

Economics Planning & Finance Report - EPF Report - Spotify

A brief history of the chosen organisation, including the major events of the organisation over the recent 5 years

Spotify was officially founded 13 years ago on the 23rd April 2006 in Stockholm Sweden by Daniel Ek and Martin Lorentzon.

The name was spawned from the combination of two words to Spot and identify. (Lang, 2014)

Spotify started as a small start-up in response to the heavy piracy issues the music industry was facing during this period and as a legal alternative to P2P music file sharing during the culmination of the Pirate Bay process in October 2008.

According to a report from the (Harvard Business School released on February 27, 2007 that analyses the state of the music industry in 2006.)

Spotify launched as a streaming service app in October 2008. Operating under a freemium business model where the basic services are free, while additional features are offered via paid subscription. Spotify is now one of the largest streaming company in the world. Spotify operations are handled through Google Cloud. Spotify generates revenues by selling premium streaming subscriptions to users and advertising placements to third parties.

In December 2013, the company launched a new website, "Spotify for Artists", that explained its business model and revenue data. Spotify gets its content from major record labels as well as independent artists and pays the copyright holders royalties for streaming their music.

The company pays 70% of its total revenue to rights holders. Spotify for Artists states that the company does not have a fixed per-play rate, instead considers factors such as the user's home country(example) and the individual artist's royalty rate (See table). The rights holders receive an average per-play pay-out between \$.006 and \$.0084.

Here is a 2016 Overview of the Top 5 Music Streamers + Amazon

Service	Avg. Pay per Stream	% of Market Volume	% of Market Revenue	"Premium" Subscription?
Spotify	\$.0044	63.0%	69.6%	\$9.99
iTunes	\$.0073	7.2%	13.4%	\$9.99
Google Play Music	\$.0068	2.4%	4.0%	\$9.99
YouTube	\$.0007	21.7%	3.8%	Ad Supported Only
Deezer	\$.0064	2.2%	3.5%	\$9.99
Amazon*	\$.0040	.6%	.6%	\$7.99

(Dabbs,2017)

Spotify offers an unlimited subscription package, close to the Open Music Model (OMM) estimated economic equilibrium for the recording industry. However, the incorporation of digital rights management (DRM) protection diverges from the OMM and competitors such as iTunes Store and Amazon Music that have dropped DRM.

Spotify encourages people to pay for music, with subscriptions as its main revenue source. The subscription removes advertisements and limits, and increases song bitrates to 128 to 320 kbit/s. For example, in Norway, the figure of 1.2 billion unauthorized song downloads in 2008 is compared to a figure of 210 million from 2012.

BBC Music (Ingham, 2019) wrote: "Unlike buying a CD or download, streaming is not a one-off payment. Hundreds of millions of streams of tracks are happening each and every day, which quickly multiplies the potential revenues on offer – and is a constant long-term source of income for artists".

Spotify originally acquired revenue through advertising, in hopes free subscribers would upgrade to the £9.99 a month ad-free subscription. But later on, Spotify's subscriptions service was launched to combat this.

Spotify was not made available to US users until July 2011. The delay was caused by long negotiations with four major record companies: Sony, EMI, Music Group and Universal. "Sony, Universal and Warner only allowed Spotify to Launch in the US once they struck deals that were incredibly favourable to them" All the major Record labels own equity in Spotify and had the option to cash out once Spotify a publicly listed company on the New York Stock Exchange in 2018.
(Herstand 2017)

According to the Biz Doc with (Ellsworth, 2017) "A case study for Entrepreneurs who claim that in 2017 Spotify we're closes to collapse they weren't making any profits. Venture capitalists were pulling out. In order to keep their head above water Spotify applied for and we're granted 1.5-Billion-dollar debt + Note and one of the terms of third funding was for Spotify to go public within year."

In 2016 Streams Officialy overtook sales

As of 1st March 2018 Spotify, has 159 million active users in 61 countries with a music library of over 35 million songs

Spotify Premium has cost subscribers \$9.99 per month since it launched in the US back in 2011.

From then to now, factoring in inflation, that same amount of money in real terms is worth just \$8.73 (or, to put it another way, \$9.99 in 2011 is now worth \$11.43).

As Spotify's ARPU rates continue to decline, pressure from rightsholders is being exerted on the company to consider raising its prices, but, so far, SPOT has resisted.

The firm's outgoing CFO, Barry McCarthy, infamously (and irritably) said last year that queries regarding a potential subscription price rise amounted to "one of the really dumb questions I get".

Recent MBW research, however, based on industry data, suggests that questions on this matter are actually anything but dumb.

Following a test price rise of 10% for Spotify Premium in Norway – launched in July 2018 – MBW found there hadn't been any subsequent slowdown in music streaming subscription uptake in the market.

Indeed, streaming revenues actually accelerated in Norway in the year that followed SPOT's price hike.

So it was interesting to hear Spotify CEO, Daniel Ek, directly address a question cantered on these price rises in SPOT's Q3 earnings call on October 28.

"Specifically related to the Nordic countries, we haven't yet – it's early days – we haven't yet seen any material impact in either gross adds or churn [from the price rise]."

Daniel Ek, speaking during SPOT's Q3 earnings call

He confirmed: "There are local nuances that happen such as... inflation and pricing, [or] tax related things, and sometimes it's even down to market maturity. And in those cases, you should expect us to accordingly adjust the [Spotify Premium] prices."

This is the important bit: Ek then added that, "specifically related to the Nordic countries, we haven't yet – it's early days – we haven't yet seen any material impact in either gross adds or churn [from the price rise]."

That sentence could be music to the ears of labels and publishers keen for Spotify to 'test' price rises in other parts of the world (especially if such a 'test', as with Norway, lasts over 16 months, with no sign of being reversed...).

Evidence, it appears, is mounting that the streaming music market could withstand a general raise in prices.

Another way streaming services can raise their prices, of course, is by layering on additional tools and services for customers – especially when it comes to those music fans with less mainstream tastes.

Amazon, for example, is trying this with its new \$15-per-month hi-def music streaming service, Amazon Music HD.

Now a new survey suggests there might be mileage in others, like Spotify, following suit.

Dutch-American classical music streaming service Primephonic commissioned YouGov PLC – a third party, professional research and consulting organization – to poll the views of 1,000 individuals who agreed to take part.

Field work was undertaken online between May 24-27, 2019 and June 10-11, 2019. The figures have been weighted and are representative of all US adults (aged 18+).

Respondents were asked if they would be prepared to pay more than the standard \$9.99 subscription fee for a service 'that truly meets their needs'.

More than half (52%) of currently paying subscribers answered yes, with some indicating that they'd even be prepared to hand over more than \$20 a month.

The survey also found that fans of specialist genres were more likely to pay extra for a service that specifically catered to their tastes, with two thirds of classical music fans stating that they'd pay more than \$9.99.

In the first quarter of 2016 sales of digital album digital albums dropped by 30.5%. In 2016 Spotify introduced a pre-save function to rival the pre-order function on physicals and downloads. The landscape of music consumption was changing. In an article on Billboard.com (Caulfield. K writes) "A Boogie wit Da Hoodie's – Hoodie SZN Album climbs to Number one on the Billboard 200. Released on Atlantic records the album earned 58,000 equivalent album units in the U.S week ending Jan. 10, 2019. According to Nielsen Music who collect the data for sales in the US market. Nearly all of that figure was driven by streaming activity.

Spotify ranked first among music streaming platforms in 2017, with 71.1 million subscribers. This represents nearly 36% of the global market (MIDI A). Although this music streaming service has increased both its ad-supported and premium subscribers over the first quarter of 2019, investors are still sceptical of its longevity. As an MRM study states, "[Spotify's] Q3 results suggest Spotify isn't growing quickly enough to stave off the rise of Apple Music" (MRM). Only time will tell if the company can maintain its position as the most popular music streaming platform.

Spotify has led the streaming world for a full decade. Customers find it far more convenient to have to the full music library streamed directly onto their device rather than deal with hassle and cost of purchasing downloads. Streaming has ultimately affected people's attitude to music consumption as it now feels more disposable than ever.

On a macro level artists all over the world complain about how little Spotify pays its artists per-stream in comparison to its competition

In early 2019, Spotify announced an operating profit of 94 million for the fourth quarter of 2018 with nearly 100 million subscribers

2008-2018 Spotify operated at a loss

According to the quarterly shareholders report. "In October 2018, we launched Spotify for Podcasters in beta, a platform that provides podcast creators with tools and data insights about audience demographics. Early adoption continues to gain momentum, as the number of podcast creators using the platform has nearly doubled in the first 6 months. More than 20,000 podcast teams are now using the platform on a monthly basis. Additionally, more than 50,000 shows have been submitted to Spotify through Spotify for Podcasters, enabling listeners around the world to discover new and unique content that suits their interests. Today there are more than 250,000 podcast titles available on our platform."

The Lean business model was created by the Japanese car manufacturer Toyota. The aim was to look at ways they could reduce time and energy costs trim the fat with the intention of saving money

Spotify could adopt a Lean Business model as they operate at a loss every single year (example) In theory if they didn't offer a Freemium service like their main competitors Apple Music and Amazon Music's if all the 248 million monthly users were paid subscribers instead of the 113 million paid subscribers to date. they currently have a Revenue 5.259 Billion Euros with a Net Income of -78 Million Euros according to (Annual Financial Report 2018 investors.spotify.com.)

Spotify is currently not profitable and just about stays afloat, with approximately 3,651 employees in over 20 locations around the world. I large chunk of Spotify's losses are on Licencing their extensive catalogue, paying royalties for streams and other company expenses.

Spotify need to explore ways in which they can transfer their free users on to paid customers and although finance is generated through advertisement. Paid subscriptions would make a significant boost to Spotify's revenue. One of the key suggestions is for Spotify to cancel their free service and run a subscription only service like their two main competitors Apple Music and Amazon music. Whilst studying the Apple and Amazon and how they have applied the Lean business model to turn over huge profits year after year consistently. Both Apple and Amazon built their streaming platforms off the back highly successful contributions to technology. Apple have the iPhone which currently has a net profit of 13.7 Billion Whereas Amazon has Amazon Prime which continues to take the world by storm turning over a net profit of 3,561 Million in 2019

Although in recent years Spotify has branched out and built partnerships with Uber, PlayStation Music, Ford, BMW, Mini, Starbucks and Spotify connect speakers and although these partnerships have potential to grow and become highly profitable Spotify have yet to see the financial benefits of these partnerships bring them out of the red.

Spotify could also look to an organisation such as Netflix who saved money on licencing by investing in and creating their own original content.

Netflix and Spotify both offer all-you-can binge content consumption for a flat monthly rate, but one analyst says investors shouldn't compare the two at face value.

"On-demand music services have many distinct differences from streaming video services like Netflix," Stifel analyst John Egbert said in a note to clients initiating coverage on Spotify Thursday.

"Streaming music is effectively a zero-sum game between competitors due to lack of differentiation in catalogues, with relatively little or no proprietary original content, whereas Netflix primarily differentiates through its original content offering and can peacefully co-exist with streaming video competitors because many households subscribe to multiple services."

Rapier, G. (2018, April 5)

Many investors have previously suggested that Spotify Mimic Netflix to quell its financial woes. Even though Spotify is the global market leader in paid music streaming, with 87 million paying subscribers as of Q3 2018, the Swedish service has yet to turn a profit — in

part because the company has to give away 70% to 80% of its revenue to music rights holders in any given quarter.

Shareholders seem to be reacting accordingly. As of January 9, 2019, Spotify's share price on the New York Stock Exchange was \$122.69—a 37.5% decline from its peak of \$196.28 in July 2018, and a 7% decline from its starting price of \$132.00 in April. Major industry investors like Warner Music Group, Sony Music Entertainment and independent trade body Merlin sold off most or all of their shares in the platform in 2018.

Hu, C. (2019, January 9)

So, Spotify has looked at the market and studied the analytics according to Spotify CEO Daniel Ek. The Average active Spotify listener takes in two and a half hours of content per day. The growth of the long play Podcast format in recent years has been a revelation in recent years the growth of the Podcast doubled between 2018 and 2019 this led to Spotify purchasing two podcast generating companies in Gimlet and Anchor deciding to invest in more original content in an attempt to keep Spotify's licencing costs down and prolong the future of Spotify. "The focus with Spotify has always been on Audio content investment thus in 2018 Spotify Launched Spotify for Podcasts. A platform where users can upload their podcasts direct to Spotify effectively cutting out any potential middlemen.

Over the years Spotify have tried so many different ways to get users to invest in the premium subscription including making exclusive deals with artists and labels to enable them to restrict certain albums to premium only for the first week of release as well as premium users get a superior sound

To its credit, Spotify has invested more in educational tools and experiences for artists than any of its mainstream rivals. Aside from outside acquisitions, the company's current initiatives under the Spotify for Artists umbrella span a regularly-updated blog, a multi-city, in-person workshop series (Co.Lab), a self-serve digital-ad tool and a network of recording studios.

But if Spotify's financial statements are any indication, all of these artist-facing elements are merely marketing and PR exercises to help drive the revenue stream that really matters for the company: consumer-facing subscriptions.

"Subscriptions are now taking up even larger pieces of Spotify's revenue and gross-profit pies compared to the same quarter last year, suggesting that the company's income sources are even less diversified than before."

According to its latest earnings report, Spotify made 90% of its revenue and 94% of its gross profit in Q3 2019 from paid subscriptions, with the minority remainder going to advertising. In fact, subscriptions are now taking up even larger pieces of Spotify's revenue and gross-profit pies compared to the same quarter last year, suggesting that the company's income sources are even less diversified than before.

Spotify declined to comment for this piece regarding whether Spotify for Artists and its adjacent services would eventually turn into a serious revenue stream for the company (even at the ~10% level of advertising), as opposed to remaining just a brand-building tool.

In any case, it's telling that Spotify for Artists tends not to get mentioned in the company's earnings reports beyond a few sentences — implying that, at least for Wall Street, it's not the star of the show.

If we follow the money, Spotify is first and foremost a consumer-facing subscription service, not a platform for artist marketing or development. But the streaming company's acquisition history over the past six years seems to insinuate a self-imposed attempt to change that narrative.

To date, Spotify has publicly announced the acquisition of 17 companies, which can be broken down into the following seven categories:

- Creator tools (Soundtrap in November 2017, Anchor in February 2019, SoundBetter in September 2019)
 - Podcast content and production (Gimlet Media in February 2019, Parcast in March 2019)
 - Music and media rights management (Mediachain in April 2017, Loudr in April 2018)
 - Social music experiences (Soundwave and Cord Project in January 2016, CrowdAlbum in April 2016)
 - Machine-learning for audio analysis and recommendation (Tunigo in May 2013, The Echo Nest in March 2014, Seed Scientific in June 2015, Sonalytic and MightyTV in March 2017, Niland in May 2017)
 - Other (Preact in November 2016)
- (Hu, 2019)

This list demonstrates how Spotify's competitive advantages have evolved over time along with the wider streaming landscape, leading to continually-shifting acquisition targets. For instance, Spotify's earliest acquisitions were focused mostly on acquiring machine-learning prowess, specifically around music analysis, curation and recommendation — which, with the exception of Pandora's Music Genome Project, were largely missing in a user-friendly, consumer-facing form in the early 2010s. But as multiple competitors subsequently bought out their own data-analysis and machine-learning talent (e.g. Apple Music and Asaii, Pandora and Next Big Sound), Spotify could no longer rely on that realm alone as its sole competitive advantage.

There was also a brief stint in 2016 when Spotify bought several startups focused on social music experiences, only to shut all of them down immediately upon acquisition. In fact, no social music experience has made it into Spotify's M&A portfolio since 2016, perhaps reflecting the wider challenges of monetizing a social music strategy (at least in Western markets).

Most of Spotify's acquisitions since 2017 have shifted away from social experiences and machine learning, and more towards rights management, creator tools and original podcast content — reflecting Spotify's ambitions to expand beyond music into podcasts and other audio formats.

Many commentators have argued that Spotify should focus its future acquisitions more on “artist-friendly” companies, in part to help mend its oft-tense relationship with musical creators.

For instance, in January 2019, Music Business Worldwide's Murray Stassen suggested that Spotify acquire more startups across personal hardware, music distribution and analytics, sync licensing, merch, ticketing and crowdfunding in order to serve artists more effectively. (His complete list of companies: Mighty Audio, Amuse, Songtradr, Awesome Merchandise, Dice, Instrumental and the now-shuttered PledgeMusic.)

Given Spotify's struggles to build distribution and monetization infrastructure for musicians in-house — e.g. its now-shuttered direct-upload tool — this line of thinking is somewhat in the right direction. In general, one of the main archetypal motivations underpinning corporate M&A is to bring in outside skills or tech at a lower cost than what could be accomplished in-house.

But this line of thinking is also incomplete because, again, Spotify is not in the business of marketing or developing artists. Its bread-and-butter comes from subscriptions.

And here is where the titular “fork in the road” comes in for Spotify's future.

Given the fact that Spotify is currently (i) a consumer-facing company, not an artist-facing one, and (ii) a general audio and podcasting company, not just a music one, the company would do well to draw a line in the sand and make a decision with respect to its future acquisitions.

Either Spotify owns up to its identity as a consumer-facing audio company, holds back on its artist-facing mission statement and doubles down on acquiring startups that will help build a superior consumer media product, particularly with respect to podcasts... or it takes its current mission statement seriously, puts its money where its mouth is and focuses more on acquiring tools that actually enable more artists to make a living through the platform, beyond trickling streams and ads.

Wall Street is pointing firmly in the former direction, which is much less risk averse as Spotify has already proved its prowess as a consumer tech company.

There are the obvious, Netflix-esque moves that Spotify should continue to make in this regard — i.e. acquiring more podcast production companies, and funding more original content.

Given that podcasts are a niche-friendly product, Spotify could also improve its prowess at serving niche rather than mass-market tastes by acquiring or investing in vertical-specific audio companies.

In fact, three investors at venture-capital firm Andreessen Horowitz wrote in a recent blog post that there is a significant opportunity for new entrants to the consumer-audio

landscape to created “verticalized” and “full-stack listening experiences” around specific verticals such as fiction, health/wellness and education.

By “full-stack,” they mean experiences that “combine original content around that particular vertical; user monetization mechanisms; and other value-added features that enhance the user experience and help users achieve their goals.”

(Incidentally, two of the examples the authors cite are the meditation apps Calm and Headspace — one of which is already releasing original content and remixes in direct collaboration with artists, and another of which already has an active bundle with Spotify.)

But beyond content alone, Spotify should also be looking into more start-ups like Preact that would help improve the service’s conversion rates from free to paid accounts.

While Spotify’s core business is in subscriptions, I was surprised to find in my research that no other acquisition the company has made aside from Preact reflects this business on the fundamental payment-model level. Payment and fintech start-ups could be especially important for Spotify in some more nascent markets across Asia and Africa, where the friction for paid music subscriptions in general is still relatively high.

“Spotify should be leaning even more into acquiring machine-learning talent for audio analysis, curation and recommendation than it was in the early days of its music-focused product.”

In addition, as a burgeoning podcast juggernaut, Spotify should be leaning even more into acquiring machine-learning talent for audio analysis, curation and recommendation than it was in the early days of its music-focused product.

Unlike with music, high-quality podcast recommendation is still such a wild-west territory that’s wide open for current market leaders like Spotify and Apple to claim as their own.

Natural language processing and voice analysis for podcasts — e.g. algorithmically curating episodes and shows based on similarities in their transcripts, or in the voices of their hosts and guests — is an especially hot terrain for machine-learning experts, and has already driven a handful of tech-specific acquisitions (e.g. podcast-editing tool Descript acquiring voice-synthesis tool Lyrebird).

Rights-management infrastructure for podcasts and non-musical audio is a similarly wild-west terrain at the moment in all respects, technologically, legally and commercially. In part because its future financial wellbeing depends heavily on licensing, Spotify would do well to acquire the equivalent of Loudr in the podcast industry, particularly to help manage the inevitable influx of illegal podcast spam on its platform.

If we go back to our original scenario, however, and assume that Spotify does want to take the artist-facing side of its mission statement seriously, a seemingly insurmountable conflict will emerge.

All kinds of creative professionals, including but not limited to musicians and podcasters, are nothing without their communities of supporters. But as has been argued previously, Spotify doesn’t need to have a community if it’s ultimately just a distribution utility. And its platform — virtually stripped of native social features and making 90% of its revenue

from a utilitarian use case — is in fundamental tension with the demands of sustainable, transparent community management and engagement.

To change this — and to actually enable a million artists to live off of their work — requires a dramatic shift in Spotify's financial structure from monetizing aggregation of content, to monetizing on the level of individuals and their direct relationships with their audiences.

Growing alongside the ongoing boom in podcast production is the demand for more effective, more direct audience-engagement tools. While Spotify hasn't touched a social-oriented music company since 2016, it may have to return to that world adjacently, by acquiring start-ups like Stationhead that are specializing in audio-centric community development (and, in Stationhead's case, it already integrates with Spotify's API anyways).

Acquiring more diverse monetization platforms will also be crucial for making Spotify's mission of "giving a million creative artists the opportunity to live off their art" not just more realistic, but also healthier for artists in the long run.

As David Turner wrote in the latest issue of his Penny Fractions newsletter: "Once Spotify starts seeing hundreds of millions of artists, it'd be hard to imagine them all being satisfied with only receiving a merger check for a few music streams. Even a modest 100,000 artists making a living off of a single platform would probably need a rather different set of features than what is offered now."

For podcasting, Anchor — which touts a direct advertising marketplace between brands and hosts, as well as direct donation and subscription capabilities between hosts and listeners — is a hopeful early sign of what this set of features could look like.

Other podcast apps that specialize in building new community and membership models for podcasters, including RadioPublic, Supercast and Glow.fm, could help round out Spotify's existing, barely-there suite of tools, mirroring the potential acquisition of the sync, merch and ticketing start-ups listed in Stassen's piece.

But again, there is an inherent conflict between strengthening the relationships of creative professionals with their audiences as a marketplace company and taking more aggressive ownership over that audience relationship as a media company.

Spotify's mission statement touts the power of both sides of the table in harmony, when in reality the service receives the bulk of its money from just one side and will arguably have to shapeshift into something almost unrecognizable to get to the other.

(Hu, 2019)

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