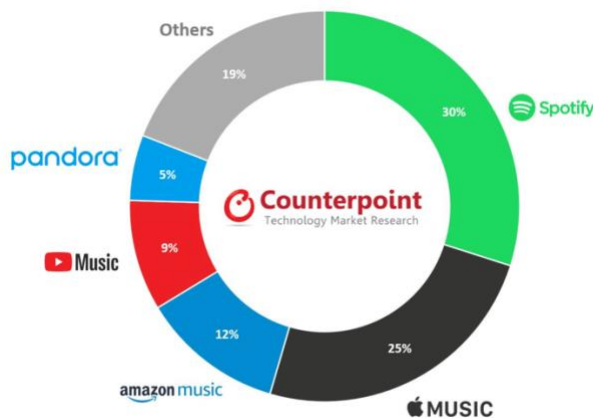


Figure 6. Global Music Streaming Revenue by Brand Share Q1 2020 (Counterpoint)

A competitor analysis illustrates the topics discussed below (Table 2).

Apple Music is Apple's music and video streaming platform created in 2015. The price for Apple Music is \$9.99 after a three-month free trial, whereas the family account of up to 5 people is \$14.99. This shows that the fee is the same as Spotify's, only the trial period is two months longer. Apple Music has the highest music library size of over 70 million songs but does not offer podcasts – they are placed on a platform. Apple Music is available in 167 countries covering almost as many territories as Spotify (Apple, 2021). For the listeners that pay attention to the sound quality, the maximum bitrate of Apple Music is 256Kbps.

Amazon Music was launched in 2007 by the American eCommerce company Amazon as an open beta edition with the name Amazon MP3. Then, in 2008, it became the first online music store. Amazon Music is \$9.99 for non-Prime members and \$7.99 for Prime customers. Amazon Music's library offers over 70 million songs and also has a podcast library. Amazon is available in 30 countries (Amazon, 2021) most of which European and

South American countries, Australia, the US, Canada, India and Japan. The maximum bitrate on the platform is 256Kbps.

YouTube Music was launched by Google's free video platform YouTube in 2015. On it, one can browse through both songs and music videos, creating lists and being given customised recommendations similar to Spotify. The service is part of the subscription income stream of YouTube that Google has been investing more in. The subscription for YouTube Music is \$9.99. Their library has over 40 million songs but also offers music videos, live show and fan uploaded media. YouTube Music is available in 100 countries and has a maximum bitrate of 256Kbps.

Pandora is a streaming service created in 2000 and acquired by the satellite radio platform SiriusXM for \$3,500 million in 2018, creating one of the largest audio entertainment groups in the world. They introduced the Music Genome Project where a song's essence is captured and classified based on the melody, harmony, instrumentation and rhythm. Pandora Premium is \$9.99, the Family plan is \$14.99 (allowing up to 6 accounts) and the Student plan is \$4.99. Pandora is only available in the United States. Out of the five services, it has the lowest maximum bitrate of 192Kbps.

Table 2. Competitor Analysis

Competitor	Overview	Key Success Factors				
		Price	Music Library Size	Podcast Library Size	Markets Available	Maximum Bitrate
Apple Music	- owned by the most valuable brand worldwide – Apple - 25% of streaming market share - 72 million subscribers	+	+++	n/a	+++	++
Amazon Music	- fastest growing music streaming service - 12% of global market share - 55 million subscribers	+	+++	++	++	++
YouTube Music	- 9% of global market share - part of Google's subscription source of income - over 30 million subscribers	+	++	n/a	+++	++

Pandora	- 5% of global market share - operates in the US only - introduced the Music Genome Project	+	+	++	+	+
Spotify		+	+++	+++	+++	+++

Overall, Spotify has a competitive advantage over the rest because they have the biggest podcast library and the highest bitrate. The only major plus Apple Music has is the three-month free trial. Amazon Music may be a platform of choice for the consumer if they already have a Prime membership because the fee would be \$2 dollars cheaper. YouTube Music offering music videos and concerts may be a preference for the more visual customers. So, in order to attract more listeners Spotify should be improving their library and making the platform more user-friendly. If they offer the best service, people would be willing to pay a little extra in the future.

The Lean Business Model

Theory

The Lean Start-up focuses on building and sustaining a successful business by “shortening the time it takes to get a product out of the market by experiments, testing and validated learning” (Ries, 2011). The framework was invented by Eric Ries and published in *The Lean Startup* in 2011.

A number of techniques for maximising success are discussed in the Lean Start-up method, including a minimum viable product (MVP), which means getting the most basic version of a product to the market to see if it works. In order to determine if the product is viable, a “build-measure-learn” continuous loop is used. “Build” refers to the MVP, the customer feedback is “measured”, and the findings help the business “learn” from the research and decide whether to adapt the product as it is, pivot or persevere (keep developing it) before doing the three-step loop again. It is argued the most important characteristic of The Lean Start-up is what Ries calls “the pivot”, which is the ability of a company to change direction and strategy on the go. Another technique is A/B testing, now

commonly used by online retailers. It focuses on offering different versions of a product are offered to customers at the same time to establish which one is best.

In the Harvard Business Review article “Why the Lean Start-Up Changes Everything”, author Steve Blank argues that business plans rarely survive first contact with customers, five-year forecasts are a waste of time, and start-ups are not smaller versions of large companies. He says, “the ones that succeed go quickly from failure to failure, all the while adapting, iterating on, and improving their initial ideas as they continually learn from customers” (Blank, 2013). This is why the Lean Start-up method is essential for companies that are starting out. That way, they would also be used to the method once they grow.

By adopting the Lean Start-up method, companies would not be limited by the high cost of retaining customers, the long technology development cycles, or getting the product wrong. Overall, Ries’ method allows companies to save money.

Drawbacks of Lean Start-up

Even though Lean Start-up is a useful method for company development, it presents a number of drawbacks. One of them is team demotivation. Revisiting the same product over and over again and not being fully satisfied can be discouraging (Tripathi, 2018). Some employees may blame themselves for the failure or not be excited for the product anymore. Furthermore, continuous innovation requires an intense work pace, which may be exhausting for some members of the team.

Another drawback is relying too much on customer feedback. While it is good to trust customers’ opinions, they might not always be right or in the company’s best interest. In a research done by Kullmar and Lallerstedt, one interviewee gives Spotify as an example of a firm that did not trust all negative customer feedback and continued with the same strategy (Kullmar & Lallerstedt, 2017). That way Spotify did not lose sight of the company’s original concept.

Finally, by exposing the product when it is not fully developed, a business may risk having their ideas stolen. In an interview with Wharton University, Andrea Contigiani says

that “in very uncertain markets when you choose the strategy of market experimentation, you really have to take into account how you can protect your invention” (Knowledge at Wharton, 2018). So, consulting customers may have to be discreet.

The Lean Start-up and Spotify

According to Henrik Kniberg, Spotify utilises a “4-stage iterative product cycle (Think It, Build It, Ship It, Tweak It), emphasising small teams referred to as ‘squads’ completing small amounts of work while producing a product” (Kniberg, 2012). ‘Think It’ stands for deciding of product and internally testing prototypes, ‘Build It’ is the stage where an MVP is ready for testing, ‘Ship It’ is releasing MVP to users while collecting data and improving, and ‘Tweak It’ is continuously tailoring product until it is revamped on shut down. This is why it is no surprise Spotify’s slogan is “think, build, deliver and adjust”, which is what the Lean Start-up method is based on (Spotify, 2021).

Spotify’s teams across all countries are responsible for various parts of the user experience and all rely on Lean principles such as MVP and validation of learning by using metrics and A/B tests to see what works and what does not. In a way, the one-month free trial of Spotify is an MVP, where the team could analyse the user data or run surveys to improve the individual experiences of customers. This is why they developed their most recent tool – the subscriber voice analysis technology. It would help them test and constantly improve a listener’s catalogue. This patent, however, is quite controversial because it invades the customer’s privacy, so Spotify may have to go back to basing their research on liked and saved songs, and what music the users are searching for.

It is advised that Spotify keeps on improving their R&D (Research & Development) split in the small regional teams across the globe. This would minimise risk because all markets are different, and it is better to invest in a few low-cost ideas rather than spending everything on one idea that may have to pivot. By working on various projects in different teams, they would improve their innovative thinking and also take advantage of the knowledge and resources of recently acquitted firms. Based on the music streaming industry metrics from 2020, Spotify really has to think of a way to attract more customers as

Apple Music is only 6 percent behind in dominating the global market (30% for Spotify and 25% for Apple Music).

Conclusion

There is no doubt that Spotify took a major role in the biggest event in the music industry in the past 20 years – streaming. It quickly became a market leader and is now experiencing pressure in remaining at the top. Spotify's economics are proving that they are aware of all external factors surrounding their business. Internally, they keep on innovating by improving user analysis and acquiring other music firms. The company's pricing strategy could be improved; however, they are experiencing pressure from competitors to not raise their subscription fees. Spotify may experience some pressure from government too to raise the payment to artists, so this might push the service to increase the monthly fee.

The company has been utilising Lean Start-up in the development of their business ever since the beginning of their business operations by assigning various projects to small teams in their different global offices. Thinking about the future, Spotify needs to find a strategy that would allow them to continue being the market leader and to turn the free membership subscribers into paying customers.

Word count: 4,843

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