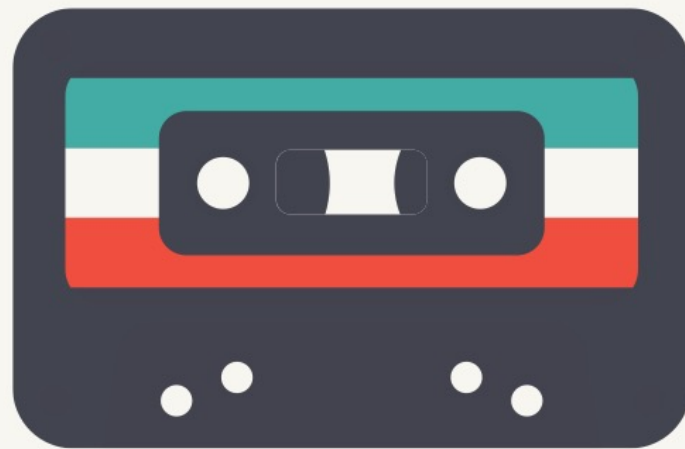
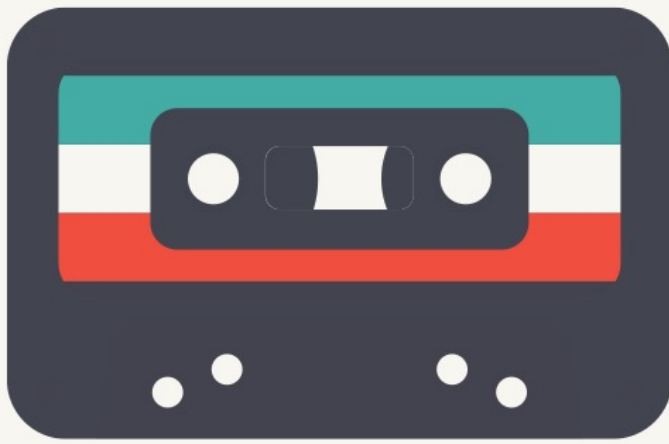




Economics, Planning & Finance
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A REPORT ABOUT SPOTIFY

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Table of Contents

1. A brief history of Spotify	3
2. Economics	5
2.1 Products and Customer Base	5
2.2 Major Competitors	6
2.2.1 Apple Music	7
2.2.2 Amazon Music	7
2.2.3 Deezer	8
2.3 Price Strategy	8
2.3.1 Premium	8
2.3.2 Freemium	9
2.4 Market	10
2.5 Macro Environment	11
3. Finance	12
3.1 Short Term Finance and Long Term Finance	12
3.2 Major Financing plus Investment Activities & their Advantages and Disadvantages	15
4. Bibliography	18
5. Appendixes	22

1. A brief history of Spotify

Spotify is a digital streaming service which provides products such as music, podcasts, audiobooks and videos on devices like computers, mobiles, tablets or home entertainment systems.

Spotify AB was founded on the 23rd of April in 2006 by Daniel Ek and Martin Lorentzon in Stockholm, Sweden and is still the main operating company headquartered in Stockholm. Additionally, they established a few subsidiaries like Spotify Ltd or Spotify USA Inc. which operate in different countries, for example in this case in the United Kingdom or the United States of America. But not to forget Spotify AB is a subsidiary of Spotify Technology S.A. headquartered in Luxembourg. Spotify AB has been in existence for 12 years now, but the product itself has been a service for 10 years as it was launched on the 7th October in 2008. During these years, the product has developed strongly and established itself in new markets. The service started in the following countries like Sweden, Finland, France, Norway, and Spain. The first market expansion took place in the UK at the beginning of 2009 and the Netherlands followed quickly just one year later. In 2011 the services in the United States of America were launched. Nowadays Spotify is available across 78 markets worldwide.

In 2014, Spotify presented a new subscription for students to use the normal premium service but at half the price. Since last year, the offer for students already exists in 33 different countries. Another new subscription they added in 2014 is a Family Premium account, which connects up to six family members to share one premium subscription together. One advantage is that all the family members can simply share music with each other and the second is that it is much cheaper overall.

In the meantime, Spotify has already purchased several companies, however, the first acquisition was Tunigo in the year 2013. This was followed by companies such as The Echo Nest and Seed Scientific. In 2016, Spotify made several acquisitions, as you can see below, with Cord Project and Soundwave, both in the social sector. Additionally,

Spotify bought CrowdAlbum, which does photo and video aggregation. Towards the end of 2016, the company Preact was added to the list to fuel their subscription business. Also in 2017, Spotify did not leave empty-handed, because they took over Sonalytic, MightyTV, as well as a blockchain start-up called Mediachain and additionally an AI search start-up called Niland.io. At the end of 2017 Spotify acquired the company Soundtrap AV and in the middle of this year, Loudr was added. The latest change was that Spotify acquired a minority stake in DistroKid, which is a digital music distributor. In short, Spotify has already acquired or taken over a total of 13 different companies and invested in three various ones.

As briefly mentioned above, Daniel Ek and Martin Lorentzon founded Spotify AB. Now Daniel Ek is the Chairman, also the Chief Executive Officer and Martin Lorentzon is a Director, among seven other directors.

The company has grown a lot over the years and has become more and more important for the music market in general. Today Spotify is one of the most important platforms in the music business with over 4.000 employees.

2. Economics

2.1 Products and Customer Base

On the one hand, there is the premium service one has to pay for in addition to utilize all services, on the other hand, there is a free service one can easily apply but which is limited in the usage compared to the premium service. Through advertisement, Spotify can provide a free service, which means that during a song, advertising pops up. One is then forced to listen to the commercial and when it is finished, the song continues.

Spotify offers one premium service but four different types to pay. The most used one is the normal premium service type for 9.99 pounds per month, which can be tested for three months for 0.99 pounds per month. After those three months, one automatically gets charged the whole 9.99 pounds per month. Then Spotify also offers a service for students, which comprise the same benefits as the normal premium service but 50% off so, it would be 4.99 pounds per month for a student. Another option is to use the premium annual, which means that you would need to pay 119.88 pounds per year. Besides the Spotify Premium account, there is also the opportunity to get a Spotify Family account, which gives you the chance to share an account with your family and thus save money. One would be able to use this Family account with six members including themselves, hence, the fee of 14.99 pounds per month can be divided by six, which is way cheaper compared to the normal Spotify Premium service. The precise differences between Spotify Premium and Spotify Free will be explained later in detail.

Besides those two main services, Spotify provides a built-in attendance, called Spotify Connect which allows users to stream music and listen to it directly on speakers, TVs, and other devices using the Spotify app as a remote. It is a Wi-Fi-enabled service that allows people to control music throughout their house from the Spotify app on a smartphone, tablet, or desktop computer (Sawers 2018). This tool is not just available for Spotify Premium users, it is also accessible for Spotify Free users. The reason for that is that Spotify tries to win more Spotify Premium users with that. In other words, they allow Spotify Free users to use Spotify Connect like the Premium users, with the

idea that these users understand how practical it would be to have Premium and to be able to use Spotify in general as they like, without restrictions.

What should also be mentioned at this point is that Spotify offers a separate user interface for artists, called Spotify for Artists. This page should help artists to learn more about their listeners. For this purpose, Spotify offers data in different areas and forms. An additional tool to that was released this September, and is only a test in the USA, is that artists can upload their music directly to Spotify. In other words, this would completely eliminate the fellow man, differently the distributor.

In November 2018 Spotify introduced an app for Apple Watch to stand up to Apple Music. Furthermore, the company has partnered with Garmin International Inc. to leverage their expertise in listening to offline music over a watch.

2.2 Major Competitors

The music streaming market is growing and becoming more important and when of course the demand is there, an increasing number of companies are appearing because they want to participate. As according to MarketLine data, Beaton (2018, p.6) states that “the global online music streaming market has grown with a compound annual growth rate (CAGR) of 46.2% between 2012 and 2016.” Thus, one can clearly see that the interest in this market exists in any case and therefore companies are fighting for the best market position. Spotify is the forerunner of this business model as it was one of the first ones, but Spotify is followed by two big fishes, Apple and Amazon. Since Apple and Amazon are both giant companies, they have big capital to remove Spotify from the way, even though Spotify has way more experience. In addition to these two big competitors, one must not forget the platform Deezer, which is one year older than Spotify. It has gained a lot of experiences over the years and not to forget it has more songs in its repertoire. In the following, a closer look will be taken at the companies individually.

2.2.1 Apple Music

With now three years of experience in music streaming service, Apple has very good opportunities to overtake Spotify in the USA. Mainly for the reason that almost everyone knows the brand Apple and they can use that as a so-called built-in-marketing. Simon (2018) describes this built-in-marketing as a premier placement on the home screen of hundreds of millions of iPhone and iPads sold every year. In other words, Apple can promote the music streaming service for free on thousands of iPhones or iPads by pre-installing the Apple Music app. On the other hand, you have to download Spotify on your own. One can recognize here the big possibility of Apple. The service between these two providers differs however in the free services since Apple Music only provides free use for three months. After those three months, the customer has to pay the normal fee for the service. In contrast, Spotify offers permanent free usage with placed advertisements.

2.2.2 Amazon Music

Similar to Apple, Amazon has good opportunities to offer the music streaming service through its own products. Referred to Simon (2018) is the popularity of Amazon Prime memberships as well as Amazon's Echo Smart Speakers, and the Alexa voice control system, a driving force for memberships of Amazon Unlimited. The normal service fee can easily be compared with Apple Music and Spotify, as all three services are about 9.99 pounds per month. Amazon tries to distinguish itself a bit by offering prime customers a fee of 7.99 pounds per month to enjoy the 40 million different songs of Amazon Unlimited. However, prime customers also have the possibility to use a limited service from Amazon Music for free, but to be able to use Amazon Unlimited you have to pay for it. Amazon Unlimited definitely has great potential to compete against Spotify because generally speaking, Amazon is such a powerful company with advanced technology, and the music streaming service has evolved very rapidly and is likely to grow even faster.

2.2.3 Deezer

With the largest selection of music, 53 million songs, Deezer is definitely one of Spotify's biggest competitors. Like Spotify, Deezer has been active in this field for a long time and has gained some experiences in the process. Even though Deezer's streaming service was on the market shortly before Spotify's, Spotify has generally developed better and gained more customers over the years. If you take a closer look at the service, you can see that they hardly differ, as both offer a freemium model and further a free use with switched advertisements or you can try their services for three months only for 0.99 pounds. So, in the end, it is actually a matter of taste which of these two services you would use, as they differ only slightly or not at all.

2.3 Price Strategy

If you take a closer look at Spotify's pricing strategy, you can see that there are only two different services. On the one, hand there is Spotify Premium, for which you have to pay and on the other hand, there is Spotify Free, which can be used for free. Of course, these two types differ not only in that one cost and the other does not, but with Spotify Premium you can use the whole service including all tools. In contrast to Spotify Free, where you can only use the service in a limited way. For a closer look at the two different services, an analysis needs to be done to understand the exact difference.

2.3.1 Premium

As already mentioned, Spotify Premium costs 9.99 pounds per month, but you can test this service for three months first. During those three months of testing the product, you would have to pay only 0.99 pounds per month and afterward it would be the usual 9.99 pounds per month. Here you can see that the pricing strategy is kept very simple. The normal fee of 9.99 pounds per month is competitive, as this fee is standard in this sector and other competitors charge exactly the same amount per month. Let's take a closer look at the exact features included in Spotify Premium.

Besides, the function shuffle play, someone can use Spotify Premium ad-free plus listen to the music offline. Listening to the music offline has to do with the fact that one can download the music to their devices. Additionally, there is no limitation about which

song someone wants to listen to, because it is possible to click on any song and thereby play it, furthermore one can skip songs unlimited. All of this is offered with high-audio quality songs, that is available to use on multiple devices if wished.

2.3.2 Freemium

After having a closer look at the Spotify Premium Product, next will be a better description of the Spotify Free Product characteristics. Spotify uses a so-called freemium model for Spotify Free, which generally is becoming more and more widespread and popular. Anderson (2010, cited by Holm and Günzel-Jensen 2017) describes the freemium model as a basic version of a product or service for free, with the intention of persuading sufficient numbers of customers to pay for a more advanced version. This model first showed up in the traditional software industry and not on the internet, which is interesting. It started with various software companies offering free trial versions and after users tried the free trial version, they could directly acquire an extended version (Hao-Chen 2016). However, it has developed much further since then, as the freemium model has become indispensable for some products like Spotify. Holm and Günzel-Jensen (2017) stated that to succeed with freemium, online digital companies need to achieve and sustain the excellent value of their offerings to free and premium users by continuous development and improvement of their value propositions, for example a better user interface, additional new features, further compatibility with other systems and solutions and more free space. This means that in the case of Spotify it is very significant that Spotify Premium differs greatly from Spotify Free to achieve this added value. Therefore, let's distinguish more precisely between these two services. As mentioned above, Spotify Premium offers different features in order to differ from Spotify Free. Of course, one will have ad interruptions during the usage of Spotify Free, plus it is not possible to listen to music without an internet connection. This implies that it would not be available to listen to songs offline, which basically means that one could not download any songs. Additionally, only selected playlists are available on demand mobile access. Moreover, it is possible to travel abroad with your music up to 14 days but not longer if one uses Spotify Free. Now that the differences between the two products are clear, one has to take a brief glance at the

similarities. What should be appreciated is that both services offer a selection of over 35 million individual songs. Furthermore, someone has access to different podcasts and audiobooks within both services.

2.4 Market

The market in which Spotify operates is a constantly growing market because it is obvious to see very well that the market had to develop first over the years. For 10 years now Spotify has been offering its service, but it was very difficult to establish itself in the beginning, since at that time music was still consumed quite differently. Let's go back and see how it all began, how people used to consume music. In short, the first device on which it was possible to listen to music was developed in 1877 and is called the Phonograph. It then developed over several years into today's record players on which one can now play vinyl records. Between 1912 and 1917 the consumption of radio developed and was at that time a very important tool. Around 1958 there was the first tape on which you could listen to music later through the Walkman. In 1980 there was the so-called CD for the first time, which was an incredibly important consumer good for a very long time and partly still is. At the beginning of 2000 mp3 had advanced so much that people began to download music illegally on the Internet at that time. Then the tools were added like an mp3 player or the first iPod to consume the downloaded music.

IFPI (2014, cited by Haynes and Lee) says that the most notable implication is that global income from the sale of recorded music has declined dramatically, falling 43 percent between 1999 and 2013 and that the decline has resulted in a significant contraction of the major-dominated recorded music industry, with the number of major labels falling from six to three, tens of thousands of job losses and a dramatic decline in the number of acts signed to major labels. As already mentioned, it is easy to see from the above number that the music market has obviously changed. First, there was vinyl, then cassettes, then CDs, then there was the possibility to download music illegally, that many did until the first streaming service came on the market.

In summary, the way music is consumed has developed extremely over the last 150 years and will continue to do so. The market potential will always be there because

people will never stop consuming music as it is too popular and too connected. It would be almost impossible to avoid music because nowadays there are so many things connected with music like watching TV, shopping, advertising, subway stations and so on.

2.5 Macro Environment

A company can have the best ideas or products, sometimes factors simply do not lie in a company's power. In other words, there are different external factors that can strongly influence a company, but then the company can't really do anything about it. Such a factor could be a legal one, for example, since Spotify must first clarify the rights with labels to be able to use the music. The three major labels in the music business are hard to do business with because they want to make as much money as possible, of course. However, considering Lucian Grainge's (Sisario 2017) testimony that says that streaming now makes up a majority of the revenue for record labels, one can understand why it has to be a big discussion how much labels get from streaming.

An ecological point that must not be forgotten is that Spotify is naturally dependent on energy since there is no such technology without electricity. However, one should not overlook that technology is constantly evolving and it could very well be that from one day to the next there is a completely new idea to consume music. This would, of course, have drastic consequences for a company like Spotify. It could of course also be that Spotify is generally just trendy and that this trend will soon be over again. The conclusion could be that people are falling back into their old habits like downloading songs. Or people are going to the competition like Apple Music or Amazon Music, just because those services are trendier then. The financial point should also not be missed, because it could be that people generally no longer want to spend money on music as there is also a free service at Spotify, which you can easily use. And instead of using Spotify Premium and paying for it, people could get involved with the disadvantages of Spotify Free in order not to have to pay for it anymore.

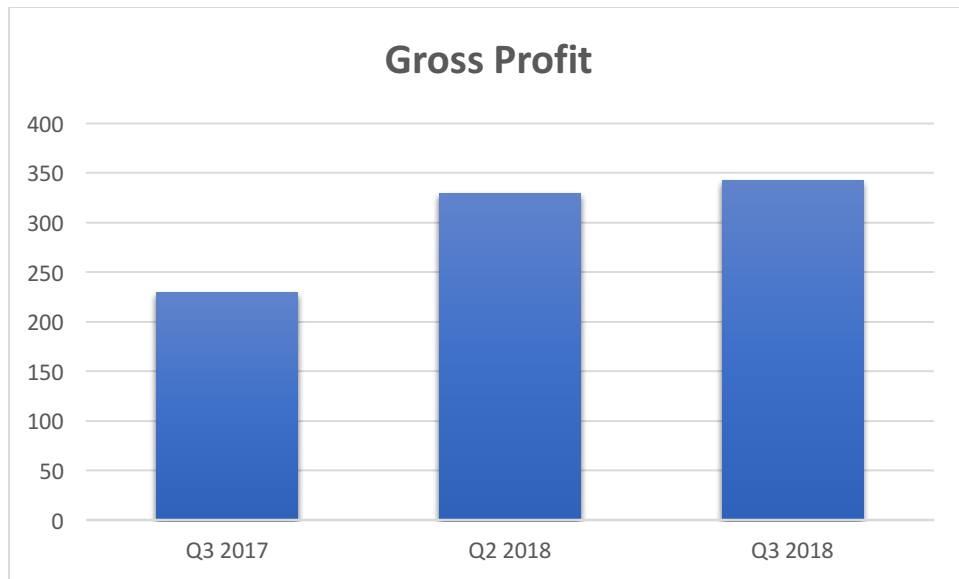
3. Finance

3.1 Short Term Finance and Long Term Finance

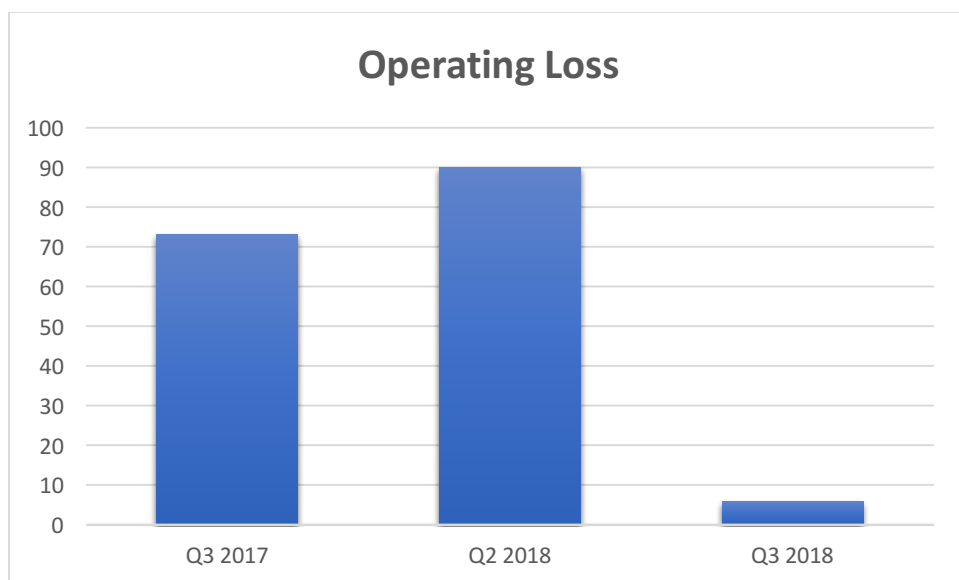
Spotify writes a total of 191 million monthly active users, also called „MAU“, in quarter 3 in 2018. 87 million out of those 191 are premium subscribers and the rest of 109 million are ad-supported monthly active users. If you compare this to the previous year, the monthly active users grew by 28%. Spotify has a total of 18,918,595 monthly app downloads if you count apps like Spotify Music, Spotify for Artists, Spotify Lite and more. This results in a monthly download growth of 7.81%. The two most popular apps are Spotify Music and Spotify for Artists. Spotify is becoming more and more acclaimed and well-known. This can be seen in the fact that Spotify is ranked 127th among the world's websites, based on its 260,816,131 monthly web visitors. (Spotify 2018)

The total revenue of the third quarter is 1.352 billion, of which 1.210 billion is from the premium service and 142 million from the ad-supported service. But let's have a glance at the following graphs, where you can see right away that not as much has changed in one graphic as in the other because you can see a drastic change in the second graphic. On the first graph, you can see that the total big profit is 342 million in the third quarter of 2018, that is a growth of 112 million if one has a look into the third quarter of last year. However, the company is still not in the black, which means that Spotify prescribes an operating loss of 6 million, which is drastically less than in the previous quarter since Spotify made 90 million as an operating loss in the second quarter of this year (Graph 2). Furthermore, this can be seen as a positive improvement. Now let's take a closer look at how Spotify makes a loss even though they prescribe a gross profit. With the Gross Profit, Spotify then invested 135 million in Research and Development, additionally 146 million in Sales and Marketing and finally 67 million for General and Administrative. So, if one would subtract the three different mentioned numbers from the gross profit of 342 million, you get a loss of 6 million. What is also an important fact to take a closer look at is the gross margin, which was 25.3% in Q3 this year compared to 22.3% in Q3 last year. The gross margin was highest in Q2 at 26.9%,

as the company generally spends the most on large seasonal advertising campaigns in quarters two and four. (Spotify 2018)



Graph 1: Gross Profit



Graph 2: Operating Loss

In the following, it is clear to see that it is about the balance sheet of the company Spotify. What can be seen under the point long term investment is that the number is rapidly higher compared to last year. The reason for this is that Spotify recently acquired shares of Tencent Music Entertainment Group. In total, the long term investment is a big sum for the non-current assets. What can also be seen at a glance is that the cash and cash equivalents point has risen considerably compared to last year, by 618 million. And by contrast, short term investments have fallen drastically by 363 million. What is a very sharp difference to last year is the total shareholders' equity, which rose by 1,356 million. This has to do with the fact that Spotify became a listed public company on the New York Stock Exchange this year. Additionally, you can see how the non-current assets have decreased by 921 million. (Spotify 2018)

Assets	2018	2017	Equity and Liabilities	2018	2017
<u>Non-Current Assets</u>			<u>Total Shareholders' Equity</u>		
Property & Equipment	135	73		1,594	238
Intangible assets	173	162	<u>Non-Current Assets</u>		
Investment in associate	-	1		88	1,009
Long term investments	1,589	910			
Restricted cash & other non-current assets	65	54			
Deferred tax assets	11	9			
	1,973	1,209			
<u>Current Assets</u>			<u>Current Liabilities</u>		
Trade and other receivables	359	360	Trade and other payables	384	341
Income tax receivable	2	-	Income tax payable	3	9
Short term investments	669	1,032	Deferred revenue	240	216
Cash and cash equivalents	1,095	477	Accrued expenses and other liabilities	1,064	881
Other current assets	35	29	Provisions	49	59
	2,160	1,898	Derivative liabilities	711	354
			Total Liabilities	2,451	1,860
Total Assets	4,133	3,107	Total Equity and Liabilities	4,133	3,107

Table 1: Balance Sheet

Other changes that should be mentioned here are the new partnerships that Spotify signed in the third quarter. These partnerships are a very good opportunity for the future to earn a profit for a long period of time. What is certainly a big step for Spotify is the partnership with Samsung. Samsung will integrate Spotify into its new phone deployment experience and Spotify will also become the preferred music partner for the multi-device ecosystem. Additionally, in the UK and Ireland, it will be possible for Sky users to add Spotify directly to their cable bill, which can also be a big step as Sky is Europe's largest pay TV service. In the future, Spotify will be supported by DAZN, a streaming service for sports subscribers, to do various marketing campaigns in Japan. Another partnership worth mentioning is the latest partnership with Google Home, where Spotify will be offering Google Home mini speakers to family plan master account holders in the USA during the holiday season. What also has an influence on a longer period of time is that Spotify owns a total of 133 patents applied for, which are in the category "Computing; Calculating" and Spotify also has registered 10 trademarks. (Spotify 2018)

3.2 Major Financing plus Investment Activities & their Advantages and Disadvantages

When one looks at the big activities of finances, one can't avoid looking at the investors of Spotify. In 22 rounds, Spotify raised a total of 2.8 billion dollars in funding and the last funding took place on December 15 in 2017, although from an unpublished round. In addition, Spotify is financed by 48 investors. The next activity that happened this year and needs to be discussed in more detail is that at the beginning of April Spotify became a listed public company on the New York Stock Exchange under the ticker symbol SPOT. This is generally a great opportunity for Spotify to grow and finally make a profit, as the main advantage of issuing stock is the opportunity of raising capital. Another advantage about issuing shares would be that it could avoid a company from taking on debts. (Wolfe 2017) But as the CEO, Ek (2018) says that Spotify has never been a normal kind of company and that the focus is not on the initial splash. Instead, they will be working on trying to build, plan, and imagine for the long term. In other words, Spotify knows that they are not yet making a profit but the reason for that is

because they are making targeted investments for the future. Therefore, they are still confident that Spotify will be the leading music streaming service of the future and that they will still benefit from these investments they are taking, which rather seem risky at the moment. Further, Wang (2018) states that Spotify's stock has remained relatively stable over the months since it became a public company. In order to analyse and understand this statement, one must look at the numbers and the journey of Spotify on the New York Stock Exchange. Spotify started with a higher opening price than expected at \$165.90. Then the price quickly dropped to \$149.01, which is the closing price when you look at the reference price of \$132. (Salinas 2018) At the moment, the price is around \$130, with small fluctuations up and down. (MarketWatch 2018)

Generally, to go a bit back in time, the investors who were involved early on were none less than the major labels. And they did not recently compete for Spotify shares, instead, they did 10 years ago. Therefore, in 2008 several labels, mainly the major labels, bought shares of Spotify. Sony BMG was able to acquire a total of 117,392 shares, which was a six percent share of the company in 2008. Universal bought 97,827 shares, which was 5% of the company at that time. Furthermore, EMI has also invested in 39,131 shares, which was two percent of the capital. However, in the meantime Universal has bought the company EMI so, these shares are now need to be added to Universal. Not to forget, of course, Warner bought 78,264 shares, which corresponds to a share of 4%. In general, these shares are now worth much more after 10 years than they were at the time when everyone invested, especially now after Spotify trades on the New York Stock Exchange. (Ingham 2018)

In addition, it has to be looked at Spotify's six big shareholders nowadays. One of the largest shareholders with roughly 47 million shares, which is 25% of the company's stock, is Daniel Ek, the founder, and CEO of Spotify. In second place is the Co-founder, Director and Former Chairman Martin Lorentzon with 24 million shares. Spotify's third-largest shareholder is Tencent Music Entertainment that holds 7.5%. Tiger Global Management is the next biggest investor with its 6.9% that equals 12.2 million shares. Sony Music Entertainment owns 10 million shares with a stake percentage of 5.7%.

This rate has increased by 0.3% compared to ten years ago. Here, however, one has to note that 10 years ago Sony had 117.392 shares. Through this big difference, one can see how much the company has grown and how the company has gained in value. Furthermore, the company with the least amounts of shares out of those six is Technology Crossover Ventures with 9.6 million, which corresponds to 5.4% of the company's stake. (Rivera 2018)

Spotify is already one of the leading streaming service providers worldwide and has generally good opportunities to stay that way. However, it would be important for Spotify to make a profit at the end of the year. Finally, as stated by the CEO, Ek (2018) says that Spotify's goal is to unlock the potential of human creativity – by giving a million creative artists the opportunity to live off their art and billions of fans the opportunity to enjoy and be inspired by it.

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5. Appendixes

Graph 1: Gross Profit

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Graph 2: Operating Loss

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Table 1: Balance Sheet

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