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**Working Paper**

## Spotify: From music streaming start-up to global audio company

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## ESCP Working Paper

No. 71 – September 2022

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Stefan SCHMID  
Tobias ROMEY

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**ABSTRACT:** During the last few decades, the internet and digital technology have fundamentally changed the global music industry. As a consequence, new companies and novel business models have emerged. Spotify, one of the new players in the music industry, has expanded its business activities and grown to become the leading streaming company worldwide. Today, Spotify offers a wide variety of audio products, such as podcasts and audiobooks, to subscribers, as well as significant service solutions for artists and music producers alike. This case study describes the development of the music industry before the advent of Spotify. After presenting Spotify's origins and after discussing Spotify's market entry into the most important music market in the world, namely, the US, the case study focuses on the company's growth. We show that acquisitions of other companies enabled Spotify to develop its services further, as well as to diversify its product portfolio. We also shed light on Spotify's internationalization as another important driver of firm growth. Over time, Spotify's relationship with major labels has changed, and this case study reveals how Spotify has gained power while getting more independent from the major labels.

**KEYWORDS:** Acquisitions, Case Study, Diversification, Internationalization, Digital Music, Firm Growth, Internet, Music Label, Market Entry, Music Industry, Platform, Podcast, Product Development, Spotify, Streaming.

**J.E.L. CLASSIFICATION CODES:** A20, A23, L13, L21, L25, L82, M10, M13, M16

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# Spotify

## From music streaming start-up to global audio company

### 1 Digital disruption of the music industry

Over the last few decades, the global music industry has undergone a radical change, in particular in the realm of technology. Until the early 2000s, most people listened to music via physical music products such as compact discs (CDs), vinyl discs, or, cassettes, etc. The rise of the internet and digital music formats changed the way in which music was heard and fundamentally affected the business models of players in the music industry.

In 2000, the “traditional” music industry generated a total revenue of around USD 23.4 billion worldwide.<sup>1</sup> Five major labels dominated the industry, namely BMG (Bertelsmann Music Group), EMI (Electric and Musical Industries), Sony Music, Universal Music Group, and Warner Music Group.<sup>2</sup> The labels covered a broad spectrum of activities across the entire music value chain. The process started by predicting future music tastes and ended with selling music and ensuring the availability of new releases in as many stores as possible.<sup>3</sup> The labels also carried out other activities, such as scouting for future talents, financing artists, recording music, advertising music, and producing music videos, CDs, vinyl discs, or cassettes.<sup>4</sup> Additionally, they signed exclusive contracts with artists which specified, for instance, the selling price of physical music, royalties or copyright ownership.<sup>5</sup> The textbox on the next page provides further information on copyright management in the music industry.

Investments in music products, especially in new but also in established artists, were risky for the labels, as only a low percentage of music releases would ever be commercially successful.<sup>6</sup> Despite the risk of financing commercially unsuccessful artists, labels usually made relatively high profits, and their business models remained essentially unchanged for several decades—until the turn of the century, when the business models started to be questioned.<sup>7</sup>

<sup>1</sup> See IFPI (2019); Statista (2020a).

<sup>2</sup> See McCourt and Burkart (2003); Moreau (2012); Peitz and Waelbroeck (2004); Schmid and Luber (2013).

<sup>3</sup> See Benner and Waldfogel (2016).

<sup>4</sup> See Peitz and Waelbroeck (2004); Thompson (2018).

<sup>5</sup> See Wikström (2009).

<sup>6</sup> See Benner and Waldfogel (2016); Vogel (2008).

<sup>7</sup> See Panda and Patel (2012); Peitz and Waelbroeck (2004).

## Copyright management in the music industry

Many artists wish to sign a record contract with a major label, as a contract increases an artist's chance of success due to increased prestige, exposure, and financial support. With a traditional recording contract, the record label bears the cost for the recording and promotion process of an artist. The label also covers other artist costs, such as producer and arranger fees, studio and equipment rentals, living expenses, etc. The cost for recording an album can amount from USD 150,000 to USD 500,000. In exchange, the record label receives ownership of the copyrighted sound recording. Depending on the terms of the contract between the label and the artist, the former can also be the sole owner, a co-owner, or a licensee of any copyrighted sound recording. Afterwards, the label has the right to license the recording (in both physical and digital form) for profit to radio stations, TV stations and other platforms. To use the recording, the licensee has to pay royalties to the label, which in turn retains royalties from sales to recoup its costs. In general, many record contracts are unprofitable for the label, as only a few artists become popular and successful. As such, these few artists have to generate enough revenues for the label to pay for the financial losses of all the other artists.

Sources: Benner and Waldfogel (2016); IFPI (2017); Lesser (2018); Okorochoa and Douglas (2010) and Passman (2019).

During the 1990s, audio compression via MP3 became increasingly popular and challenged players in the traditional music industry. MP3 is a coding format for digital audio developed by the Fraunhofer Society in Germany, and it allows for reducing the size of a music file to 12% of its original size.<sup>8</sup> Firms like Napster, a file-sharing platform founded in 1999 in the US, used this new format to introduce a previously unknown business model to the music industry by searching the hard drives of its users, listing all available MP3 music files, and allowing individuals to send files to every other user on the platform.<sup>9</sup> In 2001, Napster enabled users to share around 165 million music files per day without charging its customers and without paying the artists or the labels.<sup>10</sup> As a consequence, Napster faced several lawsuits and was accused of being an “illegal piracy service”.<sup>11</sup> Total losses for the music industry due to pirate recordings were estimated at USD 5 billion<sup>12</sup> per annum.<sup>13</sup> The new digital format fostered the development of portable MP3 players, with the capacity for thousands of digital songs to be stored and listened to by the user. The increasing success of MP3 players (such as the Rio PMP300 or Compaq's Personal Jukebox), alongside the potential of digitalizing music, directly attacked the most dominant physical music product of that time, the CD.<sup>14</sup> The Recording Industry Association of America (RIAA), for instance, criticized the growing popularity of the MP3 player, stating ‘The MP3 player has no function other than playing

<sup>8</sup> See Moreau (2012); Sterne (2012), p. 2.

<sup>9</sup> See Dowling (2019); Panda and Patel (2012); Waldfogel (2017).

<sup>10</sup> See Parloff (2003).

<sup>11</sup> See McCourt and Burkart (2003).

<sup>12</sup> All amounts in € were converted to USD by an exchange rate of 1:1.20 as this represents the average exchange rate for the period from 2008 to 2021; see Statista (2022a).

<sup>13</sup> See Parloff (2003); Woolley (2010).

<sup>14</sup> See van Buskirk (2005).



material that was stolen from record companies<sup>15</sup>. As a result of MP3 downloads, global sales of CDs fell by 7% from 2000 to 2001. Figure 1 also illustrates that CD sales in the US, the most important music market, fell by about 12% in the same period.<sup>16</sup>

In 2001, as a result of competition with online music platforms like Napster and dropping revenues in the physical music market, two of the traditional labels, Sony and Universal, started to cooperate by establishing a digital music platform called Pressplay. In the same year, BMG, EMI, and Warner joined forces and created a digital music platform called MusicNet.<sup>17</sup> Also, many other companies, such as Rhapsody and Omnifone, designed new business models around digital music, but most of them failed.<sup>18</sup>

At the end of 2001, Apple introduced their first MP3 player, the iPod, and launched the music platform iTunes, which was considered one of the first legal digital music stores offering MP3 files to buy. Initially, the iPod could only play music uploaded via iTunes. This bundle of hardware and software protected Apple's market share and allowed iTunes to grow very quickly, as iPod users were forced to use the platform.

Figure 1 shows that the launch of iTunes was a major trigger in boosting revenues generated by digital music products. Originally, it offered music tracks only, but later on, music videos, ringtones, and, in some countries, several other services like audiobooks or movies were made available.<sup>19</sup> While revenues from iTunes only provided a low-profit margin for Apple, the sales of iPods skyrocketed, and the device established itself as another high-margin product for the company (next to already existing products such as the iMac and Macintosh).<sup>20</sup> As previously mentioned, in order to load MP3 files onto the iPod, it was necessary for iPod users to download iTunes, as Apple hardware could only be operated with Apple software. This principle allowed for an easy and high-quality interconnection of different Apple products, while dependency on its software allowed iTunes further, extremely fast growth.

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<sup>15</sup> Kaufmann (1998)

<sup>16</sup> See IFPI (2019); Peitz and Waelbroeck (2004); Statista (2021d).

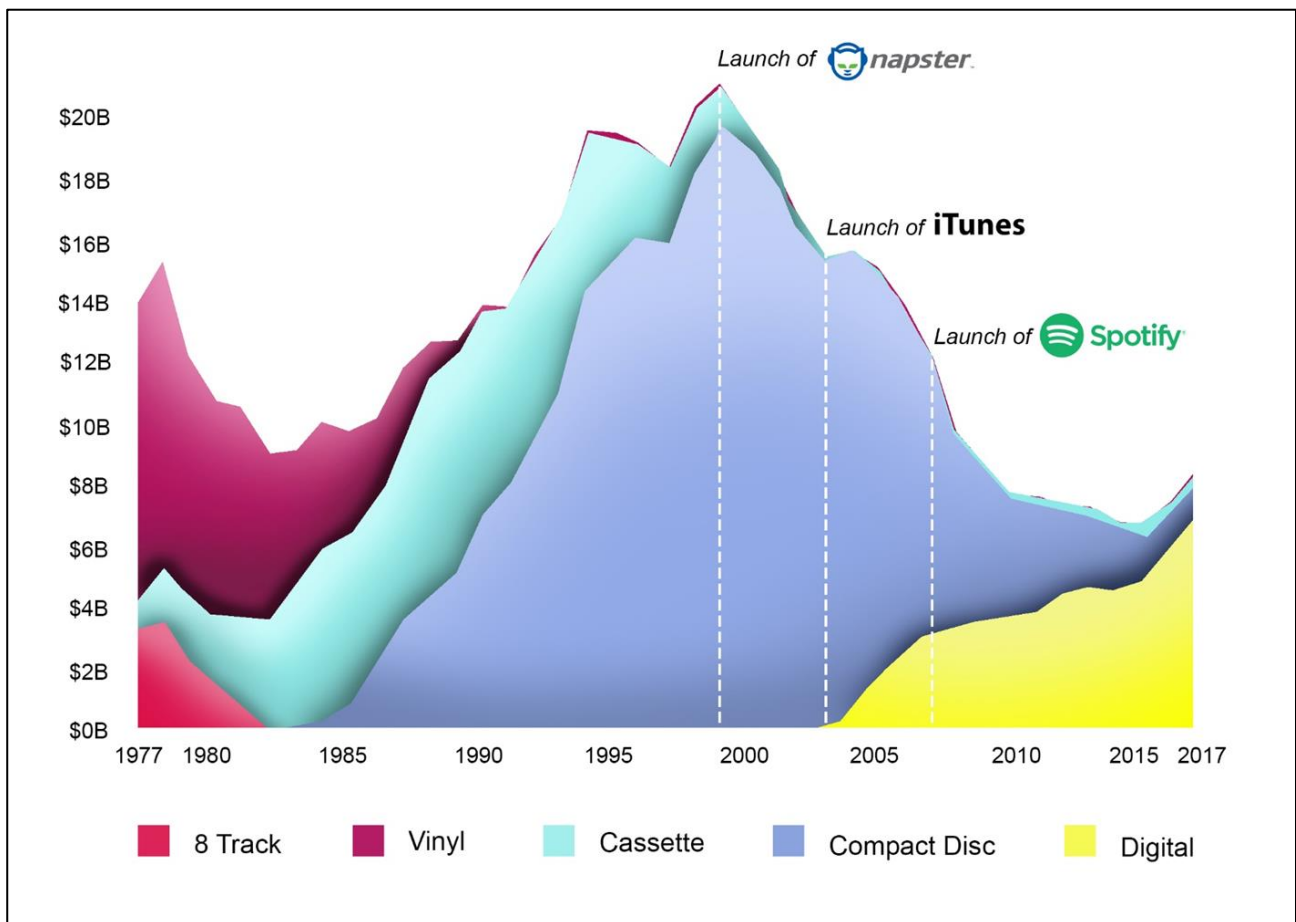
<sup>17</sup> See McCourt and Burkart (2003); Simon (2000).

<sup>18</sup> See Catalano (2018); Dredge (2016); Wikström (2009), p. 104.

<sup>19</sup> See Leurdijk et al. (2012).

<sup>20</sup> See Kim (2005); Moreau (2012).

Figure 1: Music revenues of the recording industry in the US.



Source: Based on RIAA (2022) and Routley (2018).

In the beginning, iTunes offered around 200,000 different songs for download. In the first week after launch, around one million songs were downloaded in the US, Apple’s home market.<sup>21</sup> iTunes used a uniform price model of USD 0.99 per download, and in the first year, it generated a higher turnover than the music platforms offered by the major labels Musicnet and Pressplay combined.<sup>22</sup> iTunes opted for a purchase-based and not subscription-based business model, as at the time Apple believed that users wanted to “own” music they wished to listen to.<sup>23</sup> With its focus on digital music and the changing habits of US customers who bought more digital music and less physical music products, iTunes grew and became the number one music retailer in the US, achieving a digital market share of around 69% in the US in 2008.<sup>24</sup> In parallel with the rise of iTunes, sales of CDs declined by around 70% in the US market between 2000 and 2020.<sup>25</sup>

<sup>21</sup> See Apple (2003a); Apple (2003b).

<sup>22</sup> See Leurdijk et al. (2012).

<sup>23</sup> See Knopper (2013); Martell (2007).

<sup>24</sup> See Cheng (2009); Ingraham (2013); Leurdijk et al. (2012); RIAA (2009).

<sup>25</sup> See Peitz and Waelbroeck (2004); Statista (2021d).

## 2 The launch of Spotify

Spotify was founded in 2006 by two Swedish entrepreneurs, Daniel Ek and Martin Lorentson, both of whom already had experience of digital business models. Ek started his first venture at the age of 13 by building websites.<sup>26</sup> Later on, he worked for eBay, launched his own digital advertising company Advertigo in 2005, and, in 2006, became CEO of uTorrent, a peer-to-peer file-sharing platform.<sup>27</sup> Lorentson was co-founder of Tradedoubler, one of Europe's leading affiliate marketing networks. In 2006, Tradedoubler bought Ek's company Advertigo, following which the two entrepreneurs came up with the idea that led to Spotify.<sup>28</sup> Two years after incorporation, Spotify officially launched its service in October 2008 in Sweden, Finland, Norway, France, and Spain.<sup>29</sup> Spotify's mission was 'to give people access to all the music they want, at all times – in an entirely legal & accessible way'.<sup>30</sup> This also included niche genres such as indie or metal, and classical music.

In contrast to piracy services such as Napster, Spotify signed licensing agreements with the major music labels.<sup>31</sup> These licensing agreements allowed Spotify to provide users with copyrighted music in a legal way, including a variety of top artists such as Coldplay, Miles Davis, Frank Sinatra, Madonna, and Snoop Dogg.<sup>32</sup> To reduce the amount of royalties paid to the major labels, Spotify agreed to grant the labels equity stakes.<sup>33</sup> By 2009, the major music labels owned around 16.3% of Spotify's shares (Sony BMG 5.8%; Universal 4.8%; Warner 3.8%; EMI 1.9%), by which time they had already sold their unsuccessful platforms MusicNet and Pressplay.<sup>34</sup>

From the very outset, Spotify opted for a freemium business model (a combination of the words "free" and "premium") with two subscription models, as illustrated in Figure 2.<sup>35</sup> The business model was based on two pillars, namely, an unpaid subscription and a premium subscription. The unpaid subscription allowed full access to every song in the Spotify music catalog, free of charge but with some limitations. Among these limitations were the following: song playback was interrupted by advertisements, and users could choose only a specific album or artist but not the particular track they wanted to listen to. With the unpaid subscription option, users could also not download songs or listen to them offline. These restrictions were intended to convince users to convert to a paid subscription. Years previously, Napster and other piracy services had led to a customer mindset according to which music was free. Hence, willingness to pay for music had declined significantly.

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<sup>26</sup> See Griffith (2012).

<sup>27</sup> See Bloomberg (2020); Henricson (2006); Music Business Worldwide (2019); Seabrook (2014).

<sup>28</sup> See Eriksson et al. (2018); Tradedoubler (2019); Vonderau (2019).

<sup>29</sup> See Lynskey (2013); Remneland and Knights (2016).

<sup>30</sup> Spotify (2011b).

<sup>31</sup> See Spotify (2008).

<sup>32</sup> See Brown (2015); McElhearn (2009); Spotify (2008).

<sup>33</sup> See Ingham (2016); Seabrook (2014); Teague (2012).

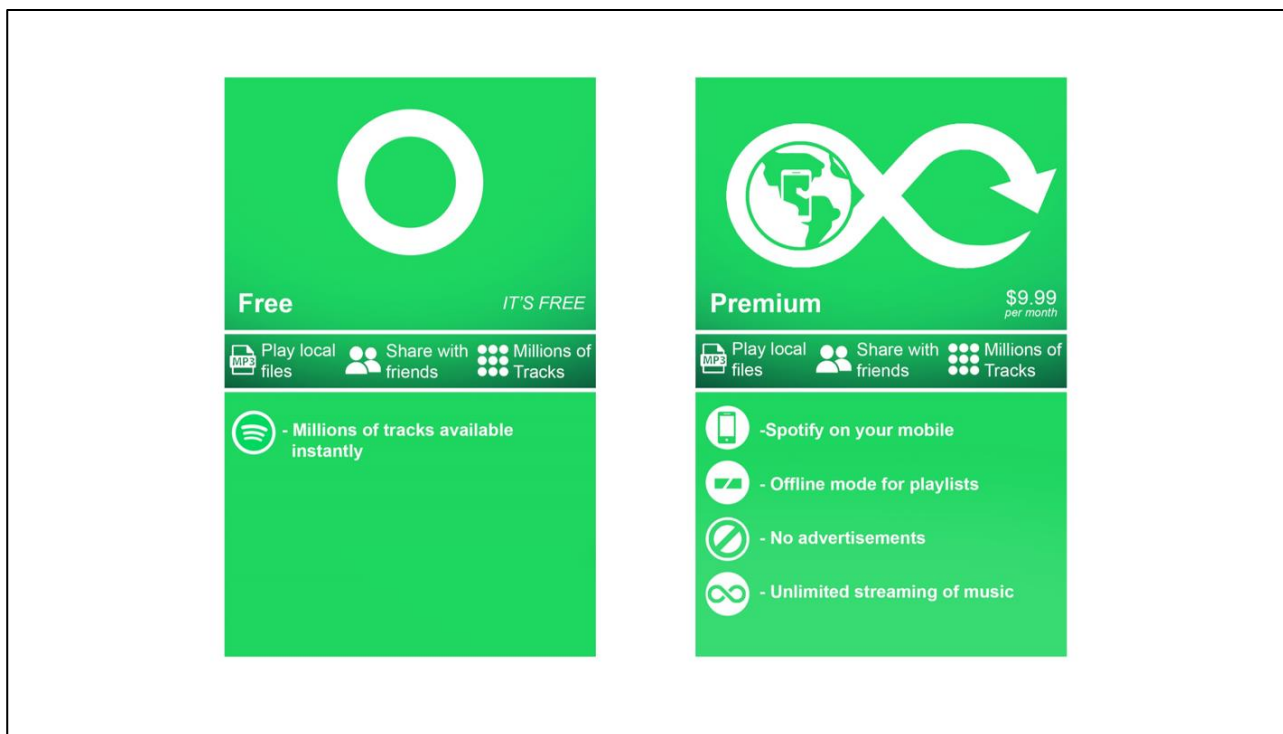
<sup>34</sup> See Forbes (2005); Gibson (2003); Leurdijk et al. (2012). Ingham (2018); Lindvall (2009)

<sup>35</sup> See Fleischer (2021); Gassmann et al. (2014), p. 167.

Spotify recognized this trend; consequently, the company identified piracy services as its biggest competitor, but it also saw piracy service users as the primary target group for its unpaid subscription option.<sup>36</sup> In the early years, around 75% of Spotify users had previously downloaded music illegally, with most of them admitting they did less illegal downloading since using Spotify.<sup>37</sup>

With the premium subscription, the above-mentioned limitations were lifted, and users could stream every song in the catalog as often as desired and without advertisements. In 2010, Spotify’s premium subscription was made available for EUR/GBP 9.99 per month in seven European countries (Sweden, Finland, France, Norway, Spain, United Kingdom, and the Netherlands) and generated around 70% of its total revenues from this offering, whilst the remaining 30% was earned through advertising.<sup>38</sup> Later, Spotify adapted its subscription prices to specific financial indicators such as the gross domestic product (GDP) or average income in the operating countries.<sup>39</sup>

Figure 2: Spotify’s subscription models in 2011.



Source: Based on Spotify (2011a)

<sup>36</sup> See Johnson and Charles (2009).  
<sup>37</sup> See Feldmann (2018); Robinson (2020); Tapper et al. (2009).  
<sup>38</sup> See Barker (2011).  
<sup>39</sup> See Charles (2009); Poples (2018).

### 3 Spotify's market entry into the US

In 2011, Spotify entered the first market outside Europe and launched its services in the US. The licensing agreements Spotify had previously signed with major labels did not include the US market.<sup>40</sup> Therefore, Spotify could not offer copyrighted music immediately and had to negotiate new licensing agreements with the labels for the US. Spotify's negotiation power was limited because the major labels owned the copyrights accounting for approximately 89% of the US market (with the following market shares at that time: Universal Music Group 31%; Sony Music Entertainment 28%; Warner Music Group 20%; and EMI 10%).<sup>41</sup> The labels knew that market entry for Spotify into the US was not possible without licensing agreements.

For a three-year contract with Sony, Spotify had to pay upfront royalties of around USD 42.5 million.<sup>42</sup> Additionally, Spotify granted Sony advertisement time, valued at USD 9 million.<sup>43</sup> The contract contained a "Most Favored Nation" (MFN) clause, which entitled Sony to make amendments to the agreement if any other label negotiated a better deal than its own.<sup>44</sup> After the deal, Spotify also had to negotiate agreements with the three other major labels and finally paid a high—but undisclosed—amount of money to obtain licensing agreements for the US market.<sup>45</sup> Hence, for Spotify, which recorded a global operating loss of USD 37 million against an overall turnover of USD 60 million in 2010, market entry in the US was not only expensive but also risky.<sup>46</sup>

The US market was a breeding ground for social media and digital business models. Leading corporations such as Alphabet (formerly known as Google, meanwhile also the parent company of YouTube), Twitter, and Facebook (now the major brand of Meta Platforms) were (and still are) based in the US, and with 33% of the population already using social media in 2011, the US market was the most prominent social media market globally.<sup>47</sup> In addition, it has been the most influential music outlet for decades, with many successful artists such as Eminem, Michael Jackson, Rihanna, and Taylor Swift growing up in the country and starting their careers at home before becoming popular abroad.<sup>48</sup> Furthermore, the US was also the largest and most lucrative music market globally and home to the headquarters of the three most important music labels: Universal Music Group, based in Santa Monica, Sony Music Entertainment, and Warner Music Group, both based in New York City.<sup>49</sup>

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<sup>40</sup> See Sisarion (2011).

<sup>41</sup> See Leurdijk et al. (2012).

<sup>42</sup> See Singleton (2015); Ulloa (2015).

<sup>43</sup> See Singleton (2015); Ulloa (2015).

<sup>44</sup> See Singleton (2015); Ulloa (2015).

<sup>45</sup> See Constine (2017).

<sup>46</sup> See BBC (2012).

<sup>47</sup> See Hudson and Hudson (2013).

<sup>48</sup> See Power and Hallencreutz (2005).

<sup>49</sup> See Kiss (2011); Lynskey (2013).

Early on, Spotify realized that users expected music to be integrated with social media, including participation in discussions, sharing and recommending favorite songs, and contributing to other people's activities.<sup>50</sup> Hence, its strategy was to integrate social features into its service and encourage its users to interact with each other. For instance, in 2011, Spotify started to collaborate with Facebook, the leading US social media company.<sup>51</sup> At the time, Facebook was reaching about 90% of US social media users.<sup>52</sup> The collaboration allowed Facebook users to listen to Spotify songs within their Facebook application, share playlists with their friends, and publish their favorite songs on their timeline.<sup>53</sup> Spotify discovered that users who linked their accounts with Facebook were three times more likely to become paying premium subscribers.<sup>54</sup>

Following US market entry, Spotify introduced a new premium trial, allowing everyone in the US to use the premium subscription for 6-months for free.<sup>55</sup> After the trial period, users had to downgrade their subscription to the free version or choose to pay. By December 2012, Spotify already counted 1 million paying subscribers in the US and a total of over 5 million paying subscribers in 17 operating countries.<sup>56</sup> Deezer, one of Spotify's competitors, only had about 2 million users despite having been founded earlier (i.e. in 2007) and despite being available in 160 countries worldwide (but with no presence in the US).<sup>57</sup>

The 6-month free trial helped Spotify increase its popularity in the US; nevertheless, it also generated criticism from famous artists such as Adele, Taylor Swift, Radiohead, and many others.<sup>58</sup> In 2014, Taylor Swift published an article in *The Wall Street Journal*, stating 'Music is art, and art is important and rare. Important, rare things are valuable. Valuable things should be paid for. It's my opinion that music should not be free...'<sup>59</sup> While around 40% of Spotify's users were listening to Taylor Swift at that time, she removed all of her music from the platform because of the availability of her music in the free version.<sup>60</sup> Swift was one of the few superstars financially independent enough through her extensive fan base and supported by her label Big Machine to boycott Spotify successfully.<sup>61</sup> Many other artists, such as Adele, Beyoncé, Coldplay, and Radiohead also criticized Spotify and tried to withdraw music or delay the release of new songs.<sup>62</sup> The ongoing discussion about artists' compensation revealed a complex payment regime between Spotify, the labels, and the artists. Spotify claimed to keep 30% of revenue per stream while paying out 70% to the labels, which depended on many

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<sup>50</sup> See Heinonen (2011); Hudson and Hudson (2013).

<sup>51</sup> See Grabham (2011).

<sup>52</sup> See Hudson and Hudson (2013).

<sup>53</sup> See Dredge (2012); Fleischer and Snickars (2017); Statista (2020c).

<sup>54</sup> See Dredge (2012).

<sup>55</sup> See Tsotsia (2011).

<sup>56</sup> See Lunden (2012b); Lunden (2012c); Reuters (2013).

<sup>57</sup> See Lunden (2012a); Warren (2012).

<sup>58</sup> See BBC (2013); Marshall (2015).

<sup>59</sup> Swift (2014).

<sup>60</sup> See Carlson (2014); Sternburg (2014).

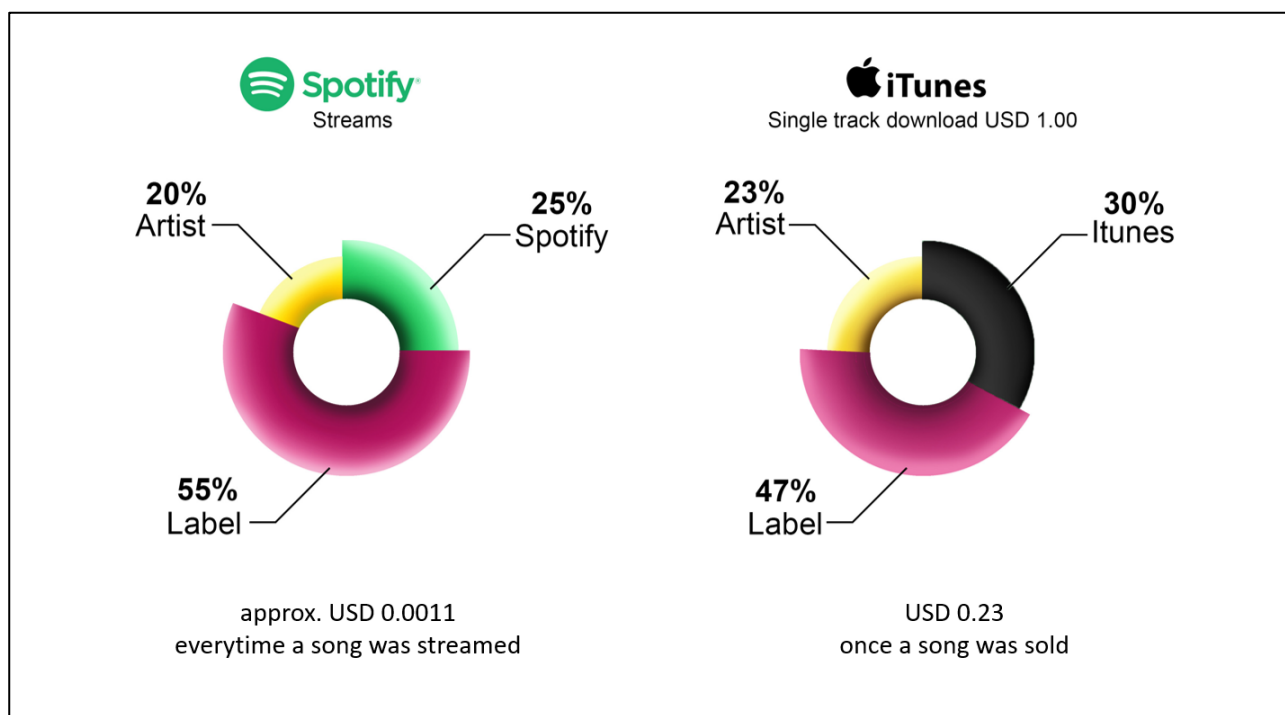
<sup>61</sup> See Knopper (2014).

<sup>62</sup> See BBC (2013); Karp (2015); Lesser (2018); Luckerson (2014); Sisarion (2016).

factors.<sup>63</sup> For example, streams from the add-supported version were less valuable than streams from the paid version; additionally, the payment per stream also differed according to the popularity of a song or the country in which the song was streamed.<sup>64</sup> In 2015, Spotify stated that the average payout per stream to the labels was between USD 0.0060 and USD 0.0084.<sup>65</sup>

However, individual payouts for each artist depended on the respective contract they had with their labels.<sup>66</sup> Some especially famous artists had good and fair deals, while others were not so fortunate. On average, the artists earned an estimated USD 0.0011 per stream on Spotify in 2015 (see also Figure 3).<sup>67</sup> In comparison, a song on iTunes generated, on average, USD 0.23 for the artists, USD 0.47 for the labels, and USD 0.30 for iTunes.<sup>68</sup> The iTunes and Spotify revenue streams were very different: the former sold songs to music listeners, while the latter sold a subscription that allowed listening to music within the paid subscription period. Therefore, the payment scheme was fundamentally different as well, in that iTunes made a one-time payment to the artists and the label, once a song was sold, whilst Spotify, in comparison, paid every time a song was streamed.

Figure 3: Artist revenue/payment scheme for Spotify and iTunes



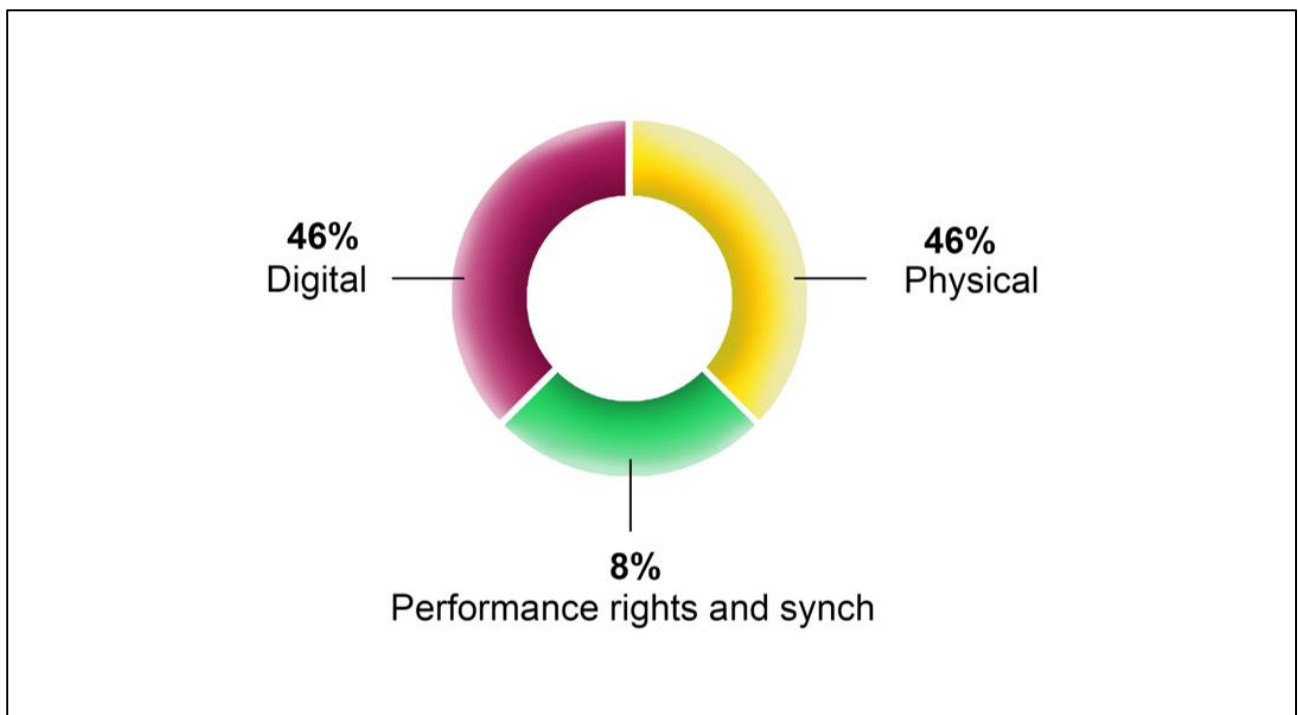
Source: Dredge (2015).

<sup>63</sup> See King (2012); Lesser (2018).  
<sup>64</sup> See Lesser (2018); Seabrook (2014).  
<sup>65</sup> See Dredge (2015); Johnson (2014).  
<sup>66</sup> See Dredge (2015).  
<sup>67</sup> See Dredge (2015); Resnikoff (2016).  
<sup>68</sup> See Dredge (2015).

Three years after Spotify's market entry into the US, digital music had become more important than physical music products—around 66% of music revenues in the US resulted from digital products, reaching a level of USD 4.5 billion (growth rate 24% from 2011 to 2014), while physical sales accounted only for 34% and USD 2.2bn of revenues (growth rate -39% from 2011 to 2014).<sup>69</sup> Within digital revenues, subscription services were a major driver of growth. Between 2011 and 2014, music streaming service revenues multiplied by a factor of 4.5 (from USD 241 million in 2011 to USD 1.09 billion in 2014). In the same period, revenues from digital downloads slightly declined, from USD 2.58 billion to USD 2.55 billion.<sup>70</sup>

On a worldwide scale, revenues from digital music sales reached USD 14.97 billion in 2014. Total revenues in the music industry were equally split between digital music (46%) and physical music (46%), with performance rights and synchronization accounting for the remaining part (8%) (see also Figure 4).<sup>71</sup>

Figure 4: Share of music industry revenues worldwide in 2014.



Source: RIAA (2015).

With the growing revenues earned from digital music (see also Figure 5), other companies, such as the global technology giants Alphabet and Amazon, entered the digital music industry and offered new services.<sup>72</sup> Amazon released its Prime Music service in 2014, and Alphabet started YouTube Music in 2015.<sup>73</sup> With Apple, Amazon, and

<sup>69</sup> See RIAA (2015).

<sup>70</sup> See IFPI (2015); RIAA (2015).

<sup>71</sup> See IFPI (2015).

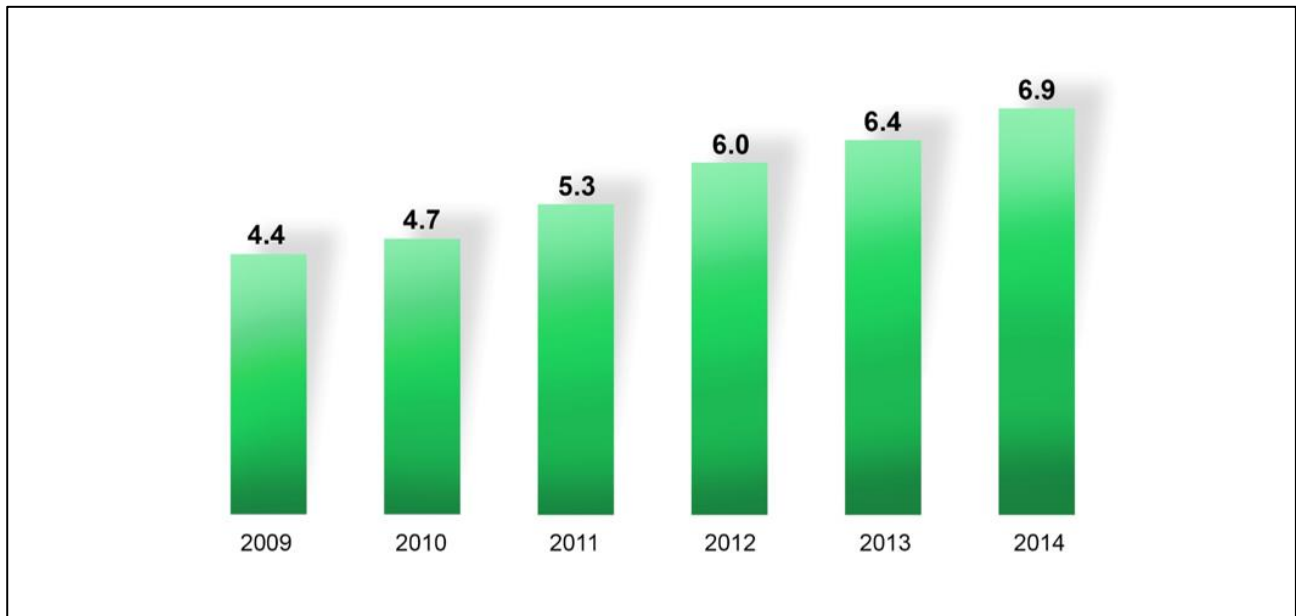
<sup>72</sup> See Gibbons (2020); Reuters (2013).

<sup>73</sup> See Dredge (2014a); Popper (2015a); Statista (2016).



Alphabet, Spotify had not only direct competitors in the US market, but all three were also hardware providers and could pre-install their music service on their own devices (Apple iPhone, Amazon Echo/Alexa smart-speaker, Alphabet Nexus/Pixel smartphones).

Figure 5: Global digital music revenues from 2009 to 2014 in billion USD.



Source: RIAA (2015).

To stay a step ahead of its competitors, Spotify took action. For instance, it offered two new versions of the premium subscriptions in the US, namely, the “student plan” and the “family plan”.<sup>74</sup> The student plan offered a 50% discount to every student in the US, thus reducing the overall price to USD 4.99 per month.<sup>75</sup> Unlike the “student plan”, which was only available for US students initially, the family plan was introduced to all Spotify operating countries and enabled up to six family members to share a premium subscription with a 50% discount.<sup>76</sup>

With all actions taken, Spotify increased its worldwide userbase to 28 million paying subscribers and to 82 million total users by 2015.<sup>77</sup> In the US, the company had grown to be one of the Top10 apps by downloads in 2015.<sup>78</sup>

Nevertheless, growing the business did not mean becoming profitable. As Spotify was under pressure from rising royalties, outraged artists, and direct competitors, operating losses at a worldwide level grew from USD 76 million in 2013 to USD 227 million in 2014 and reached USD 278 million in 2015.<sup>79</sup>

<sup>74</sup> See Constine (2014b); Dredge (2014b).

<sup>75</sup> See Constine (2014b).

<sup>76</sup> See Dillet (2016); O’Hear (2014).

<sup>77</sup> See Statista (2021b); Statista (2021c).

<sup>78</sup> See App Annie (2016).

<sup>79</sup> See Statista (2022c).

## 4 Spotify's growth

### 4.1 Software investments to enable new features

At the end of 2014, Spotify's music catalog contained over 30 million tracks.<sup>80</sup> As most other streaming services offered catalogs of similar size, differentiation by size was complicated. Therefore, Spotify started to invest heavily in technological capabilities to enhance personalized user experience and to provide intelligent music recommendations.<sup>81</sup>

Spotify already owned Tunigo, an audio analysis and recommendation company, before music intelligence and data platform Echo Nest was acquired for USD 100 million in 2014 (see also Figure 6).<sup>82</sup> Echo Nest allowed Spotify to set up so-called "taste profiles" by analyzing the metadata of what customers listen to. These "taste profiles" were then used to further improve music recommendations and playlists.<sup>83</sup> Additionally, in 2015, Spotify acquired the data analytics start-up Seed Scientific.<sup>84</sup> In 2016, the focus of the company's acquisitions changed. Social interactions became more and more important for its users, and so, for this reason, Spotify acquired Soundwave, a social music experience software that allowed users to create private groups, start chat sessions, and discuss songs, artists, and new music trends.<sup>85</sup> Spotify also acquired Cord Project, a voice-messaging platform, and CrowdAlbum, a start-up for collecting shared photos and videos of music events on social media platforms.<sup>86</sup>

In 2017, Spotify took over the audio detection start-up Sonalytic, the content recommendation start-up MightyTV, and the AI technology start-up Niland.<sup>87</sup> These acquisitions allowed Spotify to integrate new software, in order to understand better customers' individual music tastes and personalize the service even more via custom-made music recommendations.<sup>88</sup>

Spotify also built up its own social media channels on Twitter and Instagram to communicate and interact with users, promote artists, and be part of the ongoing conversation on social media platforms. Additionally, it announced cooperation with Instagram, which integrated it into the Instagram app and enabled users and artists to recommend Spotify albums, tracks, artists, and playlists directly via their Instagram stories.<sup>89</sup>

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<sup>80</sup> See Grannell (2015).

<sup>81</sup> See Cucinello (2018).

<sup>82</sup> See Constine (2014a); Etherington (2013).

<sup>83</sup> See Constine (2014a).

<sup>84</sup> See Constine (2015).

<sup>85</sup> See Lunden and Ha (2016); McIntyre (2016b); Wauter (2016).

<sup>86</sup> See McIntyre (2016b).

<sup>87</sup> See Perez (2017a); Perez (2017b); Russel (2017).

<sup>88</sup> See Perez (2017a); Perez (2017b); Russel (2017).

<sup>89</sup> See Spotify (2018b).

Spotify started to host "Music Hack Weekends" to engage software developers to build third-party apps that would hook into Spotify's music catalog.<sup>90</sup> These investments led to new features such as the Daily Mix, Discover Weekly, and Release Radar, which are unique, individualized playlists based on user preferences, big data, and deep personalization.<sup>91</sup> The producer and major label insider Jimmy Iovine stated 'the only song more important than the one you're listening to is the one that comes next. Whoever perfects this act of curation could win the streaming music war'<sup>92</sup>. Within one year, most users had listened to Discover Weekly, and industry experts acknowledged that Spotify was very successful in algorithmically-curated new playlists.<sup>93</sup> They also claimed that, with Discover Weekly, Spotify may have just out-manuevered the competition:<sup>94</sup> 'It's good. It's better than I thought it would be,' stated tech entrepreneur Anil Dash, and even though Discover Weekly is produced by machines, he confirmed 'They're as good as DJs—at scale'<sup>95</sup>.

Worldwide, Spotify's investments in music recommendation software and social interaction contributed to an increase of up to 71 million paying subscribers. Still, with losses of USD 1.2 billion in 2017, the company reported the highest global loss since its inception.<sup>96</sup> As the major labels were still rights holders to around 87% of its music streams, Spotify depended strongly on the major labels and had to pay huge shares of their income to serve royalty liabilities.<sup>97</sup> Some experts even questioned the business model of Spotify and stated that the high cost of royalties would hinder Spotify from ever being profitable at all.<sup>98</sup>

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<sup>90</sup> See Rao (2011); van Buskirk (2012).

<sup>91</sup> See Constine (2016a); Lunden (2016).

<sup>92</sup> Popper (2015b).

<sup>93</sup> See Constine (2016b); McIntyre (2016a).

<sup>94</sup> See Popper (2015b).

<sup>95</sup> Popper (2015b).

<sup>96</sup> See Kafka (2018); Statista (2022c). Statista (2021c)

<sup>97</sup> See Kafka (2018).

<sup>98</sup> See Ingham (2016).

## 4.2 Acquisitions to diversify

Spotify started to acquire companies across the entire value chain of the music industry, which granted it more independence from the major labels and the opportunity to gain new revenue streams.

In 2017, the company bought cloud-based music recording studio Soundtrap and blockchain-based media rights management company Mediachain.<sup>99</sup> In 2018, it took over the e-music licensing platform Loudr, which paved the way for a more transparent and efficient music publishing process, as it allows content creators, artists, and music services to identify, track, and pay royalties to music publishers.<sup>100</sup>

Due to high royalty costs and a total of USD 14.3 billion paid to the labels since its launch, Spotify decided to change its strategy.<sup>101</sup> In 2019, Spotify announced its ambition to become the world's leading audio platform, stating that 'audio—not just music—[would] be the future of Spotify'.<sup>102</sup> This announcement mainly led to a new focus on subsequent acquisitions.

Podcasting was a growing trend, to which (in 2019) an estimated 32% of the US population listened every month.<sup>103</sup> In order to be part of this trend, Spotify started to invest in its podcast catalog and acquired the award-winning podcast company Gimlet, the producer of famous podcasts such as *StartUp* and *Reply All*, for around USD 200 million in 2019.<sup>104</sup> The same week, Spotify announced that it was taking over the podcast production platform Anchor for approximately USD 140 million.<sup>105</sup> Furthermore, in the same year, Spotify bought the podcast studio Parcast, which creates and produces podcasts around the mystery, crime, and history themes.<sup>106</sup> The following acquisition target was the leading music production marketplace SoundBetter, which provides an online marketplace for registered artists to source singers, sound engineers, producers, and other professionals. Besides that, Sound Better enables musicians to connect with each other to collaborate on projects or to connect with publishers who want to license their music.<sup>107</sup> These acquisitions helped Spotify generate new revenue streams and tighten its relationships with artists, by offering not only music distribution via its streaming service, but also increasingly more services across the entire value chain.<sup>108</sup> This nearly full-scale service from a single source made it more convenient for artists to work with Spotify and use its software and services. In 2020, the company extended its podcast catalog by purchasing The Ringer, a widespread network of podcasts with around 100 million downloads per month.<sup>109</sup>

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<sup>99</sup> See Perez and Lunden (2017); Sawers (2017).

<sup>100</sup> See Spotify (2018a).

<sup>101</sup> See Shu and Lunden (2019); Spotify (2019d).

<sup>102</sup> See Ek (2019).

<sup>103</sup> See Edison Research (2019).

<sup>104</sup> See Russel (2019); Spotify (2019b).

<sup>105</sup> See Russel (2019); Spotify (2019b).

<sup>106</sup> See Spotify (2019e).

<sup>107</sup> See Spotify (2019a).

<sup>108</sup> See Shu and Lunden (2019).

<sup>109</sup> See Lunden (2020).

Additionally, Spotify spent another USD 235 million to acquire Megaphone, a podcast network offering podcast hosting, distribution, and ad-insertion tools as well as technology for podcast publishers and advertisers seeking advertisement slots.<sup>110</sup> It also started producing its own shows, such as the *Daily News* podcast, which has subsequently become a Top-20 show worldwide.<sup>111</sup>

Another significant investment in 2020 was the exclusive multi-year deal with Joe Rogan for USD 100 million. At the time of signing the agreement, the podcast *The Joe Rogan Experience* had around 8.4 million subscribers on YouTube and was No. 2 on the Apple Music charts (formerly iTunes).<sup>112</sup> Therefore, this deal was a direct attack on Spotify's most significant competitors and offered the chance for Apple and YouTube customers to switch to Spotify. The company also secured exclusive content and signed contracts with popular and famous podcasters such as Michelle Obama, Prince Harry & Meghan Markle, and Addison Rae.<sup>113</sup> As a result, Spotify increased its popularity: in 2020, around 25% of podcast listeners in the US used Spotify to stream podcasts, a 6% increase compared to 2019.<sup>114</sup>

Investments continued into 2021 with the acquisition of Betty Labs, the owner of Locker Room, a live audio social app that focuses on sports. According to Spotify, this acquisition was intended to develop 'future formats of audio and accelerate Spotify's entry into the live audio'.<sup>115</sup> Spotify also bought podz, to further improve its podcast business. Podz developed an audio newsfeed with 60-second clips from various podcasts, thereby enabling listeners to discover new shows easily and find the right content at the right time.<sup>116</sup> Also, in 2021, Spotify acquired the digital audiobook distributor Findaway, which connects content creators with resellers such as Audible, Scribd, Nook, Rakuten Kobo, Storytel, and a multitude of other global brands.<sup>117</sup> Another acquisition in 2021 was Whooshkaa, a podcast company that allows radio broadcasters to turn their existing audio content into on-demand content.<sup>118</sup>

While, in 2021, around 117.8 million people in the US listened to podcasts, forecasts predict that this number will rise to over 144 million by the end of 2025, i.e., an increase of around 22%.<sup>119</sup> Next to growing popularity, podcast ad spending in the US is expected to increase to around USD 2.75 billion by 2025.<sup>120</sup> To monetize this development, Spotify launched its own audio advertisement marketplace, called Spotify Audience Network, in 2021, which allows advertisers to reach Spotify users across all services, including podcasts, the Megaphone app, the creation platform Anchor, as well as its ad-supported

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<sup>110</sup> See Spotify (2020).

<sup>111</sup> See Perez (2020b).

<sup>112</sup> See Brian (2020); Bursztynsky (2020).

<sup>113</sup> See BBC (2020); Bursztynsky (2020); Carman (2020).

<sup>114</sup> See eMarketer (2020); Statista (2020b).

<sup>115</sup> Spotify (2021f).

<sup>116</sup> See Spotify (2021f).

<sup>117</sup> See Spotify (2021e); Spotify (2021j).

<sup>118</sup> See Spotify (2021h).

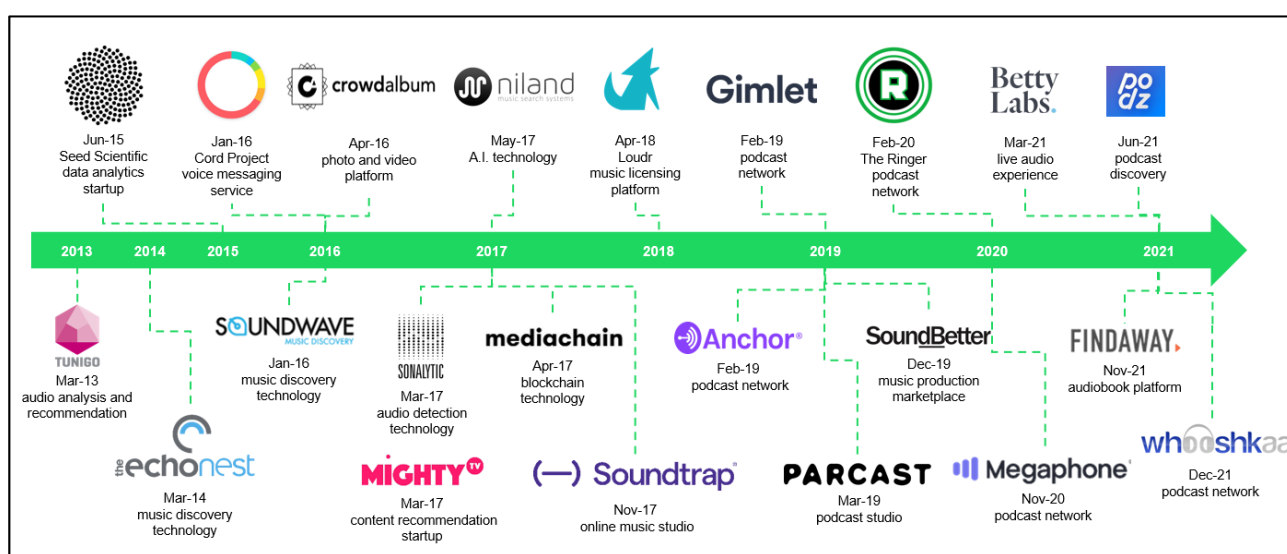
<sup>119</sup> See Insider Intelligence (2021a).

<sup>120</sup> See Insider Intelligence (2021b); Perez (2021a).

music.<sup>121</sup> With technology powered by artificial intelligence and machine learning, it enables advertisers to reach the right listeners at the right moments. Spotify also allowed artists to publish exclusive podcasts, for which fans have to pay extra fees to listen to them.<sup>122</sup>

By the end of 2021, Spotify had become an audio company focusing not only on music (see also Figure 6). With new services along the audio production value chain, exclusive content, and a growing podcast business, Spotify was attempting to attract new customers and create new revenue streams alongside copyrighted music from the major labels.

Figure 6: Spotify's acquisitions over time up to December 2021.



Source: Based on Aidan et al. (2021); Aurelius (2020); Shu and Lunden (2019); Spotify (2019a); Spotify (2019b); Spotify (2019e); Spotify (2021e); Spotify (2021f); Spotify (2021g) and Spotify (2021i).

### 4.3 Further market entries to expand globally

In order to drive growth, Spotify not only invested in usability, podcasts, and exclusive content but also expanded into many countries. In the initial years, Spotify focused mainly on European countries through simultaneous launches in several European countries, i.e. Sweden, Finland, Norway, France, and Spain, in 2008.<sup>123</sup> Thereafter, the US market was entered in 2011, followed by Australia and New Zealand in 2012. In the following years, the company launched its services in many Latin-American countries, such as Argentina (2013), Bolivia (2013), and Chile (2013).<sup>124</sup> In 2013, Spotify counted 6 million paying users distributed across 35 operating countries.<sup>125</sup> Compared to Spotify, the French-based company Deezer was available in 180 countries worldwide but with

<sup>121</sup> See Perez (2021b).

<sup>122</sup> See Perez (2021c); Spotify (2021i).

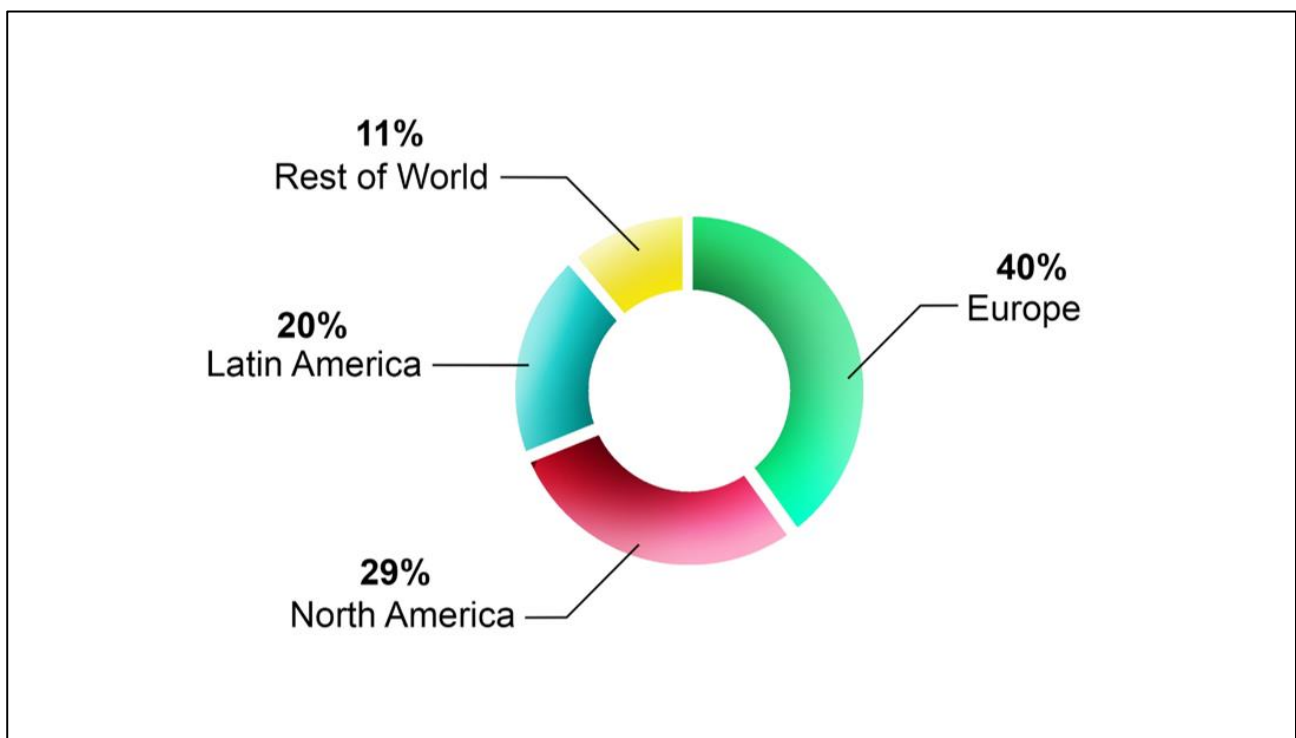
<sup>123</sup> See Lynskey (2013).

<sup>124</sup> See Grundberg (2014); Kastrenakes (2013).

<sup>125</sup> See Kastrenakes (2013).

only five million paying users.<sup>126</sup> In the ensuing years, Spotify launched its services in the Philippines (2014), Brazil (2014), Japan (2016), and Thailand (2017), and in 2018, it expanded to 13 Arabian markets, including Saudi Arabia, the United Arab Emirates, Egypt, and Morocco before entering India in 2019 and 13 East-European countries, including Russia, in 2020.<sup>127</sup> Figure 7 shows that Europe, with 40% of premium subscribers, is still the most crucial region for the company, followed by North America (29%), Latin America (20%), and the Rest of the World (11%).<sup>128</sup> At the end of 2021, Spotify was available in 178 countries worldwide, including nine of the top 10 music markets in the world.<sup>129</sup>

Figure 7: Spotify's premium subscribers worldwide, Q4 2021 by region.



Source: Spotify (2022b).

To grow its user base, Spotify not only continuously increases the number of countries it serves, but it also attempts to win new customers within the countries it has already entered. In Sweden, for instance, the company's home country and often considered an early adopter market for streaming, 43% of the population pays for subscription models to listen to music and podcasts.<sup>130</sup> Other countries, such as the United States (27%), Germany (18%), and Japan (8%), still lag behind Sweden when it comes to the popularity of streaming music with subscription models.<sup>131</sup>

<sup>126</sup> See Dredge (2013); Lunden (2013); McComick (2013).

<sup>127</sup> See Reuters (2018); Reuters (2020); Spotify (2019c).

<sup>128</sup> See Spotify (2021c).

<sup>129</sup> See IFPI (2021); Spotify (2021a).

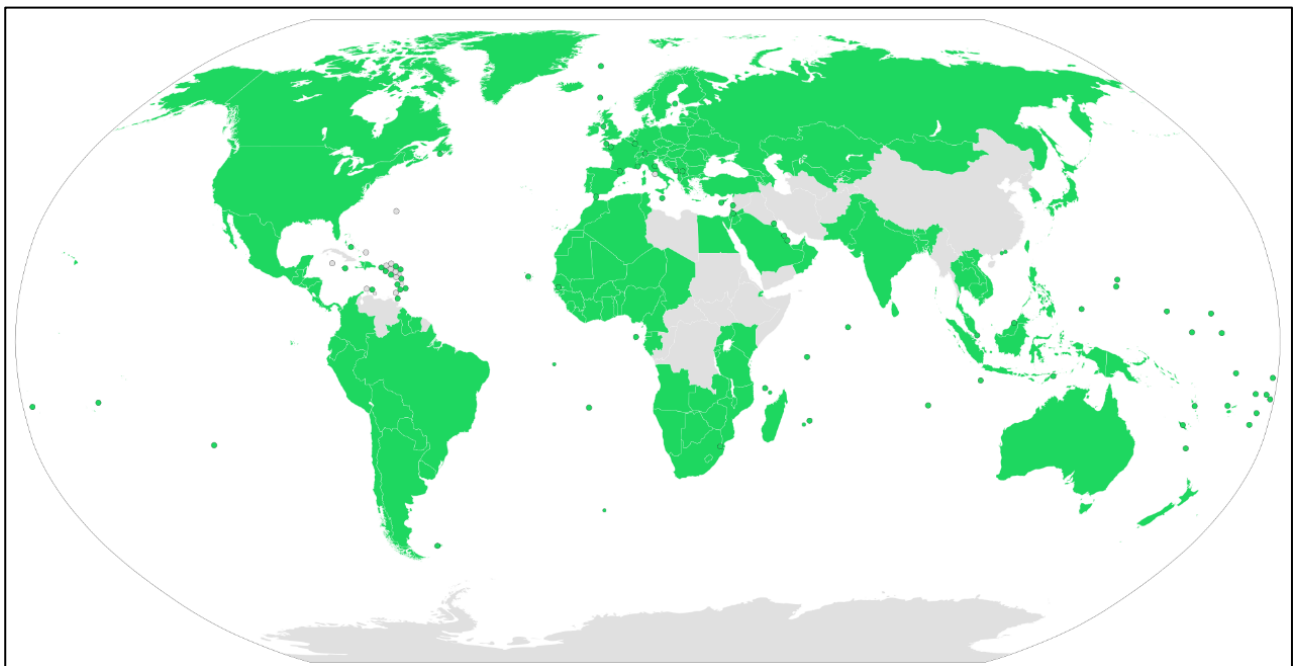
<sup>130</sup> See Goldman Sachs (2020).

<sup>131</sup> See Goldman Sachs (2020).

Additional opportunities stem from emerging markets. India, for instance, is often called music's "sleeping giant".<sup>132</sup> In 2021, for instance, only 11% of the Indian population (1.3 billion inhabitants) had signed up for a music streaming service (whether in "free" or "premium" options), and Spotify's market share was still below 1%. With millions of people signing up for online services every month, the growth rates for music streaming are currently very high in India.<sup>133</sup>

One large market still remains untouched by Spotify—China, with a population of 1.41 billion.<sup>134</sup> The third-largest shareholder of Spotify is Tencent, a Chinese multinational technology conglomerate that held 8.72% of Spotify's equity in 2021. Additionally, Spotify holds a minority stake of 16.9% in a subsidiary of Tencent, namely, Tencent Music Entertainment Group, the leader in the Chinese music streaming market.<sup>135</sup> As there are already connections to the Chinese market, it will be interesting to see whether, how, and when China will be entered by Spotify. Figure 8 illustrates that China, as with Iran, Iraq, Cuba, and Venezuela, is one of the few countries that have not yet been tackled by Spotify.

Figure 8: Availability of Spotify worldwide as of June 2021.



Source: Danindub (2021).

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<sup>132</sup> Hu (2017).

<sup>133</sup> See SN (2020). Deahl (2019)

<sup>134</sup> See Statista (2021a).

<sup>135</sup> See Ingham (2017); MarketScreener (2021); Rodenbaugh (2021); Russel (2018).



## 5 Spotify's rising power

With tens of millions of songs available in Spotify's music catalog, finding a good song is becoming more complex for users. Playlists such as Discover Weekly, an individual playlist for every user, created according to the user's music taste and updated every Monday, Release Radar, a playlist of new releases from artists a user is listening to, which updates every Friday, and many more options help to reduce this complexity. Next to individual playlists, Spotify also offers curated playlists which are similar for all users. These playlists are, for example, connected to a location (e.g., Top 50 USA, Top 50 Spain, Top 50 Global), to the mood of the user (e.g., Happy Hits, Spring Fever, Alone Again), or to a situation in which the user listens to music (e.g., Songs to Sing in the Car, Valentine's Day Love, Dinner Music).<sup>136</sup>

Playlists have become very popular, as they offer an easy solution for users to discover their next favorite songs, without spending hours searching for them. In addition, they have also become essential to the labels, since they are an effective method for music promotion, as being listed in one of Spotify's playlists can generate an increase in listeners by 50 to 100%.<sup>137</sup> Additionally, placing a song in a playlist also ensures the labels and their artists reach millions of new potential fans globally. If new releases are not listed on Spotify and its famous playlists, it is unlikely for new songs or albums to develop into a hit record, as they are inaccessible to millions of listeners.<sup>138</sup>

Although some of the playlists are the same all over the world and others are tailored individually to each user, Spotify decides which songs will be included. As the company is aware of the effect playlists have, it acts as a gatekeeper and tries to monetize these playlists; as such, it has been accused by artists and labels of trying to create digital "payola".<sup>139</sup> Payola originally describes cash bribes and other "gifts" that record labels give to music stores, radio programmers, and DJs in exchange for promotion and better placement on playlists and preferential airtime.<sup>140</sup> This procedure is said to be not necessarily illegal as long as the promoted tracks are labeled with an indication of the paid promotion.<sup>141</sup> Spotify offered a similar feature that prioritized songs in selected playlists in exchange for a cut in the royalties it had to pay to the labels.<sup>142</sup> The development of this payola feature marked a fundamental change in the relationship between Spotify and the labels. While Spotify had depended heavily on the labels and their copyrights in the past, it was the first time the labels paid or granted a discount on royalty rates to Spotify to get listed on popular playlists.<sup>143</sup> This new approach allowed Spotify to gain leverage over the labels, which could be used in license negotiations to reduce royalty rates and therefore decrease its financial obligations to rights holders.

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<sup>136</sup> See Spotify (2022b).

<sup>137</sup> See Kafka (2017).

<sup>138</sup> See Constine (2017).

<sup>139</sup> See Artist Rights Alliance (2020).

<sup>140</sup> See Hern (2020); Yoo (2020).

<sup>141</sup> See Hern (2020); Yoo (2020).

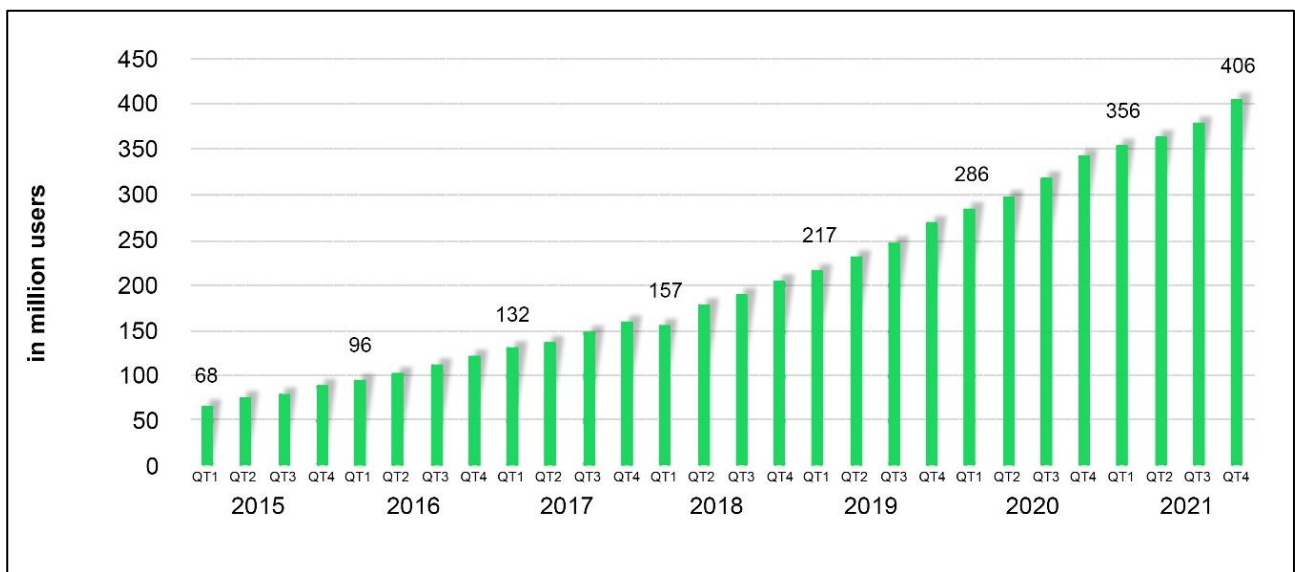
<sup>142</sup> See Hern (2020); Nicolaou (2021).

<sup>143</sup> See Nicolaou (2021); Yoo (2020).

Additionally, Spotify benefited from the general trend of music artists demanding ownership rights for new songs. In the traditional music business, ownership rights were generally the centerpiece of any contract between artists and labels, and usually, the rights were held by the labels.<sup>144</sup> As Taylor Swift refused to renounce her ownership rights in 2019 and departed the label to which she was signed, she encouraged numerous artists to also push for ownership of their work and more significant independence from their labels.<sup>145</sup>

This had a significant effect on the music industry. Nowadays, artists do not rely alone on the labels for music distribution, as they also have the ability to utilize streaming services such as Spotify. This movement has increased pressure on the labels to change their business model and enhanced Spotify's position in the music market as a distributor with access to 406 million users (see also Figure 9). Acquiring companies such as the music recording studio Soundtrap or the collaboration platform SoundBetter has tightened Spotify's relationship with artists as well as with music producers. As a consequence, the company has expanded its influence in the music business while draining the labels' dominance.

Figure 9: Spotify users worldwide from 2015 to 2021.



Source: Statista (2021b).

<sup>144</sup> See Flanagan and Tsioulcas (2019); Grady (2019).

<sup>145</sup> See Grady (2019); Hann Chua (2019) Statista (2021b).

Spotify also developed a position as an important distribution channel for the labels. In the fiscal year 2020,<sup>146</sup> it contributed significantly to the major labels' total royalties.<sup>147</sup> For Universal (52%) as well as Warner (54%), income from streaming (all streaming services such as Spotify, Apple Music, Deezer, etc.) amounted to the largest source of revenue, with Sony Music also earning 33% of its revenue from streaming.<sup>148</sup> While the exact share of Spotify's streaming revenue for the labels has not been disclosed, it is expected that the company is accountable for a significant part thereof.

Furthermore, as its userbase is still growing, Spotify will remain the most important partner for the labels in the near future, both in terms of hard power (revenues, subscribers) and soft power (ability to promote artists and songs by payola etc.). Therefore, the dependency of the labels on Spotify is expected to increase further.<sup>149</sup>

Moreover, Spotify has managed to decrease its dependency on the major labels. While in 2017, around 87% of the global music streams on Spotify were copyrighted by the major labels, this number declined to 78% in only three years.<sup>150</sup> If this decline continues at around -3% per year, the labels could own less than 50% of all annual streams on Spotify by 2030.<sup>151</sup> In addition, Spotify continues to create new revenue streams from music production, podcasts, and directly signed contracts with artists—all of which have the potential to decrease further its dependency on the major labels.

In summary, over the years, Spotify has grown and become a vital distribution channel for the labels. As the labels' business model is coming under more and more pressure, Spotify is strengthening its position in the music industry.

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<sup>146</sup> For Sony Music, the fiscal year ended March 31, 2020, for Warner Music September 30, 2020, and for Universal Music December 31, 2020

<sup>147</sup> See Constine (2017); Spotify (2021a); Statista (2021b).

<sup>148</sup> See Sony (2020); Vivendi (2021); Warner (2021).

<sup>149</sup> See Ingham (2021).

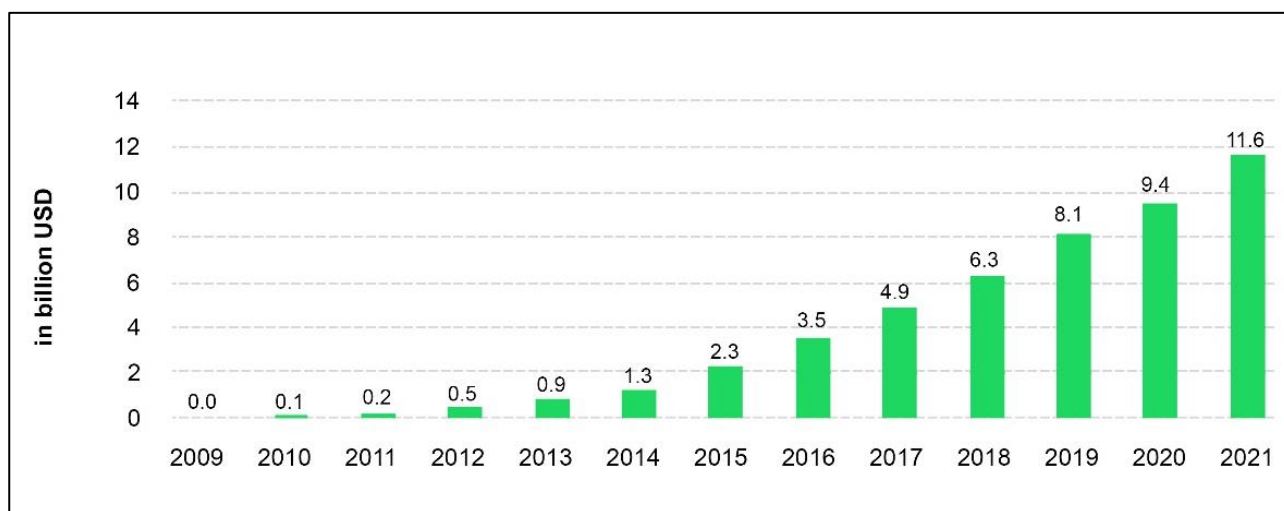
<sup>150</sup> See Ingham (2021).

<sup>151</sup> See Ingham (2021).

## 6 Spotify's future: challenges and opportunities ahead

Investors value Spotify. For instance, as of December 2021, Spotify had achieved a market capitalization of USD 45 billion.<sup>152</sup> Moreover, with USD 11.6 billion in 2021, the company generated the highest revenues in its history (Figure 10). However, while total income grew by around 23% compared to the previous year, Spotify had to report a drop in average revenue per premium user (ARPU). In 2021, its global ARPU was USD 5.15 per month, a drop of 37% since 2015, when it was USD 8.66.<sup>153</sup> This drop in the ARPU was mainly driven by the company's aggressive growth strategy, which was characterized by increasing the number of premium subscribers on free trials and discounted subscriptions, such as student and family plans.<sup>154</sup> In 2021, Spotify's cost of revenue—consisting predominantly of royalties—was high at around USD 9.5 billion.<sup>155</sup> Taking into account the cost of R&D, sales, and administration, Spotify suffered a net loss of USD 47 million in 2021.<sup>156</sup> It has been operating at a loss since its inception (see also Figure 11); in addition, Spotify accumulated a total loss of USD 4.7 billion up to 2021.<sup>157</sup> Therefore, its future will be determined by the question of whether the company can generate profit as well as pay back its debts.

Figure 10: Spotify's revenue worldwide from 2009 to 2021.



Source: Statista (2021f).

<sup>152</sup> See Yahoo Finance (2022).

<sup>153</sup> See Spotify (2022a); Statista (2022b).

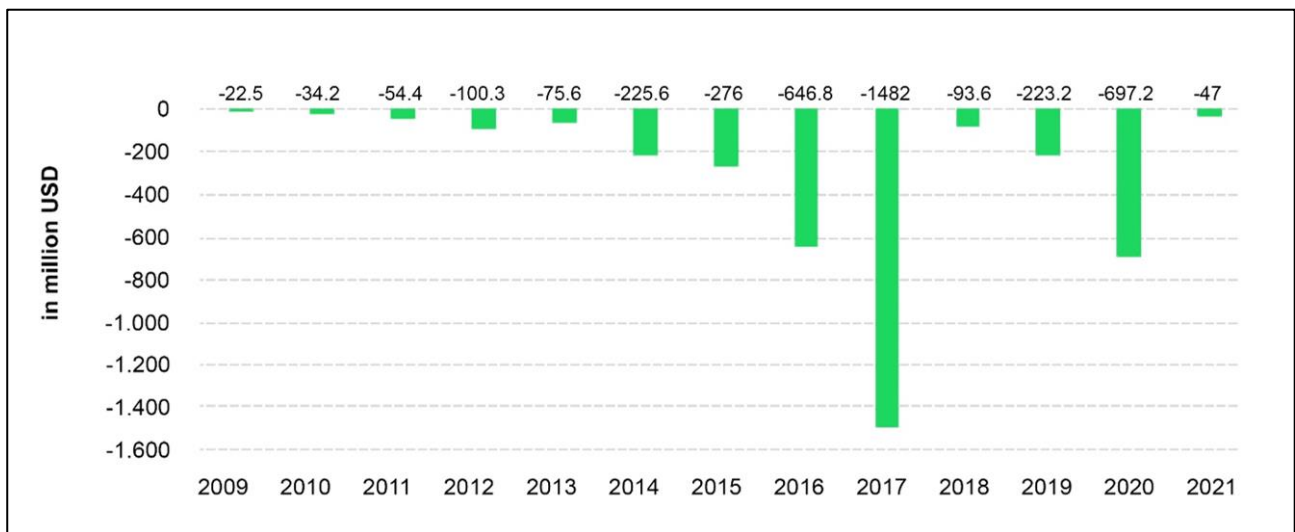
<sup>154</sup> See Peoples (2021); Spotify (2021b).

<sup>155</sup> See Spotify (2022a).

<sup>156</sup> See Spotify (2022a).

<sup>157</sup> See Statista (2022c).

Figure 11: Spotify's net income/loss from 2009 to 2021



Source: Statista (2022c).

Spotify is the most popular service in the music streaming business, but for potential customers, differentiating between the leading music platforms is not straightforward. Spotify, Amazon Music, and Apple Music offer similar music streaming services and a vast amount of songs and podcasts (as of 2021: Spotify; 70 million; Apple Music 75 million; Amazon Music 70 million).<sup>158</sup> The price for a premium subscription for all three platforms is around USD 9.99 per month (in the U.S, in 2021, without discounts).<sup>159</sup> To attract new customers, all competitors offer discounts for students, family plans, and other price reductions.

Direct competitors such as Amazon Music or Apple Music are part of huge, financially stable, and extremely profitable corporations, while Spotify is still operating at a net loss. The financial power of its two major competitors (net income of USD 33 billion for Amazon and USD 94 billion for Apple in 2021),<sup>160</sup> as well as the approach of pre-installing their own music streaming service on sold Amazon and Apple devices, is a huge competitive advantage for them. It is also questionable whether Spotify can keep up the costly approach of offering the same discounts and price reductions as Amazon and Apple in the future.<sup>161</sup>

New players, such as TikTok, could also affect Spotify's business model. TikTok is the third largest social network in the world with growth rates of 59% in 2020 and 40% in 2021, and it is expected that 755 million monthly users will use it throughout 2022.<sup>162</sup> TikTok generates its revenue through advertisements, very much in the same way as Spotify does in its free version, thereby allowing it to compete with Spotify for the budgets that third parties are planning to spend for advertising. Furthermore, TikTok has its own

<sup>158</sup> See Amazon (2021); Apple (2021); Spotify (2021a).

<sup>159</sup> See Hensley (2020); Kumar (2020); Statista (2021e).

<sup>160</sup> See Amazon (2022); Apple (2022).

<sup>161</sup> See Auchard and Swahnberg (2018); Pendlebury (2022).

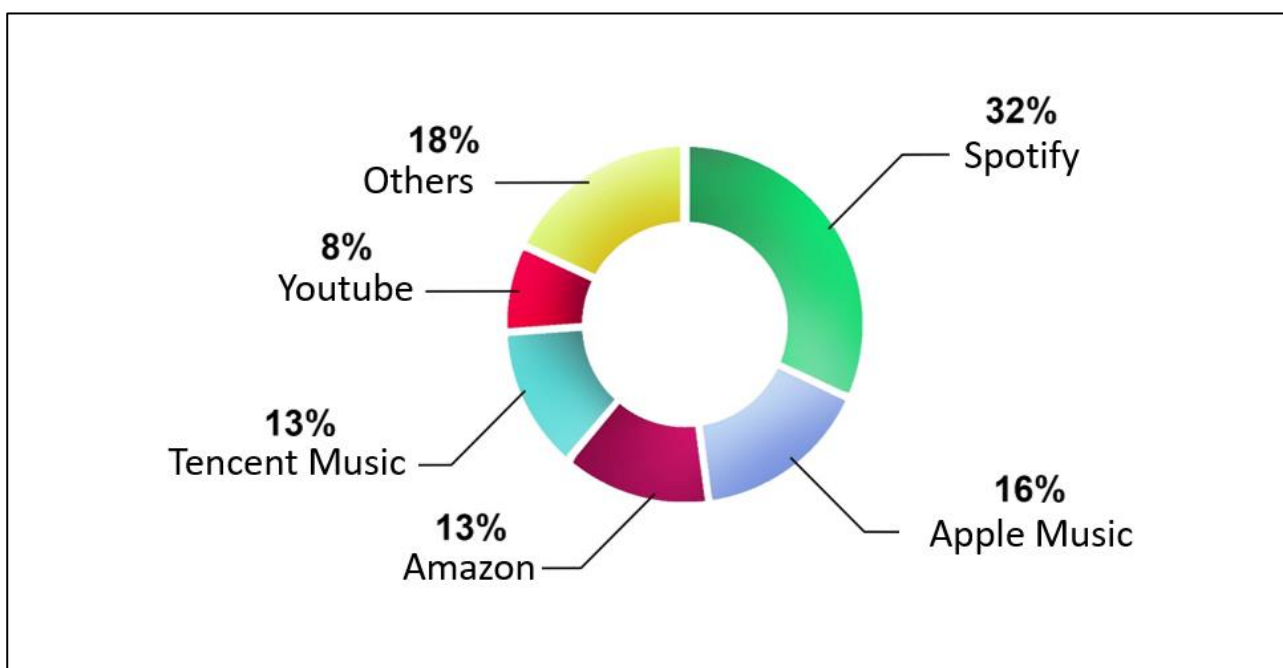
<sup>162</sup> See eMarketer (2021); Perez (2021d).

music platform, Resso, which was launched in 2020 and focuses on fast-growing markets such as Brazil, Indonesia, and India.<sup>163</sup> As Spotify is targeting the same markets, TikTok can be considered a competitor.

Additionally, Spotify must cope with increasing demands for privacy rights and data protection at the user level, next to growing nationalism, protectionism, and skepticism against foreign corporations in some of its operating countries.<sup>164</sup>

In 2021, 32 percent of music streaming subscribers worldwide had a subscription to Spotify, making it the biggest music streaming service in the world, followed by Apple Music with 16% and Amazon Music with 13% (see Figure 12).<sup>165</sup> At the end of 2021, the company had around 180 million premium subscribers worldwide. With an additional 200 million subscribers in the ad-supported version, Spotify has a vast potential to further increase the conversion of users into premium subscriptions and thus one day achieve profitability.<sup>166</sup> But when will Spotify finally become profitable?

Figure 12: Share of music streaming subscribers worldwide in 2021.



Source: Statista (2021e).

<sup>163</sup> See Cohen (2021); Freer (2020); Lunden and Sighn (2020); Perez (2020a).

<sup>164</sup> See Huang and Madnick (2020); OECD (2021); Withehead (2021).

<sup>165</sup> See Statista (2021e).

<sup>166</sup> See Spotify (2021d).

## Questions

1. Music labels and artists are two major stakeholders in Spotify. Please describe Spotify's relationships
  - a. to artists and how they have changed over time.
  - b. to major labels and how they have changed over time.
  
2. Before formulating their strategy, firms should also be aware of their culture.
  - a. Please do some research, allowing you to describe Spotify's corporate culture. When doing so, please refer to both the concept level and the perceptual level of culture.
  - b. In how far do you believe Spotify's corporate culture is influenced by Swedish culture, i.e., the culture of the country where its headquarters is located?
  
3. In the case study you received some information on Spotify's mission. It was stated that Spotify was founded with the mission to 'give people access to all the music they want, at all times—in a wholly legal & accessible way'. Do you believe that Spotify's mission has changed over time?
  
4. One instrument to analyze an industry is Porter's "Five Forces framework".
  - a. Please describe the music industry in the year 2000, using Porter's five forces.
  - b. Please analyze the music industry in the year 2021, using Porter's five forces.
  - c. What major changes can you identify when comparing Porter's five forces in 2000 and 2021?

5. Players in an industry are not homogeneous. Instead, they may be different and even belong to different strategic groups. According to Porter, a broad range of characteristics can be used to differentiate firms and form strategic groups. Examples include pricing position, ownership structure, market segments, the extent of product diversity, etc.
  - a. Based on your own choice of dimensions, please establish strategic groups for the industry in which Spotify operates.
  - b. In a next step, please compare Spotify's strategic positioning to the strategic positioning of another competitor from a different strategic group. Does Spotify only have differences with this competitor, or do you also identify similarities?
  
6. Please read the following article: Benner/Waldfogel (2016): The Song Remains the Same? Technological Change and Positioning in the Recorded Music Industry, *Strategy Science*, Vol. 1, No. 3, pp. 129-147.
  - a. The article compares traditional, major labels, such as Sony, Universal, Warner, and EMI, to independent labels. Which hypotheses do Benner/Waldfogel establish when comparing major labels with independent labels? Are these hypotheses supported by the empirical study conducted by Benner/Waldfogel? Please provide a short summary.
  - b. The Spotify case study that you have read did not include information on Spotify's relationship with independent labels. Please do some research on your own and discuss the role that independent labels play for Spotify. Can you identify changes over time? If yes, what consequences could these changes have for Spotify?
  
7. Imagine you are asked to analyze macro-environmental trends for the music streaming industry.
  - a. In the case of Spotify, please discuss five major threats within the macro-environment that affected the company between 2011 and 2021.
  - b. In your opinion, what five major threats within the macro-environment could affect Spotify from now until 2030?



8. Please imagine that as of today you have to conduct a SWOT analysis, by identifying strengths, weaknesses, opportunities, and threats for Spotify. To arrive at the SWOT analysis, please use tools and frameworks that help you analyze the firm as well as the macro-environment and the micro-environment.
  - a. Please establish a SWOT analysis for Spotify in the US market.
  - b. Please establish a SWOT analysis for Spotify in another country of your choice.
  
9. Spotify has shown strong growth over the last few years.
  - a. Please describe Spotify's growth strategy over the previous years by using the Ansoff Matrix (i.e., referring to market penetration, market development, product development, and diversification).
  - b. What would be your recommendation for Spotify's development in the next five years (market penetration, market development, product development, diversification)?
  
10. Companies have to decide what they do within the firm and what they source out.
  - a. As a first step, please use Porter's value chain and adapt it to Spotify. What would the Spotify value chain look like?
  - b. Which of Spotify's activities are currently outsourced?
  - c. Would you recommend changes in Spotify's outsourcing strategy? Please justify your answer.
  
11. Firms must have an underlying logic to their acquisitive behavior, since acquisitions could fail and be very expensive. Please have a look at Spotify's acquisitions in recent years.
  - a. Do you recognize an underlying logic behind the acquisition activities of Spotify?
  - b. In your opinion, has Spotify's acquisition logic changed over the years?

12. In a “winner-takes-all industry”, the best performers can capture a very large market share, while remaining competitors are left with small market shares. Spotify has already been able to capture a significant share of the streaming market. Please answer the following questions:
- Please describe some characteristics which enable a company to lead a winner-takes-all industry in general.
  - Would these characteristics also apply to the industry Spotify is in? Please explain your answer in detail and provide reasons for your position.
13. While Spotify has been offering a streaming service since its inception, Apple Music represents a “pay-to-own” service. Steve Jobs (Apple Music) stated in 2007: ‘The subscription model has failed so far’ and ‘People want to own their music’. Please compare Spotify’s service with Apple Music’s service.
- Describe the advantages and disadvantages of how Apple Music sold music in 2010 compared to Spotify’s streaming service.
  - Why did Apple Music later revoke this decision and implement a subscription service?
  - How did Apple Music’s strategic change affect Spotify?
14. Even though Spotify has a dominant position in music streaming worldwide, plenty of other firms, such as Apple Music, Amazon Music, Deezer, and YouTube Music, successfully offer music. Please select one of these companies and conduct some additional research
- Please first establish some criteria in order to help you compare Spotify with the other music service, and second, perform your comparison based on these criteria.
  - Finally, please argue which of the two companies will be more successful in the future.

15. Spotify not only has large competitors such as Apple or Amazon. Berlin-headquartered Soundcloud is an example of another competitor. Please do some research on Soundcloud.
- Please compare Spotify with Soundcloud by establishing criteria that help you to contrast both companies.
  - Imagine that you are managing a venture capital fund. Would you have provided funding to Soundcloud in 2010? Please formulate your arguments.
  - Would your decision to fund Soundcloud have been different in 2020? Please justify your argumentation.
16. Please consider Spotify, Apple Music, and Amazon as well as two other competitors of your own choice (such as Deezer, Soundcloud, etc.)
- How would you describe Spotify's competitive advantage as of now?
  - In your opinion, can Spotify's competitive advantage be sustained over the next few years? Or do you believe that Spotify will change its base for a competitive advantage?
17. Please read the following definition of the term "business model" by Osterwalder/Pigneur (2010):
- "A business model describes the rationale of how an organization creates, delivers, and captures value. [...] Building blocks [of a business model] cover the four main areas of a business: customers, offer, infrastructure, and financial viability. Thus, the business model is like a blueprint for a strategy to be implemented through organizational structures, processes, and systems.
- How would you describe Spotify's business model in 2010?
  - How would you describe Spotify's business model in 2021?
  - What are the similarities and differences between the business models in 2010 and 2021?

18. Spotify has yet to attain profitability. Please discuss its efforts to monetize its services over the years.
- Why has Spotify never generated an operating profit since its inception? Please summarize some arguments you draw from the case study and add additional potential reasons.
  - Please explain two approaches Spotify has used to increase profitability over the last few years (while still not being profitable).
  - What would you recommend to help Spotify increase profitability in the future? Please describe two suggestions in detail.
19. Considering that Spotify is generating its income mainly through premium subscriptions, please discuss three approaches to how it could convince more users to sign up to its premium subscription.
20. Spotify opted for the freemium pricing model.
- Please describe how Spotify's freemium pricing model has contributed to its growth.
  - The freemium pricing model faced major criticism from the artists. Please summarize three criticisms.
21. In 2021, Spotify was available in 178 countries worldwide, including nine of the top 10 music markets globally, China being the exception.
- Why was China treated differently compared to other countries? Please provide your arguments.
  - Will Spotify enter China in the next five years? Please find at least five arguments for and at least five arguments against market entry into China. What would be your final recommendation?

22. You read that Spotify has a presence in nearly 200 countries. Please do some research on Spotify in Japan.
- Compare Spotify's offer in Japan to its offer in Germany in terms of service, price, and communications. What similarities and differences do you see?
  - How would you explain the differences you identified with regards to the macro-environment and the micro-environment?
23. In 2020 Spotify entered Russia. In 2022, Russia invaded Ukraine and the Russian-Ukrainian war started. Imagine that, at the beginning of 2022, you were responsible for Spotify's business in Russia. Which measures would you have taken?
24. Sweden is a relatively small country in terms of population and GDP. Nevertheless, several Swedish companies have expanded successfully abroad, such as Ikea.
- Please do some research and compare the personalities of Ingvar Kamprad, the founder of Ikea, with the personalities of Daniel Ek and Martin Lorentson, the founders of Spotify. Do you see similarities or differences?
  - Do you believe that Ingvar Kamprad would also have the personality to successfully found and manage a company like Spotify? Please provide justifications for your answers.
25. What recommendations would you give to Spotify for its future strategic development?
- In terms of Porter's generic strategies, should Spotify be a cost leader, a differentiator, or a focus company? Please justify your reasoning.
  - In terms of growth strategies, should Spotify concentrate on market penetration, product development, market development, or diversification? Please justify your reasoning.
26. You know that there are different reasons/motives for firms to internationalize. Please briefly name each of Dunning's main reasons/motives and apply them to Spotify's internationalization.

27. The Uppsala School advocates a particular pattern of internationalization in terms of psychic distance. Please argue whether and, if so, how Spotify internationalized according to the so-called “psychic distance chain”.
28. Please carry out some research on the market entry modes Spotify uses when expanding abroad.
- a. Why did Spotify prefer this/these entry mode(s)?
  - b. If Spotify eventually enters China, which entry mode would you recommend, and why?
29. Not only music, but also videos and movies can be streamed. Netflix has developed into a major (subscription) streaming company. Please establish some criteria that help you to compare a music streaming service company like Spotify with a video/movie (subscription) streaming service company like Netflix.
- a. What are the similarities and differences between Netflix and Spotify?
  - b. In April 2022, Netflix shares dropped by 35% compared to the beginning of 2022. Please carry out some research on Spotify by analyzing Spotify’s share price development in the first quarter of 2022. Which conclusion do you draw when comparing Netflix with Spotify?

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