Case Study: Spotify and the Music Industry

Shreeharsha G Bhat
BE21B037
MS5014: Managerial Economics

Introduction:

Founded on 23 April 2006 by Daniel Ek and Martin Lorentzon, Spotify as of June 2024 is one of the largest music streaming service, controlling more than 30% of the market share. With its origin in Sweden, Spotify's core business model relies on the freemium model, which combines ad-supported free access with an option for paid premium subscription. The company's revenues heavily rely upon advertising revenue and subscription revenue. The music industry's profits were majorly dependent on CDs and DVD sales before the 2000s. With the rise of the internet, came multiple pirated websites that allowed the illegal streaming of music, one of which being Napster. Napster started out as a file sharing service but people soon realized that music could be shared as MP3 files without having the need to buy records or albums. In 2003, Apple filled the market gap for legal online music. Apple introduced the iTunes music download store, which was initially released exclusively to mac users and then later to PC users as well. However mass music streaming had to wait for technology to catch up, with broadband internet still in its infancy. The Recording Industry Association of America (RIAA) - 2004 reported that only $6.9 million of royalties were collected from SoundExchange collecting society. The next year this figure had increased to $20.4 million. Music Download sales increased but fell sharply in 2012 once music subscriptions service took over. In 2015, the music streaming industry surpassed the $1 billion mark, and is currently valued at $10.2 billion.

Overview of the Online Music Streaming Industry:

The current music streaming industry plays host to more than 11 million artists and creators that either put out music or stream podcasts. This plethora of choices acts as a cyclic incentive for more users to stay in the platform and for more artists to get on to the streaming service. With the rise in online content being consumed, music has become an integral part of everyone's lives. Currently the music streaming service accounts for 84% of music industry revenue. Over the last year itself the industry has grown by 10% and its current global revenue sits at $17.5 billion. Paid music streaming accounts for 23% of all music streaming and over 600 million people subscribe to a music streaming platform. The current market structure is that of oligopoly in nature, with a few key players controlling almost 75% of the market shares. Spotify's competitors include giants such as Apple music, Amazon music, Tencent music(which targets the chinese market), Youtube music and other smaller streaming services. Apple and Amazon cover close to 15% of the market share each and Tencent music just behind at 13%. The music industry has undergone rapid evolution, marked by several major shifts in trends, including the following:

1) Shift to Streaming and subscription models

This marks the global shift from ownership (buying music) to access (subscriptions). There has been a rising demand for subscription based unlimited access to music over purchasing individual tracks and albums. This marked the death of CDs, DVDs and mixtapes to a new era of music, which included ipods, playlists and shuffles.

2) Personalization and Artificial Intelligence
With the rise in AI, music can now be molded based on personal preferences. The two sides of the coin included an increase in the number of artists and songs going viral, and also a variety of new song styles from different regions being introduced, like EDM and K-Pop. The world got to experience multiple genres of music all at the touch of a button. This bombardment of new music increased the demand for personalized playlists and a new way to discover good music intune with your preference.

3) Rise of PodCasts
Talk Shows like “Late Night with Conan O’brian” or “The Ellen Degeneres show”, requires a lot of fixed costs and investments, and with networks competing for the top time slots, there was a market that emerged with a rise in online music services. Podcasts enabled the same level of interactions with high networth individuals while saving on time and effort required on make-up, production and set designs. Podcasts allowed people to be more engaged with the host given that they had a lot of time to sit and discuss/debate over various topics. These podcasts started with the birth of the ipod. “Ipod” and “broadcasts” gave “podcasts”.

Other minor trend shifts included, growing demand for high quality audio, Integration of other social features (“what's on your Ipod ?”), audiobooks, royalties and artists compensation.

Spotify’s Business Model and Strategy:

Spotify pioneered the freemium pricing strategy. This implied that users could get access to a large database of music for free but also face the downside of watching ads between their songs. Itunes was the first service that allowed users to buy music at a fixed price of 99 cents per songs, which did gain some popularity, but the freemium pricing strategy allowed free music and gave the choice to the user to pick whether or not they want premium. Spotify has been extremely successful at converting their free users to premium users, with almost 46% of its current users being premium users. They achieved this using multiple positive and negative incentives. Positive incentives that allowed them to acquire a large user base and negative incentives that allowed them to shift these users to premium. Incentives such as a large database, curated playlists, social features like spotify blend, attracted people to spotify. But features such as multiple ads between songs, 6 songs skips per hour and only 6 song searches per hour, lower audio quality, not being able to download songs and listen to them offline, acted as incentives for users to get premium subscriptions.
Spotify also capitalized on user experience, with manually curated playlists to a “ This is …” playlists that allowed users to experience and experiment with their music interests allowed them to dominate the market.

Their pricing strategy for premium users also allowed them to discriminate against different users' reservation prices. Spotify offers multiple classes of prices based on premium being bought by an individual to premium being bought as a family (6 members). They also allowed price discounts to students as their largest consumers being millennials and Gen Zs, accounting for up to 62% of their total users. To let users experience the taste of premium Spotify has a 30 day free trial which enhances the customers experience with the software.

Market Position and Competitive Advantage:

Currently leading with market shares and number of users, spotify has the following key competitive advantages that allow them to dominate the market.

1) **User Interface and Experience:** Spotify is renowned for its friendly user interface and seamless inter device accessibility.
2) **Personalized Playlists:** Spotify excels in personalized playlists such as "Discover Weekly/Daily", to using algorithms to fine tune music recommendation given the past data. This level of personalization is the key difference between Spotify and others such as apple music and amazon music.
3) **Cross-Platform Compatibility:** Unlike apple music which is integrated best with the apple ecosystem, spotify offers broader compatibility across various devices and operating systems
4) **Pricing:** Both apple music and spotify have similar pricing, but apple music does not provide free music. (pay to use)
5) **Social Features:** Spotify allows users to form music blends with friends and also allows users to make collaborative playlists and see what your friends are listening to
6) **Branding:** Spotify has been involved in multiple tech collaborations with Samsung, PlayStation and Uber to diversify its user base.

Challenges:
The current challenge spotify is facing is that the majority of their earnings are split into royalties and labels. Only in 2019 did spotify have the first financial profit year. Its competitors like apple music, amazon music or youtube music however are dependent on multiple streams of revenue. Apple is essentially a tech company that builds phones, PCs, and iPads. Apple has also entered the streaming service market with Apple TV. Amazon is also a multinational tech company focused on e-commerce, cloud computing and streaming services as well. Youtube started out as an online video platform, and has recently dwelled into music streaming. Spotify on the other hand is focused only on music streaming, and has no other source of revenue apart from advertising and premium users. Spotify has also faced criticism over its royalty payments to artists but they have recovered by making efforts to be more transparent by introducing "spotify for artists", where artists can track and analyze their performance and royalty returns.

Future Outlook for Spotify:

The future of Spotify is currently focused on multiple avenues, these include

1) Enhancement in the area of AI & shifting customer experience

In July of 2017, Francois Pache, ex-Sony, was hired by spotify and currently serves as the Director of the Spotify Creator Technology Research Lab. This was done with the intention of providing resources to artists that will aid them in their creative endeavors. Spotify can also use enhanced AI to predict more accurately the user preference and make the listening experience more engaging.

2) Content Expansion

Though Spotify still remains the prince of online music streaming, their platform is well positioned to expand into new forms of content creation. A greater emphasis on integrating video content including music videos and live performances, would transform Spotify into a more comprehensive entertainment platform. This improvement as of October 2024 can be seen in spotify where it now allows you to watch the performance on video as you listen to the music.

3) Software Expansion

Integration of Spotify with streaming services and with other smart devices is a growing trend. Spotify's partnership with smart home devices, wearable and in-car entertainment systems has been shown to work in the past. Integration of spotify into health and fitness, with a more seamless user experience using voice-controlled music playback would enhance its user experience.

4) Revenue streams

As the market becomes more competitive, Spotify will need new methods to monetize. Beyond freemium models, the platform will need to diversify their revenue streams through ads and exclusive content for premium users. Spotify has built a very loyal customer base, and can now focus on customer retention.

Conclusion:

Spotify has been able to establish itself as a strong competitor in the evolving music streaming industry, by investing on innovation and strategic expansion, and a strong understanding of user experience. By capitalizing on economies of scope, Spotify has diversified its offerings from music streaming to podcasts, personalized contents, and even to audiobooks. But with the market changing, Spotify must adapt to face the challenges, the company's current focus on user retention through personalization and creative & exclusive content will also help them attract new users. Looking ahead, Spotify's success will largely depend on innovation with sustainability, and addressing the needs of the artists and creators. Expanding on to a global level with a strong brand and vast data resource, Spotify is well positioned to continue changing the future of the music streaming industry.

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