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MA Music Business

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1. Introduction

Different factors are existing within the micro as well as macro environment of a business, which directly affects its operations. Based on the factors within the business environment, companies need to adopt and apply business techniques and methods. In this report, there is going to be an in-depth analysis made on Spotify, the business providing digital music streaming services in different parts of the world. It will discuss and evaluate the micro and macro environment of Spotify while evaluating its financial position and products and services along with competitors. Depending on these findings, the report will be discussing on ways in which lean business techniques and methods could be applied in Spotify.

2. History of Spotify

Spotify is one of the most famous and popular music streaming subscription business having 320 million monthly active users throughout 92 markets and 144 million subscribers (newsroom.spotify.com, 2020). The company was launched in 2008 since when it has transformed listening to music forever. Spotify offers customers with the opportunity of discovering, managing and sharing more than 60 million music tracks inclusive of above 1.9 million podcast titles. Some of its tracks and podcasts are free while some of them need subscribers to upgrade to Spotify Premium. The company also allows customers to browse artists, celebrities, adding friends along with creating radio station and just sitting back (spotify.com, 2020). There have been several

expansions made in Spotify and launch of new services. For example, in 2016, it launched its biggest marketing campaign. In February 2017, Spotify announced a key expansion of its operations in the US to Lower Manhattan of the New York City, which led to the generation of 1000 new jobs on an average while retaining 832 existing job positions. On the other hand, in November 2018, Spotify expanded its operations to 13 new marketplaces inclusive of developing a new hub in the Arabic region.

3. Economics

The market

The industry of music is rapidly growing as well as evolving marketplace recording continuous changes because of new technological advancements. These advancements render the norms of the old market as obsolete while leaving the ones that cannot adapt behind. One of the best ways in which the changes occurring in the music industry can be evaluated and their effects can be analysed is via analysing the statistics of the global music industry. As per the Global Music Report of IFPI, during the year 2001, almost 100% of the revenues by the music industry were due to the physical sales of CDs and cassettes. However, in 2002, the RIAA (Recording Industry Association of America) recorded a fall of 8.9% in the sale of CDs along with revenues worth 6.7%. The period of rampant piracy recorded losses of 12.5 billion USD each year out of which 5 million USD was directly from the music industry (riaa.com, 2020).

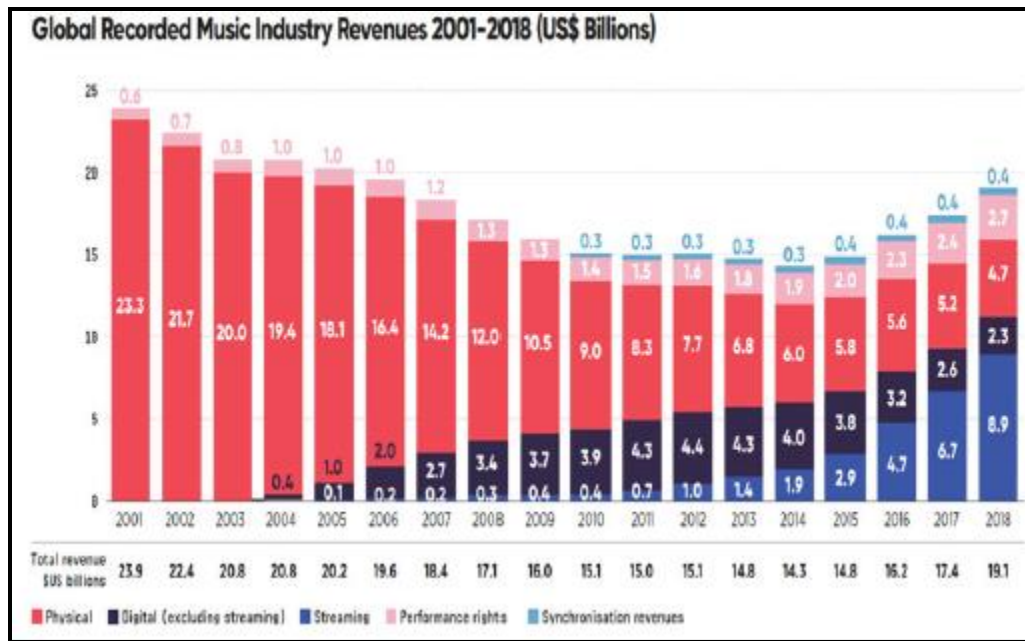


Figure 1: Revenues of the global music industry

(Source: Ingham, 2020)

The graph above also shows considerable losses in revenues from 2002 until 2014. This is because of the streaming services that Spotify, Pandora, Apple Music and others introduced. These new service-based ways of music consumption have however led to the development and growth of the music industry again. During the year 2019, the total revenues earned by the industry of global recorded music had an increase of 8.20% to 20.2 billion USD (ifpi.org, 2020). On the other hand, the revenues of music streaming increased by about 22.9% to 11.4 billion USD during 2019 (ifpi.org, 2020). This amount is about 56.1%, which is more than half of the revenues earned for global recorded music. In this context, ifpi.org (2020) further mentioned that such a growth of the global music industry is driven by an increase of 24.1% in the paid subscriptions for streaming music.

Contrastingly, Richter (2020) mentioned that as per the latest Global Music Report of IFPI, streaming acts as the driver of the resurgence of the global music industry. There are various economies, which are being benefitted from the music industry. For example, anticipations show that the music industry largely contributes to the wider UK economy, which spans sales of music and licensing to various stadium tours. These are likely to plummet to 3 billion USD in the

upcoming year. The GVA (Gross Value Added) if the UK music industry includes British music that is exported overseas, for example, tours. The graph below shows the revenues earned by the global music industry since 2001, reflecting the growth of the music industry as a whole -

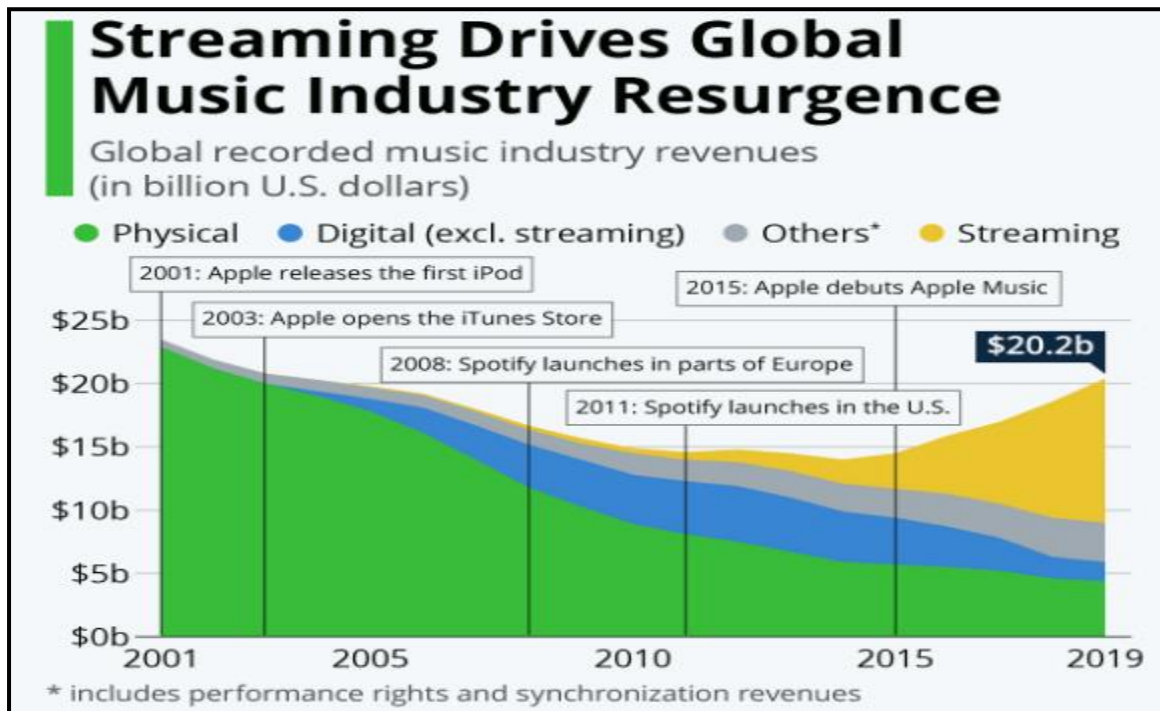


Figure 2: Globally recorded music industry revenues from various sources

(Source: Richter, 2020)

On the other hand, it can be identified that during 2012, the revenues of the global music industry was 45.5 billion USD, which has increased to 56.74 billion in USD (ifpi.org, 2020). Watson (2019) also mentioned that predictions reflect that this figure is likely to increase and cross 65 million USD by 2023.

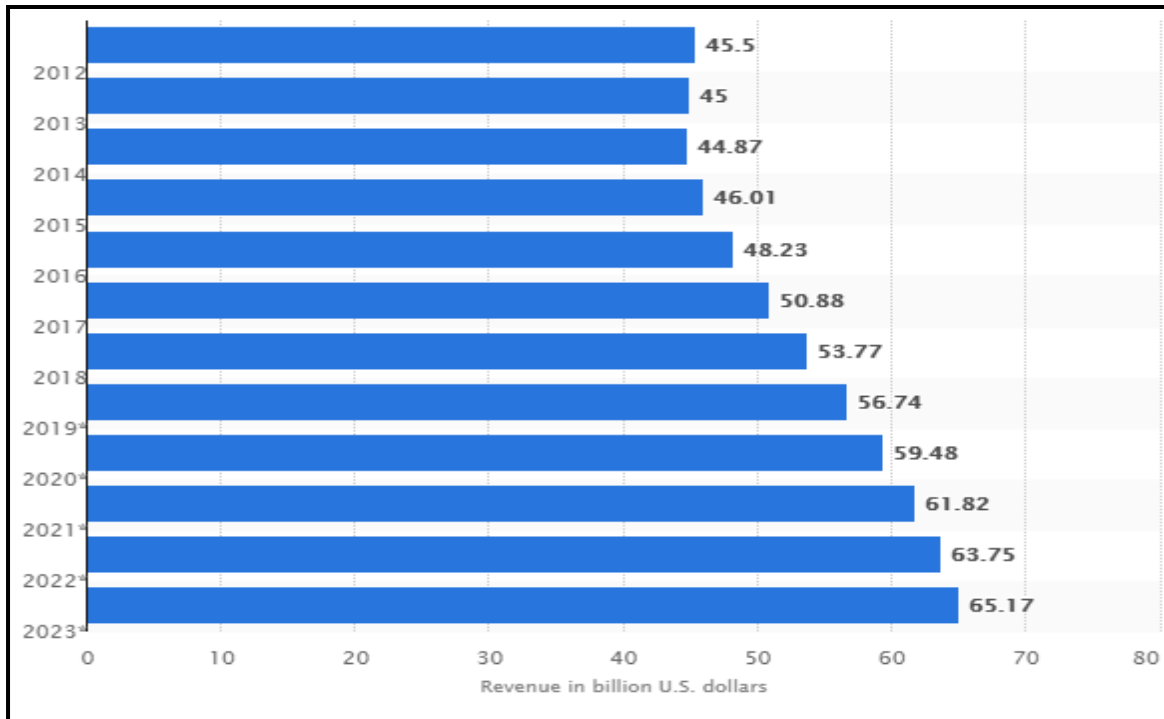


Figure 3: Forecast of revenues of the global music industry

(Source: Watson, 2019)

Macro and Micro environment

The business environment is of great significance when it comes to the operations and performance of a firm (Akhmetshin *et al.*, 2017). However, there are two different parts in which the business environment can be segregated and these include macro environment and microenvironment. The following is a detailed analysis of these two business environments of Spotify -

Analysis of Macro environment

Macro environment indicates the broader or overall economy of a country and the forces that affect it as a whole instead of a specific region or sector (Priporas *et al.*, 2019). The PESTLE is one of the best frameworks, which can be utilised to analyse the macro environment of a company, which identifies six major external environmental forces. Spotify's macro environment has been analysed below through the application of this framework -

Political forces - There is a range of political forces, which harm Spotify, as the company operates in various parts of the world. For instance, according to Chandler (2019), during 2018, Donald

Trump signed the MMA (Music Modernisation Act) for music copyright in the digital era. This was done for ensuring that people receive royalties despite the COR (Cost of Revenue) comprising predominantly of royalties on songs have gobbled up by 74.60% of total sales. Similarly, new laws and policies in various countries is a threat to the profitability of Spotify and can put in a vulnerable position in the future.

Economic forces - Economic forces negatively affecting the operations and performance of Spotify are considerable as well. One of the key economic forces negatively affecting the business is the global economic slowdown, mainly because of Covid-19, which is slackening consumers' spending over non-essential items. The poor economic outlook is reducing the willingness of consumers to subscribe to Spotify, which is predicated on reducing further in the future. This will not only reduce the sales but also the customer base and profitability of Spotify in the upcoming years.

Social forces - Social factors, however, have a positive effect on the operations and performance of Spotify. It is because the growth of smartphones can be seen in various countries across the world such as Germany, Ireland and the UK including developing nations such as China and India. Moreover, Spotify can cater to the needs of local people through the addition of local songs, options for changing language along with algorithms for recommending playlist. Social trends are also of specific interest since they directly affect how marketers of Spotify understand customers and developing services that can drive them.

Technological forces - Technological forces existing in the marketplace are considerable and the only negative effect they have on the performance of Spotify is through increasing the company's cost structure. However, Spotify has been successful in embracing technological advancements. This is being done as the business is going to introduce its smart speaker in the future, which might put Apple, Google and Amazon into a direct competitive rivalry. Increasing use of smart speakers is likely to increase the subscribers of Spotify, which can increase the company's revenues.

Legal forces - Legal forces also harm the performance of Spotify. It is because there are various legal forces in various countries, which are affecting the company's performance. For instance, Tabackman (2018) mentioned that for increasing tax revenues, Virginia and various other US states have decided on charging 5% taxes on streaming services. This will be compelling Spotify

to increase its subscription fees in the future, thereby threatening the company to lose customers and have low profitability. Various countries are noticed taxes as high as 6.35% in areas such as Texas and Connecticut on online streaming services, which are also hampering the profits of Spotify.

Environmental forces - Environmental forces do not have any negative effects on the performance and operations of Spotify. This is because the company is one of the main businesses across the world that evaluates the environmental influences of its operations. It follows the policy of reducing, reuse and recycle and is ranked as one of the worst sustainable companies by Greenpeace. Spotify has adopted the servers of Google, which is one of the highest sustainable organisations that is committed towards the usage of 100% renewable energy. As Spotify is an entirely online streaming business, the products or services of the company are not likely to be affected in the future because of climate change.

Analysis of microenvironment

The environment of a business, which consists of all the factors of its immediate environment that act as an influence over its performance, is called the microenvironment (Maqin and Hendri, 2017). SWOT is one of the main frameworks used for analysing a business's microenvironment. In the discussions below, the microenvironment of Spotify has been analysed with this framework -

Strengths

- Spotify has a library comprising of more than 60 million songs available on smartphones and modern devices.
- It offers music to customers free with advertisements while providing opportunities to listen to high-quality music without any cost.
- The business offers podcasts, songs as well as channels for users for listening to audio in their own liked way.
- Spotify has high brand equity and available in all major nations globally.
- It is available for both users for seeing insights and artists along with providing music personalisation and suggested feeds depending on user preferences via machine learning.

Weaknesses

- Spotify, in the present scenario, is conventionally operating on zero profitability with huge dependence on internet connectivity.
- The paid version of Spotify is often expensive for customers to subscribe.
- All features of the application of the business are similar to that of other applications that offer similar music and features.
- Considerable complexities exist related to the scheme of royalty payment, which makes it tough to forecast the amounts payable under license agreements.

Opportunities

- Spotify has the opportunity of producing its music through the usage of artificial intelligence and data in the future.
- It has opportunities for using the B2B model while forging partnerships with telecom or mobile companies.
- The business can enter into markets that have a high population density.
- It can also be exploring the option of video streaming services in the future by checking viability.

Threats

- The download of music and loyal players are a threat to music apps such as Spotify.
- Licensing and collaborating with various artists and music companies is a sensitive problem and can be influencing businesses drastically.
- Competition with established players such as Amazon and Apple is a key threat.
- Breach of security along with arduous pre-requisitions of licensing for getting artists on-board is a threat as well.

Competitor analysis

The business environment, apart from the forces identified above, also comprises of competitors. In the music industry, there are a large number of competitors of Spotify. According to Pessanha (2020), TIDAL, SoundCloud, Deezer, Pandora, Apple Music, iHeartRadio and Napster are the key competitors of the company. However, there are various other factors related to competitors in the market, which include the availability of substitutes. Porter's five forces framework is of great

benefits for the evaluation of the competitive position of a company. This framework is applied below for the competitor analysis of Spotify -

The threat of new entries in the market is low for Spotify. This is because, in reality, the set up of online music streaming business as big as Spotify is quite difficult. Most importantly, the acquiring tools, resources and other capital investments such as technological integration are huge.

The threat of existing competitive rivalry is high in the case of Spotify. This is because there are a large number of businesses providing online music streaming options to customers. Major examples of competitors of Spotify include TIDAL, SoundCloud, Deezer, Pandora, Apple Music, Google Play Music, Slacker, iHeartRadio and Napster.

Buyers' bargaining power is, however, moderate in case of Spotify is low since the switching costs of customers from one online music subscription to another one is often quite expensive. Even though Apple Music and several other companies offer the same monthly subscription, the yearly subscription charges of Spotify are offered to subscribers at a low price. This is often not found in other companies.

Suppliers' bargaining power is low in the case of Spotify. This is because, despite intense competition, the company has created "blue oceans", which are defensible and helpful for capturing market share as well as maintain a competitive edge. As Spotify is a key player in the music industry, suppliers are not willing to hamper or lose their relations with this music industry giant.

Threat from substitute products is high. This is because the numbers of competitors that provide customers with services of streaming music online are huge. There are several alternatives and substitutes that customers can avail whenever they feel like streaming online music.

Pricing Strategy

Pricing strategy refers to the method or model, which is utilised for establishing best prices of a good or service so that both shareholder value and profits can be maximised (Kienzler and Kowalkowski, 2017). Spotify has a strategic way of pricing its services. For example, there is a range of music tracks and other ways of music streaming, which it offers as free. Spotify has been one of the key dictators of the pricing done by various music service providers in the global market.

The company prices its subscriptions depending on the GDP, GNP and various such economic indicators of the country of its user. For example, the main market in which Spotify operates is the US. During 2019, the US economy secured a GDP of 21.44 trillion USD (Silver, 2020). On the other hand, the US economy had national income (NI) worth 21.43 trillion USD during 2019 (bea.gov, 2020). Since these indicators reflect the economic stability of the country, Spotify charges \$9.99 per month for adults and for students, the price is \$4.99 per month (Sraders, 2019).

The GVA of the UK music industry was about 5.8 billion pounds during the year 2019 (thecreativeindustries.co.uk, 2020). On the other hand, the GNP of the UK economy contributed by the music industry amounted to 5.2 billion pounds in 2018 (musiciansunion.org, 2020). Depending on the economic conditions of the UK, Spotify charges £9.99 per month from customers. However, as the economic conditions of countries such as India are poor, Spotify adopts various pricing strategies. For example, Mukherjee (2019) mentioned how Spotify offered a big price cut for a subscription for a limited timeframe. Thus, in these ways, the pricing strategy of Spotify changes depending on countries and their economic indicators, which affect customer purchasing power.

4. Finance and Revenue

Cash flow and financial statements

The financial statements provide considerable information regarding the changes in the financial performance of a company (Easton *et al.*, 2018). They also reflect the cash flows of a company. In case of Spotify, the financial statements of the organisation show that the revenues of the organisation have increased by 29% from 2018 to 2019 with an increase in the cost of sales by 29% as well (Spotify, 2019). An increase of 27% can also be noticed within the gross profit of the company. However, it can be determined that the company has ended up with net operating loss during both the years with an increase of 70% from 2018 to 2019. This has been because of the increasing operating expenses of Spotify such as research and development, general and administration expenses along with sales and marketing. However, such increasing expenses have led to a net loss of the company instead of net profit during both the years showing an increase of 138% (Spotify, 2019).

On the other hand, the balance sheet of the company shows that the company's total assets have increased by 18% with an increase of 38% in total liabilities (Spotify, 2019). This reflects a negative aspect of the company's financial performance. The total equity of Spotify has also decreased by 3% from 2018 to 2019. However, the cash flow statement of the company reflects that the cash and cash equivalents are increasing with each year, which has increased from 477 million Euros to 1065 million Euros in 2017 to 2019 (Spotify, 2019). Thus, it can be evaluated from this that the financial performance of Spotify is poor in terms of profitability and solvency due to net losses and high liabilities with decreasing equity. However, the cash flows of the company are increasing. Thus, all these reflect that the financial performance of Spotify is not good and is decreasing further.

Short-term financing

Short-term financing refers to the process of generating funds in a business context, which will be repaid or met in a short timeframe. In Spotify, as the company is earning losses in the past few years, short-term financing is a key area of financial back up and support for the company's expansion and stress reduction. The evaluation of the current liabilities of the company shows that Spotify's main financing source is trade credit. Trade payables of the organisation amounted 427 million Euros at the end of 2018 (Spotify, 2019). However, the amount of trade payables has increased by 28.57% to 549 million Euros at the end of 2019. This shows increasing dependence of the company over trade credit. The company also derives short-term finances through deferred revenues, derivative liabilities and accrued expenses. However, all these sources are non-cash financing sources.

Current structure of long-term financing

Long-term financing is the funds generated from financial instruments, which have the maturity of more than one year. In the context of Spotify, it can be identified that in term of long-term financing, debt financing, as well as equity financing, has been used. However, during 2018 as well as 2019, the company is more dependent on debt financing than equity financing. The total debts of Spotify during 2018 had amounted to 2242 million Euros (Spotify, 2019). This value shows an increase to 3085 million Euros during 2019, which shows an increasing reliance on the company over debt financing. Contrastingly, in terms of equity, it can be seen that Spotify had 2049 million Euros as equity during the year 2018 (Spotify, 2019).

However, this value has changed and decreased to 2034 million Euros during the year 2019. This is an indicator of more dependence on debt financing than equity financing. The capital structure of the company can be better understood from the calculation of the debt to equity ratio. Interpretation of the company's balance sheet shows that the debt to equity ratio of Spotify was 1.07 as at December 2018 (Spotify, 2019). However, this ratio has increased to 1.51 during the year 2019. Since the ratio does not exceed 2.0, it can be stated that the risks of the company are low. However, more of debt financing can lead the company towards major financial issues. Hence, this is the current structure of Spotify's long-term financing.

Recent major financing and investment activities

There are different financing and investment activities of Spotify. There are various investments for the company. SharesPost Investment Management and EquityZen are the two most recent companies in which Spotify has invested. It invested an amount of \$1.8 million in Sounder.fm during March 2020. The company also acquired various organisations, the most recent one being Megaphone that had a value of \$235 million (Spotify, 2020). Megaphone was acquired in November 2020. On the other hand, the major financing activities of Spotify include the issue of new shares, from which \$274 million Euros cash was received until September 2020 (Spotify, 2020). Other than this, various debts such as lease liabilities, deferred revenues and several others have been used.

Pros and cons of alternative ways of financing of the company

There are both pros and cons of the alternative ways used in Spotify for financing. As the company relies more on debt financing, the company enjoys the advantage of maintaining company ownership, availing tax deductions for interest payment while having greater flexibility and freedom. However, the cons of this way of financing in Spotify are that it requires the company to repay both the principal amount of loan and interest. Other cons of debt financing are that it negatively affects its credit rating while requires meeting the lenders' requirement of cash in hand. Contrastingly, equity financing provides Spotify with the advantage of no repayment and no financing costs along without any obligatory dividend payments required. However, equity financing does not provide the company with any tax shield, involves the high cost of funds, no advantage of leverage along with dilution of its ownership and control.

5. The product and services

Music

Music is the key product and service offered by Spotify to its customers. It gives access to customers for streaming through millions of songs and many other contents from artists worldwide. Spotify offers music of various genres and types, which include hard rock, indie pop, jazz and pop, techno, classical and folk. Besides this, it also provides music that includes waltz, heavy metal and any other fancy music people want to listen. The new version of the company's smartphone application allows customers to choose the sort of music they want to listen to. However, this choice is going to be limited to the music tracks, which have been selected within 15 discovery playlists on Spotify, which are entirely personalised.

Music Industry (royalties) VS Spotify

In the music industry, royalties can be described as the compensatory payments, which are received by the rights holders in exchange with the licensed usage of music. These right holders include recording artists, music composers, songwriters as well as each of their respective representatives. Music royalties are generated within the music industry through various sorts of usage and licensing. There are four key forms of royalties, which comprise of print music, public performance, mechanical and synchronisation. The entire music industry depends upon these royalties as a fundamental type of payment for its musicians.

Spotify also requires paying royalties since it operates within the music industry. Mechanical royalties are generated whenever one's songs are retransmitted, reproduced or re-broadcasted. Such royalties are collected by HFA from Spotify, based on which the money is paid to the publishers depending on the obligatory license. The money is then finally distributed to the songwriters. Digital royalties have increased largely during the recent past due to the enlargement of the size of the digital music industry. Spotify requires working closely with various other major labels for demanding a fair payment of royalties from social media channels such as this company when getting a license for their music.

Podcasts

Another effective product or service of Spotify is the podcasts. A podcast is a series of episodes, which are audio files stored with a podcast hosting business. The podcasts can be subscribed that

makes it easy for subscribers to be notified whenever new episodes come up. Spotify is one of the businesses, which is gaining the audiences quickly. It has been quite successful in the capture of podcast listening. As stated by Benton (2020), during January 2019, 20% of all the podcasts were downloaded from Spotify in Germany. The company has more than 299 million listeners throughout 92 different markets worldwide, which are waiting for discovery of podcasts. According to Spotify for Podcasters (2020), Spotify has been successful to double its podcast audience until 2019. The company has mentioned growing its catalogue of podcasts to above a million shows, which is more than 700000 podcasts reported during March 2020. Some of the best podcasts on Spotify include Listen to Giant, Listen to Son of a Hitman, Listen to You're Dead to Me, Listen to Soul Music and Listen to Crimetown.

6. Lean Business

What is Lean Business

The lean business can be defined as a process or model used in businesses across its value stream for the elimination of wastage along with the delivery of optimised value to customers (Balocco *et al.*, 2019). The method teaches one about driving a start-up by guiding it in terms of how it can be steered when it should turn and when it should persevere. It is one of the principled approaches towards the development of a new product. There are various principles of the lean business approach, which include entrepreneurs are everywhere as well as entrepreneurship is management. The other ones include validated learning, innovation accounting along with building, measuring and learning.

Critical analysis of lean

According to Caldera *et al.* (2017), there are various benefits of the lean business approach or method. For example, Goureeva and Lathia (2020) mentioned that the key benefit of lean is gaining efficiency within business processes, decreasing lead-time and improving the visibility of stakeholders. Besides this, it also includes the increase of team productivity and better management of changes in priorities. Contrastingly, Dalla (2020) mentioned that there are various limitations to this approach. For example, one of the key loopholes of the lean business approach is that they often have to go off course, follow metrics that are non-actionable while gaining validation from bias sources.

Also, entrepreneurs are easily mistaken because of changing their lean business ideas frequently that they turn out being disheartened. They are also noticed to reject good business ideas mistakenly because of being unsure about when should they stop testing. However, it must be remembered that higher validation is not essentially better since there exists no clear relation amongst validated hypothesis and success. It ends up reducing the confidence of workers and causes employee dissatisfaction. In this context, Seifullina *et al.* (2018) stated that lean business often results in equipment failure, which in turn leads to inconsistencies in delivery. This is yet another drawback of lean business.

Application of lean business techniques

The techniques of lean business can be effectively integrated within the context of Spotify. However, to do so, the business requires having a clearly defined strategy, which involves innovation as well as flexibility, the key principles of lean business. A key example of how lean business techniques can be utilised successfully in a large company can be identified through ***The Lean Start Up*** of Eric Ries (Bortolini *et al.*, 2018).



Figure 4: Lean business start up process

(Source: theleanstartup.com, 2020)

Before the application of lean business methods, Intuit, the financial software corporation worked on one of its key new initiatives each year with expected revenues of 50 million USD. After the application of lean, Intuit has admitted that it tested more than 500 changes throughout 2.5 months, which helped it in generating 50 million USD as revenues. Such huge revenues did not exist within the company even 12 months ago. Spotify could be adapting lean business technique and roll out new and efficient services fast through this sort of past-paced cycle testing. Moreover, the process of rolling out new services should be a tailored management process, which can be eliminating uncertainty. The company must be using the approach of working smarter instead of harder. Besides this, Spotify must also be developing an MVP (Minimum Viable Product) followed by adapting validated learning, which is a rigorous technique to demonstrate the progress of the new service. Thus, in this manner, the application of lean business techniques can be of great value to the customers of Spotify while minimising the risks of the company.

7. Impact of Covid-19 on Spotify

According to Donthu and Gustafsson (2020), there has been a great impact of the Covid-19 outbreak in businesses all over the world. Spotify is one of the biggest examples of organisations, which have been affected due to Covid-19. Despite having more users than ever, the organisation's advertisement revenues, as well as the premium average revenues per user (ARPU), have decreased. During the second quarter of 2020, Spotify recorded year-over-year losses of 21% in terms of its advertising revenues and 9% in terms of ARPU (Wang, 2020). During this period, the company recorded losses worth 419 million USD.

These decreasing financial figures are largely related to the impact of Covid-19 over normal operations. This is because the effect of Covid-19 on people's income has led to covering actual revenue from a subscriber of about \$5.17 per month, the standard rate being \$9.99 per month. The liabilities of Spotify have also increased from 3085 million USD from last quarter of 2019 to 3298 million USD in the third quarter of 2020 (Spotify, 2020). Thus, this shows that the performance of Spotify has been affected largely due to Covid-19. However, it must also be remembered that global lockdown and Covid-19 outbreak has increased the increase of music streaming of Spotify. There are various positive effects that the future can have on the performance of Spotify such as an increase in sales.

8. Summary and Critique

Thus, to summarise, it can be mentioned that Spotify is underlining financial trouble and instability in the current scenario. There are several political, economic and legal factors, which influence it negatively and are likely to affect it negatively in the future. Besides this, the weaknesses and threats of Spotify are considerable, which can however be overcome through exploiting opportunities and using strengths. The competitive rivalry in the music industry is considered as well. Moreover, the financial performance and capital structure of Spotify is poor and can deteriorate further in the future. Considering all these aspects, the report helped in concluding that application of lean business techniques is going to be an effective strategy for Spotify. It is a **good strategy** for the company. This is because the hypothesis shows that lean business can be of great value to the customers of Spotify while minimising its risks. However, it must be remembered that there are various drawbacks of lean business methods, which include equipment failure and employee dissatisfaction. Decisions on applying these techniques must be taken by considering their drawbacks.

9. Reflective Analysis

Reflective analysis performed on this report prepared on Spotify helps in understanding a large number of aspects. Firstly, reflection on the report helps me in reflecting on the things I could learn from it. For example, the first thing I could learn is the importance of analysing the macro and micro business environment of a company inclusive of the analysis of its competitors. In addition, another lesson I learned is that whenever any new business method is being recommended or any suggestion is being given to a company, the market must be analysed. It is essential to analyse the characteristics of the market in which a company operates, which helps in better understanding the trends that affect it. The evaluation of the pricing strategy of Spotify assisted me in analysing the significance of reviewing prices to understand the financial performance of a company.

In addition, the importance of measuring financial performance and analysing capital structure could be determined. Lastly, the significance of lean business methods in both start-ups and big organisations could be identified. Secondly, the reflection helps me in understanding that I have gained various skills from this report, which include time management, as I learned about task prioritisation and timely submission. The skills I could develop also involve numeracy skills that

I could develop due to the financial analysis done for Spotify. Similarly, I also developed research skills, as I had to conduct detailed research on Spotify, the music industry as well as lean business methods to recommend the company.

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