

Spotify - “Music for everyone.”

Rise of Spotify from the ashes of Napster

In the early 2000s, the music industry was struggling, and over the years, physical media sales like CDs were falling¹ (Figure 1 below). In the world of technology, when record labels struggled to find the reason behind reduced sales, this crisis identified an opportunity. Pirated music started to be shared and downloaded through torrents and the web, becoming the recording industry's biggest nightmare. This opportunity gained another face when a peer-to-peer music sharing service, “Napster” was released. However, it wasn’t long before the Music Industry sued Napster for copyright infringement². Moreover, pirated music started to be shared and downloaded through torrents and the web.

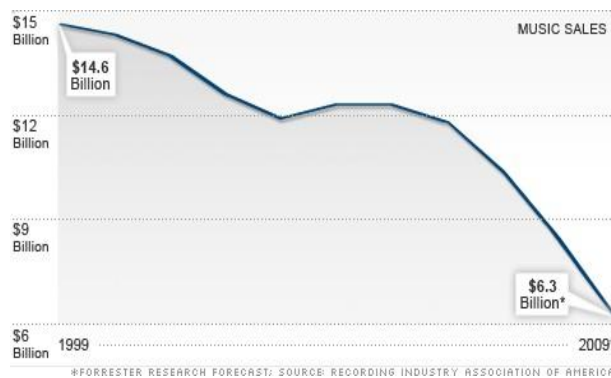


Figure 1

Piracy was illegal, and though Napster was no longer in use, the demand indicated a massive opportunity among music consumers who wanted a better music experience. In 2006, Daniel Ek identified this opportunity and did what Napster did, but legally. He launched a product called Spotify, which is now one of the industry's most prominent and influential players³. Spotify offers copyright-restricted recorded music and podcasts from record labels and media companies to music consumers legally.

When Spotify launched in 2008, the revenue for the global music industry was declining drastically (Figure 1 above). With sales shrinking, the “Big Four” American record labels—EMI, Sony, Universal, and Warner Music—and a couple of smaller labels agreed to make their entire back catalogs available to Ek and his company for use outside the U.S. on a limited basis. In return, the Big Four record labels became Spotify’s most significant shareholders⁴. Moving forward, we will analyze the evolution of Spotify from its genesis to the present and see how this disruption changed the landscape of the music industry.

¹ [Recorded music industry - global revenue 2021 | Statista](#)

² [Napster - Wikipedia](#)

³ [Product Habits Blog](#)

⁴ [producthabits.com](#)

Growth and Development of Spotify over time

Spotify's vision of providing free music to everyone legally enabled it to focus on low-end customers during its origin. The founders wanted to provide instantaneous music streaming, i.e., load music within 300ms and believed in using the best technology for their product. This was a revolutionary idea at the time. However, to make Spotify economically successful and viable, they adopted a "freemium business model". It provides the basic features as a freemium option with advertisements and limited control, while additional features, such as offline listening and commercial-free listening, are offered via paid subscriptions⁵.

On October 7, 2008, Spotify's services were initially made available to the general public (by invitation only) in Scandinavia, the UK, France, and Spain. In the UK, Spotify began providing free but constrained access to its services in 2009. Spotify's strategy was to eventually take over mainstream customers by providing them with premium features. Although the conversion rate of users from free to premium was very low initially, Spotify's innovative technology did justice to its strategy.

In 2021, Spotify is the world's most popular audio streaming subscription service, with 356M monthly active users, including 158m paid subscribers. (Figure 2, below)

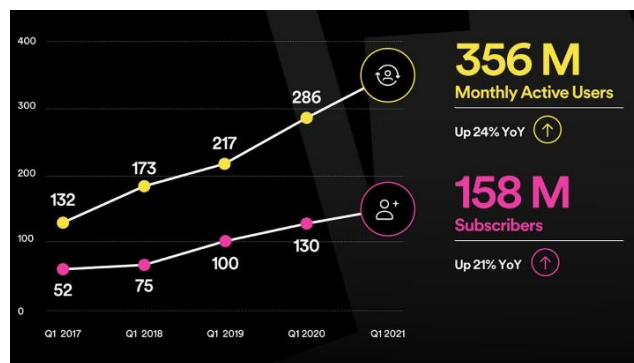


Figure 2

Product-Market fit and Spotify taking over the incumbent

Spotify succeeded because it identified a major market opportunity and pursued it relentlessly. It entered and overpowered a world where many start-ups tried and failed before it came. The major incumbent players were the physical stores selling the CDs and Vinyl copies of the music. But as consumer habits changed, Spotify saw this opportunity to digitize music and captured the market by competing with physical stores and collaborating with record companies. It overcame these high barriers to entry in the market (expensive managing proposition of music rights). It brought a streaming model that wasn't yet adopted by many consumers (who were still downloading or buying discs).

In the USA, when it launched in 2011, other subscription services like Pandora and iTunes were also available, which were Spotify's competitors then; hence, Spotify didn't have to grow a new market of

⁵ [Spotify - Wikipedia](#)

consumers there. However, it developed a new need for music streaming in many geographies like Sweden, Europe, etc. Spotify cruised into the world of music and gained traction by providing the best quality product for the mainstream market and attracting consumers to its platform.

Spotify overcame the incumbents in the music industry and now has reached the stage where it is the incumbent. (Figure 3, below). Spotify⁶ has captured 31% of the music subscription market and is the lead with Apple music at just 15% (Figure 4, below)

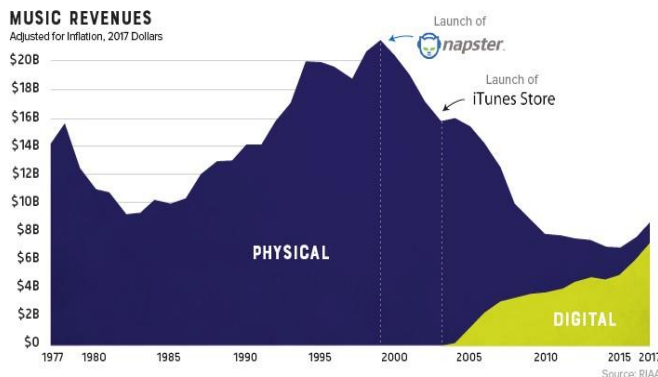


Figure 3

Global streaming music subscription market, Q2 2021

Global streaming music subscription market, Q2 2021, global

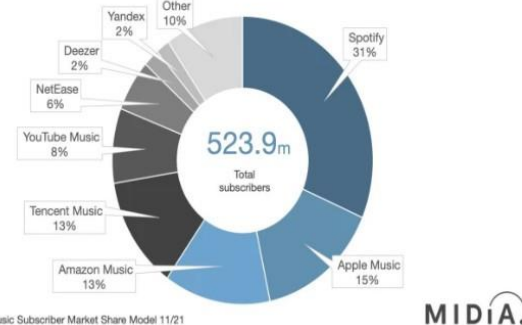


Figure 4

Spotify's Customer Segmentation, Revenue generation, and Benefits to customers

Spotify has divided its consumer segments into two major parts- the users and the advertisers reaching out to the low-end users. Spotify, in turn, offers its users three kinds of memberships: free, freemium, and premium membership, as described below.

Spotify's free service is for low-end users unwilling to pay for the increased functionalities. This helps users access its free services like music, podcasts, and advertisements. The free subscribers can only access its services with limited features like listening to music on shuffle mode, limited skips of 6 skips per hour, and are devoid of premium services. The advertisers reach out to this community who cannot afford to buy the premium version or the young people looking for affordable ways to listen to music. Spotify generates revenue from these low-end users through advertisers who want to reach out to these users.

Its freemium subscription model enables users to experience the premium features at no cost on a trial basis. This encourages users to switch to premium membership. Around 27% of conversion occurs from Spotify freemium. This forms the base of the mainstream market.

Spotify also has a huge market segment for its high-end consumers who are willing to pay for improved functionalities being premium subscribers of around 45% of the users. Spotify premium features include unlimited skips and replays, not being forced to use shuffle mode and play full albums, enhanced audio quality, downloading up to 10,000 songs, streaming music abroad, etc. They provide different bundle offers for individual, duo, family, and student premium packages ranging from \$5 to \$10 per month. Spotify generates revenue from these premium subscribers. (Figure 5)

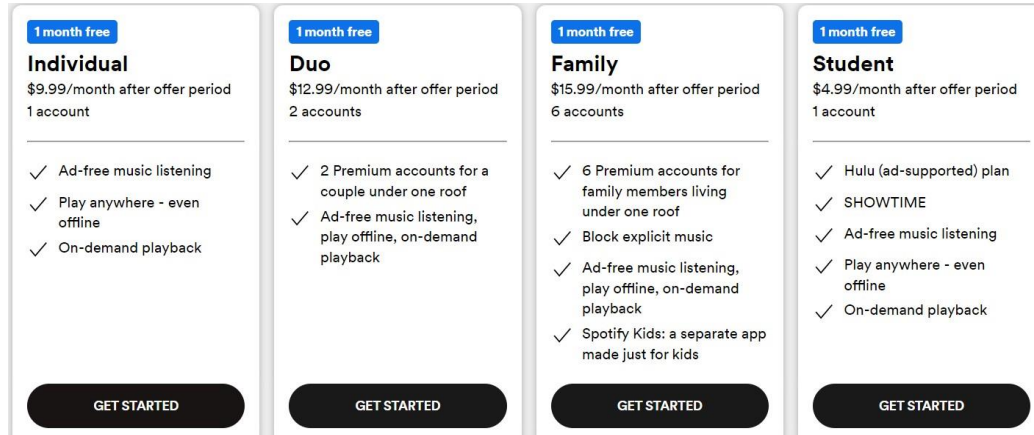


Figure 5

With the vision to constantly improve and provide the best services, Spotify focuses on loyalty programs. They provide customers with personalized recommendations, share experiences, and create, share and download playlists. When Spotify was introduced, it enabled users to explore more features for free like no forced shuffle mode, search and change songs, etc. Over a while, they have reduced the flexibility in the Spotify free subscription, encouraging people to purchase the premium subscription based on their loyalty program and retaining the existing customers. However, Spotify's primary source of income is through premium subscriptions to paid services. It also generates revenue by leasing out advertising space on its free streaming service.

Conclusion

After analyzing the case that Spotify makes and in accordance with the disruption theory, we can conclude that Spotify is a disruptive innovation. The company started small, used new technologies and challenged the incumbents. It began as a low-quality product, providing only music streaming services. Over the years, it used machine learning and artificial intelligence capabilities to curate playlists based on mood, genres, and consumer behavior. It has become the leading platform to share and listen to music with friends and family simultaneously and now also provides a platform for audiobooks and podcasts. Spotify targeted low willingness-to-pay users by offering free music streaming. Later, they introduced freemium and premium models to cater to mainstream and high-end users. Additionally, Spotify resolved the major piracy issue by providing a legitimate platform for consumers and artists. It made legal streaming easy. Thus, it established stability in the music industry.

It has been an incredible journey for Spotify. It truly disrupted the landscape of the music industry and changed the way people thought and operated in the industry.

References (click on the link to view):

[Daily Music Roll-Blog](#) [Quantum Maker](#) [CNET](#) [Statista](#) [Newsroom](#) [Process.st](#) [Real Business Startuptalky](#) [Figure1 - CNN](#) [Figure2 - The Verge](#) [Figure3 - Visual Capitalist](#) [Figure 4 - The Verge](#) [Figure 5 - Spotify Premium plans](#)