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Ben Morling

2016417

Economics, Planning & Finance

Report

Judith Shapiro

Introduction

This report will analyse the micro and macro environment of music streaming service Spotify. The assignment will explore the company's business structure, pricing strategy and financial standing. It will compare Spotify with its competitors on a global scale, reviewing the issues it faces and how they intend to retain their place as market leader amongst growing competition. Lean start-up concepts and application will be discussed in the context of Spotify, if and how it is used within the company and how the principles of lean could be applied to improve their business strategy.

A Short history of Spotify

Swedish company Spotify was founded in 2006 by Daniel Ek and Martin Lorentzon in response to a changing music landscape brought about by new technology, a decline in music sales and the rise of illegal file sharing platforms such as Napster. To tackle the piracy that was rife in the industry, Ek's idea was to offer a method of streaming that would appeal more to consumers than illegal file sharing. "I realised that you can never legislate away from piracy," he said in an interview with the Telegraph, *"Laws can definitely help, but it doesn't take away the problem. The only way to solve the problem was to create a service that was better than piracy and at the same time compensates the music industry – that gave us Spotify."* (Neate, 2008)

After launching in 2008 in Scandinavia, France, United Kingdom and Spain, Spotify's concept was met with initial resistance from major labels in key territories, who had seen a huge decline in consumer spending. These labels initially preferred to persevere with the then popular digital download model championed by iTunes (Auchard, 2018) rather than adopt a universal "unlimited access" approach that Spotify felt would help to combat the issue of piracy that was devastating the music industry. Spotify finally launched in the US in 2011 after securing deals with the 4 major labels at the time, Universal, Sony Music, Warner Music and EMI. The deals were widely reported to come with a number of concessions requested by the labels, including limiting free users to 10 hours streaming per month, and a cap of 5 listens per track. (Kiss, 2011)

Spotify quickly established itself as the market leader in the streaming sector, and its rapid expansion can be attributed to significant investment, financed by funding rounds that amounted to a reported \$1.06 billion in raised capital (Vroom, Boquet, 2019), and included investment from Napster founder Sean Parker, reported at \$15 million. (Ingham, 2017).

Spotify has often faced backlash from the music industry, from major labels to artists who argue that the streaming service doesn't remunerate musicians fairly, with high-profile artists such as Taylor Swift removing their music from the platform. Swift had argued that her art wasn't being valued enough (Swift, 2014), and it is a struggle Spotify has faced throughout its existence, culminating in the Commons inquiry into streaming economics that is currently taking place. Spotify has always strived to innovate and cement itself as the #1 in the market, at the cost of profitability. Spotify didn't record a net profit until Q3 2019, with the initial high cost of obtaining the rights to use music, coupled with paying around 65% of its revenue to labels (Dredge, 2015) and advertising costs, resulting in net losses. As a result, Spotify faces a constant balancing act of investing in order to maintain their position in the market and keeping artists and labels on the platform.

Macro environment

While reports of global music revenues for 2020 are still due to come in, the expected impact of COVID-19 was forecasted to see a 25% decline in music industry revenue, largely down to the disruption of live events, which was set to see its revenue fall by 75%. Recorded music saw a growth of 9.2% last year in the US, coming in at \$12.2 billion (RIAA, 2021). Entertainment services thrived during the pandemic, with on-demand video streaming platform Netflix adding 36 million subscribers through the year, seeing a 21% increase year-on-year (YoY). Social media video platforms such as Instagram and Tik-Tok also saw a huge increase in their user base, with 315 million new installs of the latter in Q1 last year (Jeffries, 2020). Exercising from home also saw a huge spike in lockdown, with recent data from Garmin fitness trackers suggesting that exercise increased substantially, and 31% adults reporting increasing their activity level (Ding, Cruz, Green, *et al*, 2020). The music industry and major labels have been quick to react to this adapting consumer behaviour and have struck a number of licensing deals with these platforms in response to the surge in use. Universal Music Group (UMG) recently signed a deal with Equinox Media to license their catalogue to their Variis digital fitness app, with the home fitness equipment market set to reach a value of \$23.2 billion by 2025 (Hale, 2021). Universal also recently signed a licensing deal with Tik-Tok to allow its users to include tracks from Universal's full catalogue, as major labels continue to turn to publishing and other digital revenue streams (Stassen, 2021) moving forward.

Goldman Sachs reports that the music industry venue will grow to \$80 billion by 2030 (Goldman Sachs, 2018). This will inevitably change in line with the developments of the music industry over the past 12 months due to COVID-19, although it is clear that the industry can't be reliant on touring as the main source of revenue as it has done in the past. Moves by labels, artists, and the industry on the whole would indicate a shift towards a more balanced approach when restrictions are eased, and while the inevitable dip in people's free time may see some decline in music consumption, more commuting and the slow return of live performance income will go some way to ensuring the music industry is able to recover. With regards to streaming's place in the ecosystem, that is something that is set to remain consistent and less affected by fluctuations in the economy. As Song Management company Hipgnosis' Founder Merck Mercuriadis put it; "If people are living their best lives, they're doing it to a soundtrack of songs...equally, if they're experiencing the sort of challenges we've experienced over the last six months, they're taking comfort and escaping in great songs, so music is always being consumed and it's always generating income." (Mercuriadis, 2020)

The Market

In 2019 the global streaming market was valued at \$20.9 billion and is expected to grow “at a compound annual growth rate (CAGR) of 17.8% from 2020 – 2027” (Grand View Research, 2020).

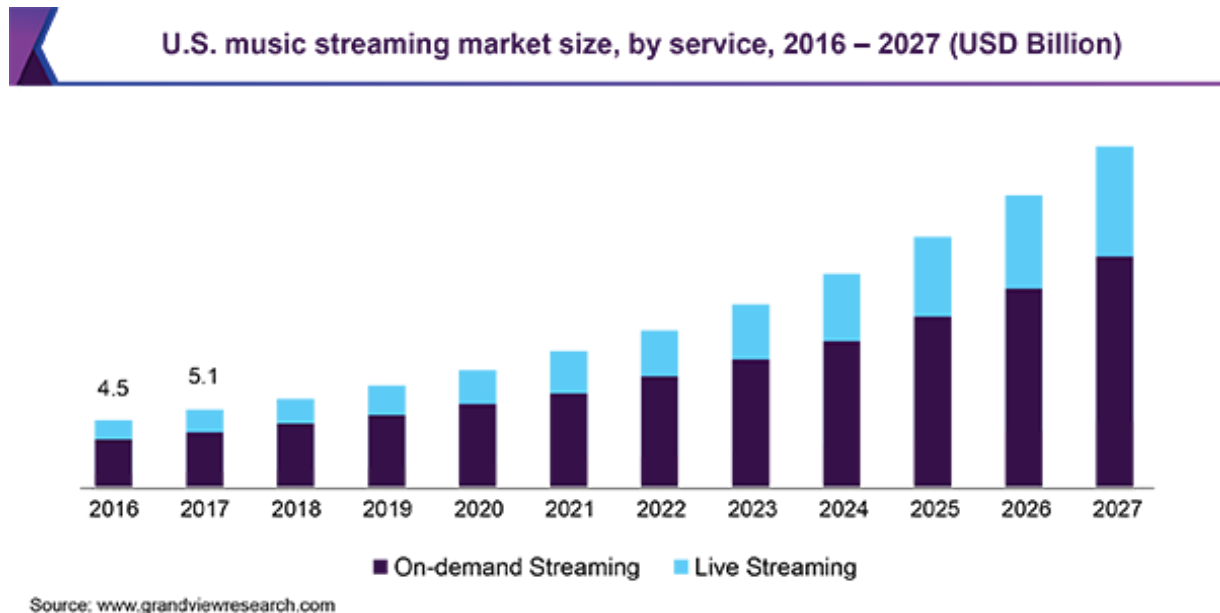


Figure 1. (Grand View Research, 2020)

During the COVID-19 pandemic, which saw the majority of the world placed into lockdown streaming numbers initially saw a downturn early into the outbreak, with streaming numbers on Spotify dropping by 11% in April, 6 weeks after the first lockdown measures were introduced, widely regarded as a result of less consumers streaming music on their commute to work due to working from home (Cooper, 2020), which was estimated to have seen as much as a 40% drop due to not travelling to work or using the car (Goldman Sachs, 2020). However, over the course of the year subscriptions to on-demand streaming services, such as Spotify and others, grew from \$60.4 million in 2019 to \$75.5 million last year, an increase of 25% (Steele, 2021). While this accounts for other on-demand entertainment subscription services like Netflix, music streaming accounted for 83% of US music industry revenue (RIAA, 2020), a huge increase from 56.1% in 2019 (IFPI, 2019), as Spotify maintained its position as market leader with 30% brand share during Q1 of last year (Kumar, 2020). The Gross Domestic Product (GDP) in the US shrank at an annual rate of 32.9% in Q2 2020 (Horsley, 2020), suggesting that subscriptions to streaming platforms such as Spotify have income elasticity of demand which is low. Chinese company Tencent also saw paying subscribers of its music streaming platform surge by 51.9% YoY to 47.1 million in Q2 of 2020, with music subscription revenues growing by 64.7% to \$186 million.

Spotify reported that independent artists and labels' market share on the platform grew from 28.3% in 2018 to 31.1% in 2020 (Mulligan, 2021). While this indicates a growth in the number of creators, and a slight shift away from major label domination on the platform, the sheer number of artists releasing music feeds one of the main issues Spotify has faced since its inception, fair remuneration to artists. Dawn Ostroff, Spotify's Chief Content Officer, stated in a recent Spotify 'On Stream' event that: "Over the last four years, the number of recording artists whose catalogs generated more than \$1 million a year [from Spotify] across recording and publishing is up over 82% to more than 800 artists," and, "[the] number generating more than \$100,000 a year? That's up 79% to more than 7,500 artists." While this may seem like impressive figures initially, given there are 8 million creators on the platform that equates to 0.094% making over \$100,000 per annum (Ingham, 2021). Spotify is

already tackling this, recently announcing the new Loud and Clear portal for increased transparency and data on the streaming economy. (Paine, 2021)

The issue of fair payment to artists is currently being discussed in UK parliament with the Economics of music streaming inquiry, looking at the business models streaming services employ and whether they need to pay more to artists (UK Parliament, 2021). This is a significant move, as it could affect Spotify's business strategy in order to pay artists more within their already slim profit margins.

An area of particular interest for streaming services is emerging markets, which is set to grow from 3% to 10% in the same time period (Goldman Sachs, 2018) and represents huge potential in markets that are seeing large growth, with Latin America seeing a 18.9% growth in 2019, and other territories such as South Korea (8.2%), China (16%) and India (18.7%) experiencing a large upturn. (IFPI, 2020). These emerging markets are expected to continue to grow, and streaming services will continue to look at capitalising on these markets.

Technology continues to see huge growth, with over 1.39 billion smartphones sold in 2020, slightly down on the previous year but increasing from 680 million units sold in 2012. This has stoked a rise in people streaming music on their devices, which was measured at 18% of people who owned a smartphone in developed markets in 2018 and is expected to rise to 37% by 2030. Smart speakers and other innovations have also informed the business strategies of streaming companies, and one of Spotify's issues is that, as a two-sided platform, they are under threat from other streaming platforms who are multi-sided, such as Amazon, and able to offer an Amazon subscription alongside other products, such as an Amazon Echo smart speaker or bundled with an Amazon Prime subscription (Towse, 2020). With an estimated 94 million people owning a smart speaker in 2021, this is up from 23% to 33% of the population. This percentage increases dramatically when measuring people working from home, with 49% reportedly owning a smart speaker (Edison Research, 2021). With the changing work environment as a result of COVID-19, and the real prospect of businesses moving a portion of their workforce to homeworking permanently, it is an area of concern for Spotify, who have to devise their own innovations in order to stay top of the market.

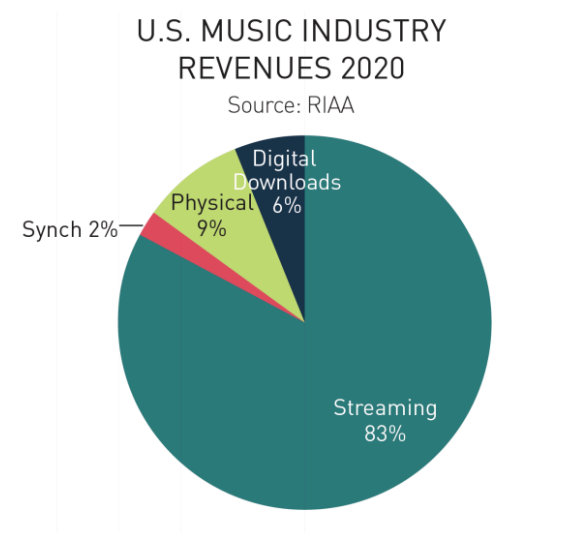


Figure 2. (RIAA, 2021)

Product and customer base

Spotify operates a freemium model which allows user to subscribe to a free account, giving them the ability to listen to music for free with limitations defined by-territory, and the addition of advertisements played between songs. Spotify also offer a premium service, which allows users to pay a monthly subscription to listen to unlimited music on the platform uninterrupted.

One way in which Spotify looks to maintain its position as market leader is by its unrivalled personalized recommendations. Spotify puts a lot of focus on the data it is able to generate from listeners habits, and the strength of its curated personalised playlists such as 'Discover Weekly' and 'Release Radar' have been a unique selling point that helps drive the platform with artists and consumers alike, and data is at the majority of all of Spotify's business moves. Spotify launched the Spotify For Artists backend platform in 2016, a tool that gives artists a detailed breakdown of their music's performance, any playlists it was being added to and streaming numbers by territory and even city. This has been used by artists and their management teams to help organise touring for areas where a track is performing particularly well. This invaluable tool strengthens Spotify's position with artists as it provides them with data they can utilise for other aspects of their careers. Spotify also allows artists to list tour dates and merchandise on their artist profile, encouraging artists to use and promote the platform.

In 2019, Spotify moved from music-only to adopt an audio-first business strategy, (Ek, 2019) recognising the shift in consumers' needs, a move aimed to tap into the growing podcasting market. The percentage of consumers in the UK who reportedly listened to a podcast weekly went up from 14% in 2019 to 18% last year. It would appear to be a shrewd move from Spotify, who invested heavily in podcasts in 2019, with acquisitions of Studio Gimlet and anchor for \$340 million (Russell, 2019) and bought the exclusive rights to shows such as The Joe Rogan Experience, which cost more than \$100 million (Steele, 2020). Spotify reported that its monthly active users (MAU's) grew 27% YoY in Q3 of 2020, and with a quarter of all users engaging in podcast content, it would seem that the investment into podcasting has contributed to that growth in MAU's. The podcast market is predicted to grow to \$1.1 billion in 2020, when you compare the market's expected 25-30% growth against overall media and entertainment's 4% growth (Deloitte, 2019), this is clearly a market seeing huge growth and fits within Spotify's audio-first focus.

In addition to podcasting, Spotify continually looks at way of implementing new consumption methods for its listeners and has recently announced a lossless hi-fi audio subscription model aimed at audiophiles. While they aren't the first to do this (TIDAL and Amazon Music currently offer this service) this move could be a direct response to the demographic of Spotify's current subscribers, with millennials aged 18-34 currently spending more of their annual budget on music than other age groups (Goldman Sachs, 2017). The move into lossless audio could be seen as a strategy to target a more mature audience with more disposable income, who may have the home monitoring/speaker setup to utilise the high-quality audio (McGlynn, 2021).

Spotify has introduced a number of features designed to strengthen the relationship between artist and fans. Spotify trialled a Stories feature, mimicking the popular Instagram Stories feature and enabling a select number of artists to release a short series of videos around a public playlist (Perez, 2020). Spotify also introduced an 'Artist Fundraising Pick' last year amidst the pandemic, allowing fans to donate directly to artists or a charity of their choice (Savage, 2020). By keeping all offerings within one app, Spotify maintains a focused costumer base that isn't spread across numerous platforms, unlike the majority of their competitors.

Spotify's customer base consists of free users and premium subscribers. As of 31st December 2020, Spotify has 155 million paid subscribers, and 345 million MAU's (Spotify, 2020). Spotify's average revenue per user (ARPU) fell by 8% in Q4 2020 a move that has been attributed to its expansion into emerging markets, where Spotify has offered discounted prices to entice new subscribers, as well as a higher proportion of free users (Steele, 2021).

Pricing strategy

Spotify's free tier drives revenue through advertising, and the company argues that a free option is necessary to get people into the funnel that leads to paid subscription. In the uncertain economic times brought about as a result of COVID-19, this freemium model allows Spotify to adapt better and offer a flexible subscriber model that allows subscribers to stay within the platform even if their circumstances have changed.

"We have a freemium model, you start out being free on our platform and eventually people move into being paid users – more than 60% of them," he said. "This is a great thing in an uncertain economic environment like this one, because if you're feeling economic pain, you can easily go back down to the free service, then back up to the Premium service when you have the means to do so. We think that's going to be a very strong competitive driver in an uncertain environment." (Ek, 2020)

Spotify's basic premium plan has been \$9.99 since it launched in 2018. With inflation taken into account, as of 2019 the price for a subscription would have risen to \$13.36 (Mulligan, 2019). Spotify has been reluctant to increase its prices in line with inflation, placed in a classic prisoner's dilemma due to the other streaming similar offerings and price points. Unlike Netflix in the TV and film space, who have more bargaining power due to a number of exclusive titles and content only available on the platform, Spotify has to contend with offering a similar product to its competitors, as well as risking pushing subscribers to return to piracy if they increased their prices or priced too highly in the emerging markets they have entered. (Vroom, Boquet, 2019).

OTHER STREAMING SERVICES

SPOTIFY	No price change	Decrease price
	All streaming services - Demand constant All streaming services – revenue constant	Spotify – demand decreases Other streaming services – increase demand increases
Decrease price	Spotify – demand increases Other streaming services – demand decreases	All streaming services - demand remains consistent All streaming services - revenue decreases

Figure 3. Spotify's prisoners dilemma

The prisoner's dilemma, one of the concepts of game theory, also restricts Spotify from reducing prices and undercutting its competitors due to the similar nature of the service provided. Figure 3 (above) shows that if Spotify were to decrease their prices, their demand is likely to increase, while the other streaming services demand would decrease. However, if all streaming services were to decrease their prices, they would all receive a decrease in revenue as prices would have fallen while demand stayed the same.

Spotify uses price discrimination to inform its pricing strategy by market. For emerging markets Spotify typically charges less in order to remain affordable to prospective subscribers. Spotify launched Premium Mini in December 2020 in India, allowing for daily (\$0.10) and weekly (\$0.34) subscriptions. This may seem extremely cheap to more affluent countries but given that the average per capita income is \$533 a month as of 2019, "relative to average income it is 9.3 times more expensive than \$9.99 is in the US" (Mulligan, 2019). This is a smart move by Spotify and shows a market-specific flexibility that aims to make Spotify available and affordable to all.

Spotify also employs price discrimination in other ways, such as offering the new lossless audio service for higher earning subscribers. While the pricing for this has yet to be announced, it is guaranteed to be a higher subscription cost than its basic premium plan, likely to be in line with Amazon (\$14.99) and TIDAL's (\$19.99 Hi-fi options). Spotify also offers a student subscription priced at £4.99 per month (p/m) and a family plan for £14.99 p/m, highlighting their widespread application of price discrimination.

Spotify argue that a free option is necessary to get people into the funnel that leads to paid subscription, however this isn't necessarily the case, as advertising time is a lot less per hour than other traditional media. The roughly 2:1 ratio of free-to-paid subscribers suggests that ads don't interrupt the Spotify experience enough to cause a user to switch to premium. Further, latest figures released 3rd February show that advertising spend had outperformed the forecast, with a revenue of \$281 million highlighting an upturn after an initial dip at the start of the pandemic. This would indicate that Spotify's free account advertising revenue is a lot more volatile and exposed to external factors influencing market changes.

Spotify has begun testing price increases in select countries and has seen "no meaningful impacts to churn or customer intake in these markets" (Stassen, 2021). This would suggest that the price elasticity of demand for Spotify is low, although this would need to be tested further in other markets who may not behave the same and is also difficult to predict with the unpredictable nature of the economy due to COVID-19.

Spotify has also offered bundled subscriptions with a number of other companies. One such example is Headspace, which offers a £14.99 joint subscription to both services. While Spotify is a two-sided company, this approach enables it to branch out and offer its platform alongside external companies who offer a different service, operating in a similar fashion to multi-sided streaming service.

Major competitors

Spotify has long been the market leader in the music streaming market. However, innovation by its competitors, a rapidly changing market accelerated by COVID-19 and evolving consumer habits have resulted in Spotify's competition gaining market share over the past year. As a result, "Spotify's market share of the global streaming music subscription market fell from 36% in the first half of 2018 to 32% in Q2 20. Over the same time, Amazon Music, YouTube Music, and Tencent Music have all gained market share." (Trainer, 2020) Spotify has since slightly recovered, reporting a percentage point increase of 2 in Q2 (Kumar, 2020)

Global Music Streaming Paid Subscriptions by Brand Share (In %) – Q2 2020

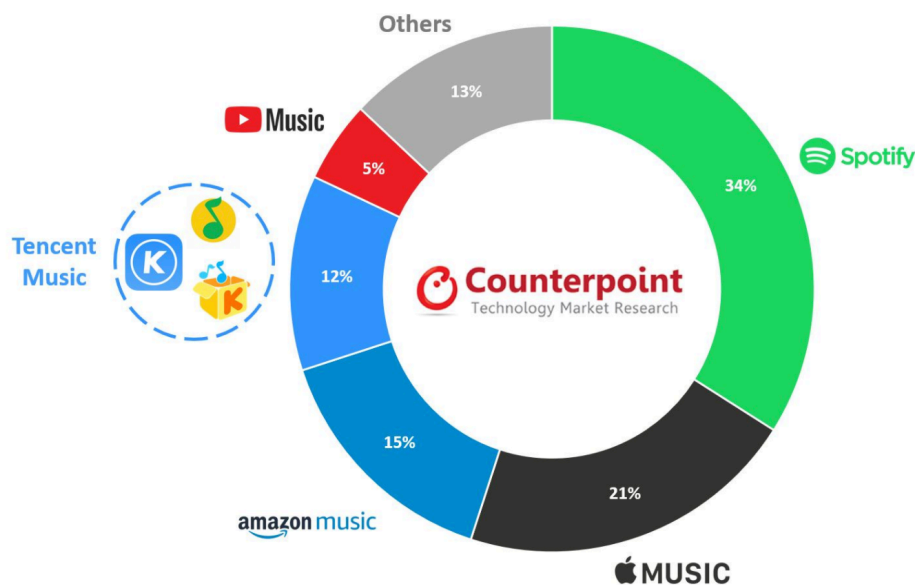


Figure 4. (Kumar, 2020)

Apple Music

Apple Music maintains its position as Spotify's biggest competitor, at 21% (see fig. 3), although it has also seen its market share dwindle over recent times. Apple Music launched in 2015 to directly compete with a variety of similar companies that offered the three-pronged approach Apple Music's platform would offer, music streaming, radio through its Beats 1 platform and Apple Connect (Dredge, 2015). Since then, Connect has been shut down due to lack of use (Welch, 2018) and Beats 1 was rebranded to Apple Music 1 last year to better align with the Apple Music brand, as streaming services adapt to streamline their offerings.

It was reported in September 2020 that Apple Music converted paid users 2.5x faster than Spotify in the US (Smith, 2020). However, Spotify still maintained a healthy lead in terms of paid subscribers, with 144 million compared to Apple's 60 million, although a lot of that was due to offering cut-price subscriptions in new markets. (Lovejoy, 2020) With the exclusive acquisition of podcasts such as the hugely popular Joe Rogan experience, many believe Spotify will push Apple into reacting and driving their own Apple Podcast platform forward, and the arrival of new podcasts such as long-time Apple Music affiliate Zane Lowe's The Zane Lowe Interview Series, it appears that would be Apple Music's next move (Quah, 2020)

Amazon Music

While Spotify and Apple Music have fought it out for the top spots in the music streaming market, Amazon has been able to swiftly gain momentum due to the huge network of interchangeable products and services the company offers. Amazon as a company have experienced huge growth in 2020 due to the pandemic and people turning to online shopping. Sales for Q3 2020 were \$96.1 billion, up 37% YoY (Wakabayashi, Weise, Nicas and Isaac, 2020) and this push towards the platform has led to impressive growth for Amazon Music, which saw its subscriptions more than double (104%) YoY in Q1 2020, while it's revenue share was at 12% for that period. That market share further increased to 15% during Q2 (Counter Point Research, 2020), highlighting the streaming service's growth.

With the pandemic also seeing a huge growth in the use of smart speakers, Amazon's penetration in the market with their Echo smart speaker, (which is the market leader as of Q4 2019 (see fig. 4)), has contributed to their growth in market share. Integrating Amazon Music as the default music streaming service on the device offers a simple funnel to convert people who may otherwise have not been exposed to the streaming service. As a result, Amazon has been able to gain a market share in demographics where Spotify has typically struggled with, with Amazon Music's vice president Steve Boom telling *FT* that "14% of Prime Music subscribers are aged 55 and older, while that demographic only accounts for 5% of Spotify subscribers." (Kelley, 2019)

Global Smart Speaker Market by Vendor: Q4 2019 (Shipments in Millions of Units)					
Vendor	Q4 2019 Shipments	Q4 2019 Market Share	Q4 2018 Shipments	Q4 2018 Market Share	Growth Y/Y
Amazon	15.8	28.3%	13.7	35.5%	16%
Google	13.9	24.9%	11.5	30.0%	20%
Baidu	5.9	10.6%	2.2	5.7%	171%
Alibaba	5.5	9.8%	2.8	7.3%	94%
Xiaomi	4.7	8.4%	1.8	4.5%	167%
Apple	2.6	4.7%	1.6	4.1%	65%
Others	7.4	13.3%	5.0	13.0%	49%
Total	55.7	100.0%	38.5	100.0%	44.7%

Source: Strategy Analytics Smart Speaker and Screens service

Figure 5. (Strategy Analytics, 2019)

TIDAL

TIDAL is a late entry in the streaming market, launched in 2015 by artist Jay-Z with the backing of superstars such as Kanye West, Beyoncé, Deadmau5 and Jack Black. The service was pushed as an artist-owned music platform aiming to "preserve the value of music" (Iyengar, 2015). TIDAL was the first streaming platform to offer lossless audio, at an increased monthly subscription cost of \$19.99, alongside its premium subscription price of \$9.99.

It is widely regarded that TIDAL's initial launch was a failure, in 2018 the company reported losing approximately \$37 million and 100,000 subscribers (Silva, 2020). With a model that relies solely on premium subscriptions, which accounted for 97.7% of revenue (the remaining revenue was made up of sponsorship), TIDAL has suffered from not diversifying and offering potential subscribers a cheaper point of entry into the service.

TIDAL recently announced it had been acquired by Twitter co-founder Jack Dorsey's Square cryptocurrency payment business. While this may seem like a strange coalition, the team up could help to realise Jay-Z's vision of putting more power into artists hands. As micropayments and Non-fungible tokens (NFT's) and digital artwork

have been predicted to transform the music industry, Perhaps TIDAL will gain the first mover advantage of integrating this within the platform (Brown, 2021).

Pandora Music

Pandora was one of the first to move into the music streaming space. Launched in 2000, Pandora began as an online music streaming platform, with radio style programming that utilised its Music Genome Project (Waniata and Kennemer, 2021). Pandora performed so well that it was bought by Sirius XM in 2019, merging Sirius' curated and exclusive content and programming with Pandora's highly personalised free ad-supported service, with Sirius XM expected to reach more than 100 million people as a result of its acquisition (Aswad, 2019)

Pandora offers three tiers of subscription, Free Pandora, Pandora Plus and Pandora Premium. Pandora Free offers an ad-supported radio service, with a limited amount of control over music played based upon liking (giving thumbs up) songs played by the platform. Pandora Plus gives user the radio station service without ads for \$4.99 p/m, while premium offers users the ability to access music offline, and the ability to search for and play songs on-demand, at a cost of \$9.99 p/m (Pandora, 2021).

Pandora's strengths for premium customers are similar to Spotify's, with heavy investment in personalised playlists and recommendations that are detailed to a granular level. As well as providing song recommendations based on over 450 attributes, Pandora also auto-populates personal playlists after a user has added a few songs (Laffey, 2020) as part of its Pandora Premium subscription, which sets it apart from Spotify, who only give recommendations.

Finance

SUMMARY USER AND FINANCIAL METRICS					
	Q4 2019	Q3 2020	Q4 2020	% Change	
USERS (M)				Y/Y	Q/Q
Total Monthly Active Users ("MAUs")	271	320	345	27%	8%
Premium Subscribers	124	144	155	24%	7%
Ad-Supported MAUs	153	185	199	30%	8%
FINANCIALS (€M)					
Premium	1,638	1,790	1,887	15%	5%
Ad-Supported	217	185	281	29%	52%
Total Revenue	1,855	1,975	2,168	17%	10%
Gross Profit	474	489	575	21%	18%
Gross Margin	25.6%	24.8%	26.5%	--	--
Operating Income/(Loss)	(77)	(40)	(69)	--	--
Operating Margin	(4.1%)	(2.0%)	(3.2%)	--	--
Net cash flows from operating activities	203	122	107	(47%)	(12%)
Free Cash Flow¹	169	103	74	(56%)	(28%)

Figure 6. (Business Wire, 2021)

Spotify posted their financial results for the fourth fiscal quarter 2020 in February 2021 (fig. 5), and while their total revenue has increased YoY from \$1,855 million to \$2,168 million, they made operating losses of \$69 million. This is slightly less than the company lost in Q4 2019 but given that they increased their monthly active users (MAU), premium subscribers and ad supported MAU's substantially (27, 24 and 30% respectively), the relatively high operating losses and low cash flow is a result of the growth-focused approach Spotify has long adopted.

Executives recently said they would continue to give priority to growth, gaining new subscribers and investing into podcasts (Steele, 2020). Daniel Ek has previously stated that they would eventually “get to more of a point of maturity where we’ll focus more on profit over growth, but for the next few years it’s going to be predominantly growth” (Ingham, 2020)

Their falling ARPU isn’t necessarily a negative either, as they offer discounted prices to try and entice new subscribers in emerging markets, and the total revenue increase and huge growth in subscribers suggests that Spotify is succeeded in their stated short term aims of growth over profit. As Spotify moves away from being a monopoly and more into being an oligopoly, the consideration of bargaining comes more into the equation, and so a Porters Five Forces analysis would be appropriate to review Spotify’s position amongst growing competition and a changing market.

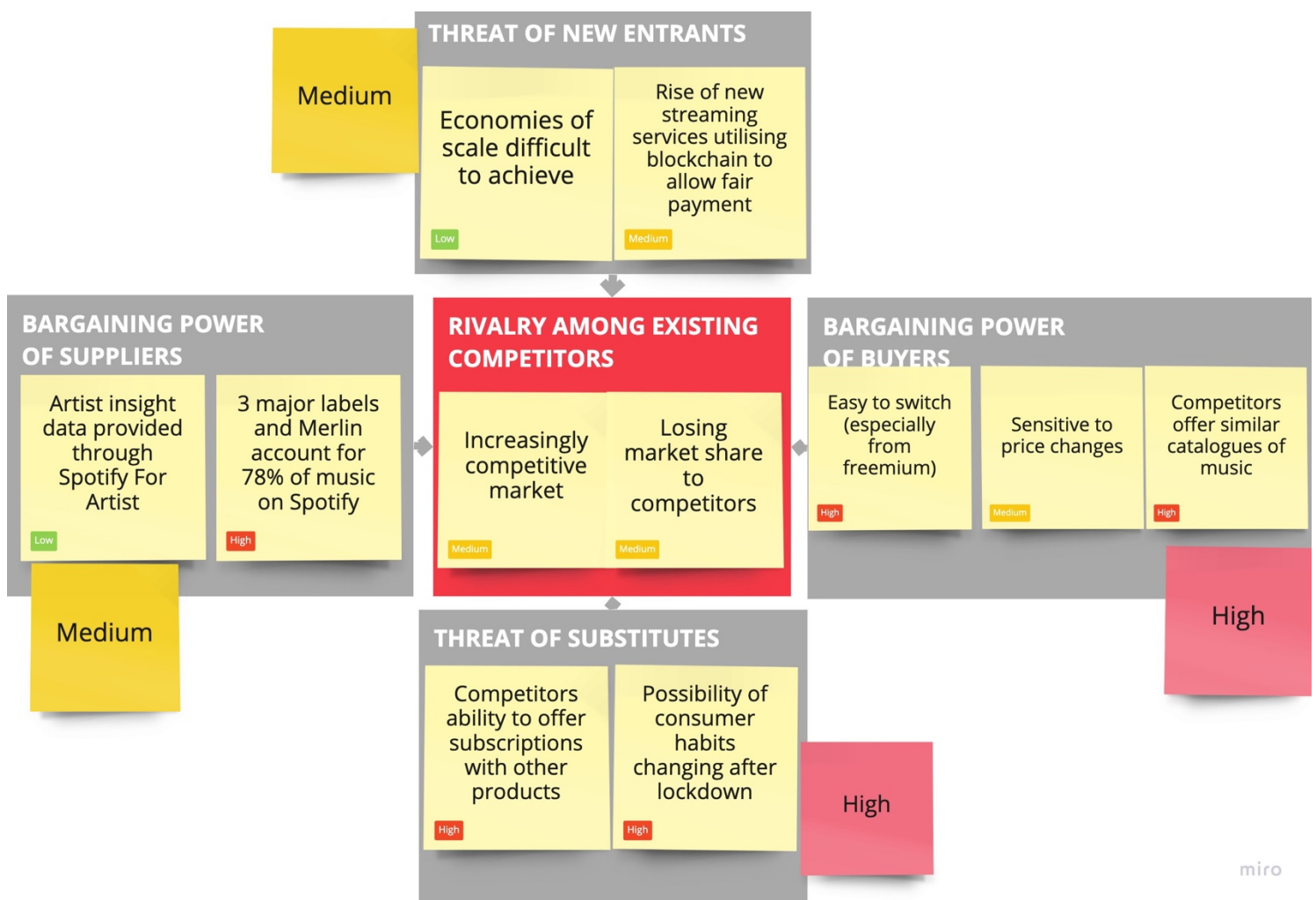


Figure 7. Spotify Porters 5 forces analysis

Lean business

Definition

The concept of Lean Startup businesses was coined by Eric Ries in 2008, and later published in his book 'The Lean Startup' in 2011. The idea behind the Lean method is that, in theory, it is a "cheap, quick and less risky strategy to take your business idea to market" (McKay, 2016). The method used to achieve this involves businesses testing hypotheses while creating their product and launching a 'Minimum Viable Product' (MVP) to test the feasibility of the product, built around a build-measure-learn feedback loop.

The lean startup philosophy advocates efficient use of resources by introducing a minimum viable product to the market as soon as possible in order to test its value and the entrepreneur's growth projections (Moogk, 2012).

This continuous loop of feedback allows businesses to persevere with the idea they have, or pivot to adapt the idea or change the concept completely. Steve Blank, one of the early adopters of Lean business ideas, suggested the best method for businesses looking to utilise Lean business methods was to sketch out a business model canvas, rather than write a detailed business plan, and an example of a Spotify canvas can be found in figure 8.

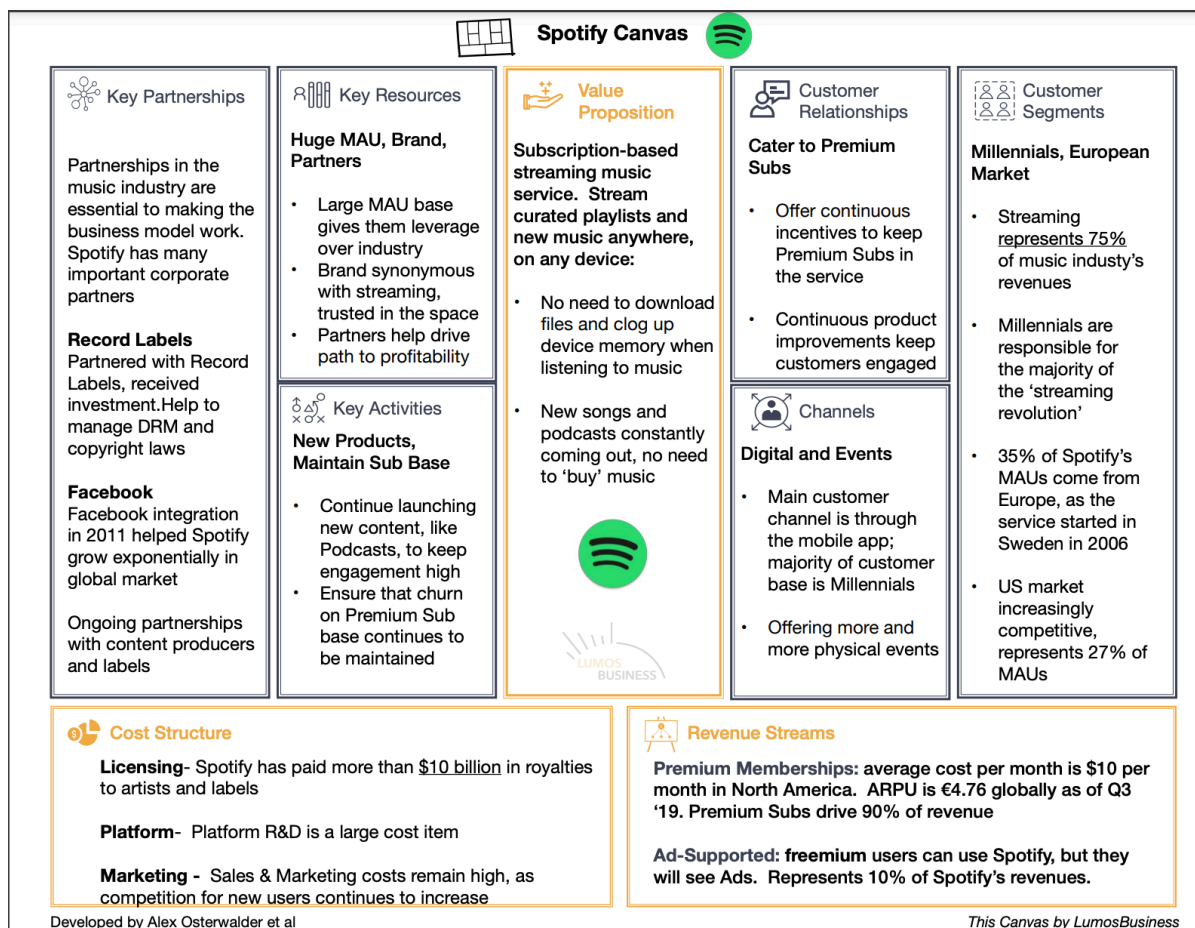


Figure 8. Spotify business model canvas

Criticisms of Lean

While Lean has been praised by a lot of entrepreneurs and business schools (Blank, 2013), a number of issues have also been raised about the principles behind it. Firstly, Lean lacks long-term vision, favouring instant customer feedback and relying heavily on customers real-time opinions. While this may be favourable in the short term, this relies on incremental changes and could be stifling to real innovation. Christensen (2015) argued that “novelty is often initially disliked by customers”, and as a result, Lean may hinder a real breakthrough product from making an impact or may even cause a business to pivot too early due to initial resistance to a new idea, when perseverance may have resulted in success long-term.

Hjalmar Nilsson used Spotify to criticise Lean’s short-term approach. Major labels initially resisted Spotify, insisting that they wouldn’t ever license their catalogue to the platform. Had they used the Lean startup model, Spotify may have chosen to pivot and done something different than the product that has brought them so much success (Kullmar & Lallerstedt, 2017).

Spotify’s application of Lean business methods

While Lean may not have been a useful tool for Spotify to utilise as a startup, there are certain concepts within the model that the company has been able to implement to help with its continued growth and introduction of new products. Although it is widely regarded as applying to startups, Ries argues that Lean business methods can be applied to any scale business (Blank, 2013).

Spotify’s strategy of testing new products in their strongest markets and measuring the response fits with the build-measure-learn feedback loop. As discussed, there have been numerous recent cases of Spotify launching new products in a market, measuring the response and effect on subscribers and revenue, and acting on the response by either rolling out the products further, adapting them or removing them completely.

Spotify are regarded as adopting a number of principles to continue to strive for innovation and growth. Agile principles, Kaizen and Kanban (Castelli, 2020) are all considered to be used as a mix of principles that allow Spotify to drive forward innovation within their product base and inform decisions on rolling out new features. Something that is extremely useful to a business the size of Spotify, who are completely focused on global growth and emerging markets where numerous variables differ greatly.

Conclusion

Spotify have enjoyed a period of being a monopoly within the streaming market. Over recent times that has changed, with technological innovation and multi-sided businesses able to integrate their streaming platforms into other aspects of their business offering. More recently, they have also had to adapt to changing consumer habits brought about by the pandemic and homeworking, and uncertainty over forecasts due to the unpredictable nature of the economy as a result. Spotify’s strength lies within the influence it still has within the music industry, and the huge data analytics it gives artists access to. A key issue it faces is keeping market share, and ultimately, its market leader position, whilst it moves into emerging markets. The economic implications of issues such as remuneration, and emerging technology offering new possibilities to rivals and new threats, means that Spotify will have to remain astute if they are to retain their position as the primary music streaming service.

Word count: 5,490

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