

the report



Spotify®

music:ally

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**Spotify
in 2018:
its critical
next year**



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AWAL



From 'Here' to where? Spotify in 2018

Alessia Cara strides onto the stage in New York's Skylight Clarkson Sq venue looking, it has to be said, not much like the "anti-social pessimist" of her breakthrough track 'Here'. As Daniel Ek, Troy Carter and other Spotify executives look on, Cara's performance at the streaming service's pre-Grammys party is a true barnstormer.

With Cara winning the Best New Artist at the Grammy Awards a few days later, her appearance at Spotify's shindig would normally be seen as a coup. Except the company didn't leave anything to chance: fellow nominees Khalid, Lil Uzi Vert, Julia

- Michaels and SZA also perform at its party. It's a timely reminder, as Spotify prepares for its long-awaited public listing, of the clout wielded by the streaming service, nearly 10 years after its commercial launch.

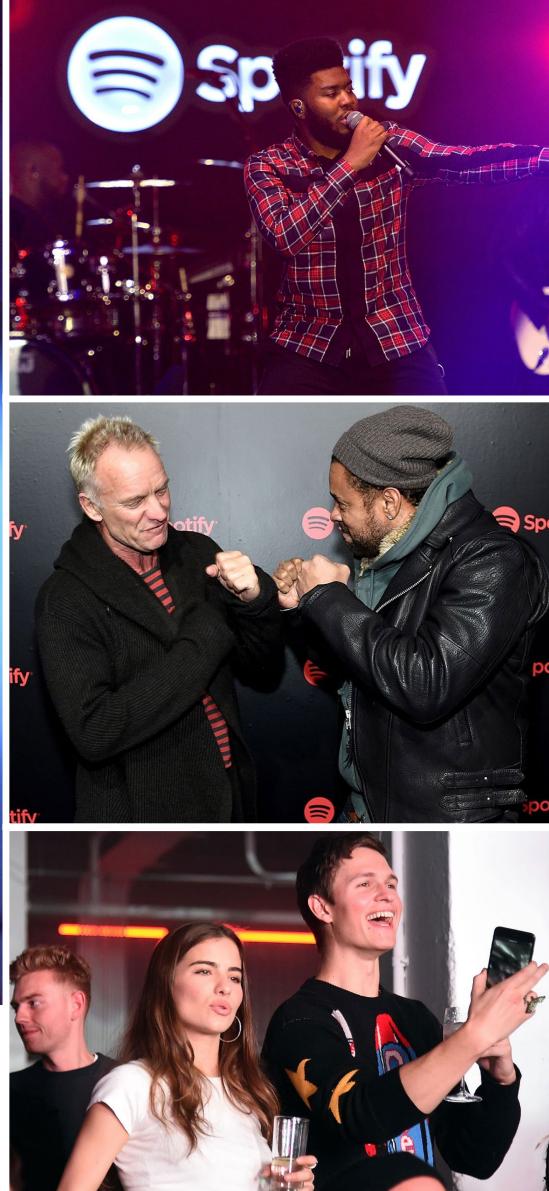
The party is as much a statement of intent: the pulling power (both in terms of artists on stage as well as the celebrities and industry faces in the crowd) of a service that has grown to 70m subscribers, and more than 140m active users.

- Is life all champagne for Spotify in 2018, though? As the company prepares to go public - expected to be through a direct

- listing rather than a traditional IPO - it faces some enormous challenges, as well as some huge opportunities that it has yet to capitalise on.

Going public isn't the end of a company's story: it's just the beginning of its next chapter. And that's particularly the case for Spotify at this stage in the music industry's transition from ownership to access, and from sales to subscriptions.

- In this month's report, we: consider Spotify's path to this point; analyse the big challenges and opportunities facing the company in 2018; track the growth of some of its key playlists; and explore some of the



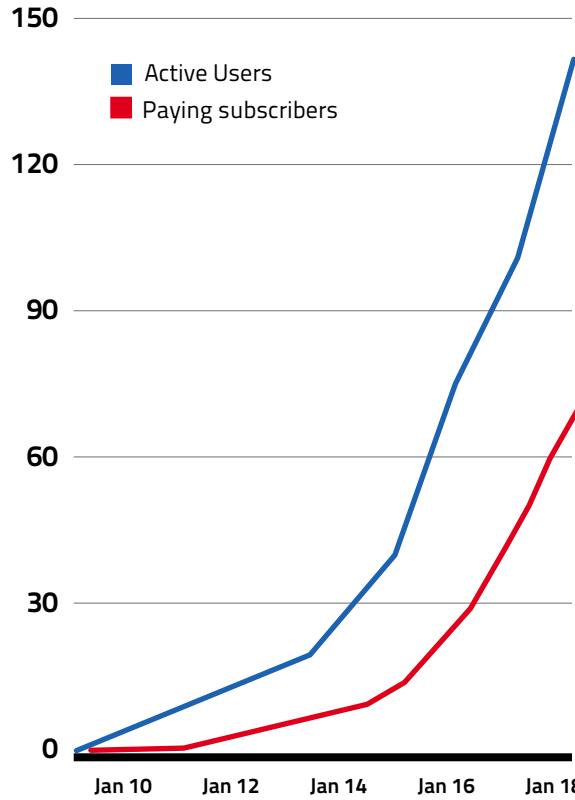
lessons from Pandora's last seven years as a public company.

Plus, we've got Spotify's story through the words of its CEO, the man who from his vantage point in the Skylight Clarkson Sq, will surely have taken at least a moment to reflect on the journey the company he founded has taken to this point - and where it might head next. :)

Spotify stats

Whenever Spotify announces a new user milestone or publishes financial results, it makes headlines – even if some of its investments go under the radar. Here are the key figures on how the company has grown.

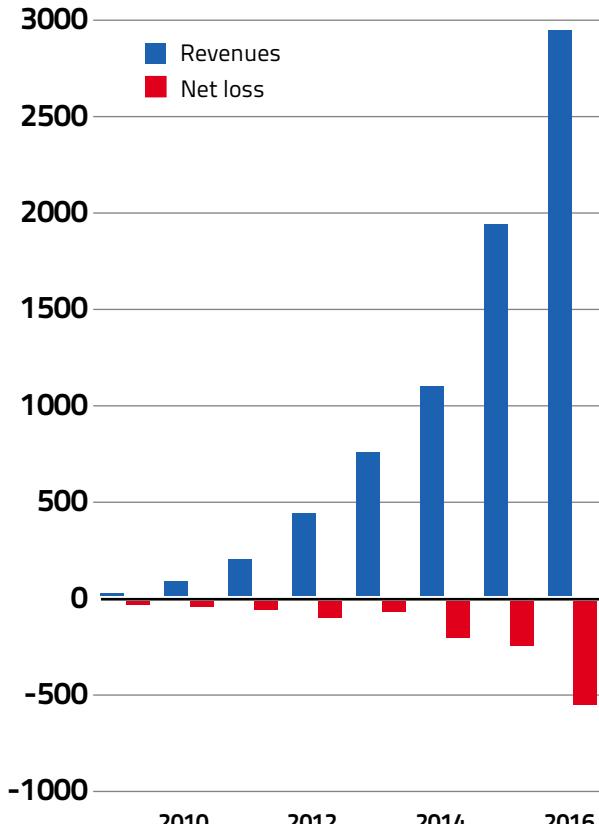
SPOTIFY ACTIVE USERS AND SUBSCRIBERS (m)



Spotify's growth to 70m subscribers

"Late last night we passed a big milestone in our history, at 19.50 GMT we registered our one millionth Spotify user!" blogged Spotify in March 2009. Nearly nine years on, Spotify is currently adding 2m new paying subscribers every month.

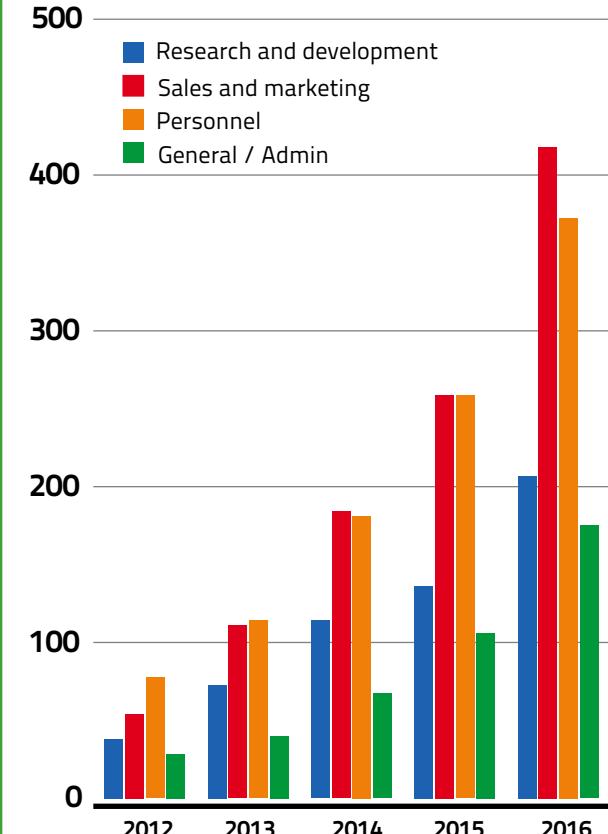
REVENUES AND NET LOSS (€m)



Rising revenues... but also losses

"The question of when we'll show a profit actually feels irrelevant. Our focus is entirely on growth," said Spotify CEO Daniel Ek in April 2012. That's borne out by his company's growth in revenues – but also in losses.

SPOTIFY INVESTMENT (€m)



Spotify's investment in R&D and marketing

We've heard a lot about Spotify's royalty payments down the years, but less on its other spending. In the five years from 2012 to 2016, Spotify spent €567.8m on research and development; €1.03bn on sales and marketing; and €1bn on personnel costs.



Status update: Spotify in 2018

From publishing wrangles and playlist powers to video expansion and access to big-tech platforms... as a public company Spotify has plenty of big challenges in store

Remember when Spotify was “the last desperate fart of a dying corpse”? Thom Yorke delivered his scalding assessment of Spotify and its major label relationships in October 2013, but the company has come a long way since then.

Yorke’s main band, Radiohead, is fully on Spotify now, for example, as are his two solo albums and Atoms For Peace’s AMOK. In the post-corpses-fart years, Taylor Swift and Prince have both withdrawn their catalogues from Spotify, before returning later – albeit posthumously in the latter case.

At points in its near-decade-long history as a commercially launched streaming service, artist holdouts and criticism have threatened to become a defining aspect for Spotify.

It’s to the company’s credit that its growth – and the work it has put in courting artists – have filled the prominent gaps in its catalogue and dampened down the public criticism. Of course, YouTube’s emergence as the industry’s pantomime villain of choice has helped, too.

As we explain elsewhere in this report, when Spotify goes public in the near future, it may be an exit – but it’s far from the end of its story.

In fact, some of the big challenges the company faces will be magnified under the unforgiving lens of the markets, although getting that long-awaited listing out of the way could also free up corporate energy to tackle problems and go after new opportunities.

Here’s **music:ally**’s take on some of the key priorities for Spotify post-listing.

DON’T BECOME A PUBLISHING PARIAH

Artist unrest over Spotify may be quieter than it used to be, but the company continues to have trust issues (and, indeed, potentially-expensive-lawsuit issues) with the songwriter

community. As Pandora has found in the past, being seen as the big bad digital service exploiting songwriters is a very uncomfortable place to be.

Some of Spotify’s issues with songwriters and publishing aren’t of its making. The company didn’t create the initial problem of mismatched recording and publishing data, for example; nor was it responsible for a streaming licensing ecosystem that sees publishing taking a smaller share of the royalties than master recordings.

Other issues are of its making. The mechanical licensing tangle it found itself in for the US – one that even a settlement brokered with the National Music Publishers’ Association (NMPA) hasn’t entirely set to rest – was triggered by decisions made by Spotify as it entered the market there, as well as by the industry’s fragmented metadata.

Meanwhile, the suggestion in a legal filing that Spotify might not even owe royalties for mechanical reproductions anyway – regardless of the merits of such a claim – managed to alienate the NMPA to the extent that by September 2017 its boss was talking of “a fight with all songwriters [...] If Spotify does not withdraw this offensive and baseless claim, it will become public enemy number one to the entire songwriting community”.



SPOTIFY 2018

It's all gone quiet on that front for now, but publisher relations must be one of Spotify's priorities in 2018. The company has made some small-but-showing-willing moves towards the songwriting community: its Secret Genius podcast and awards, for example, or its songwriting camps.

More of these opportunities may spring up: quick wins like more prominent credits for songwriters on the service and help for publishers wanting to get more engaged with playlists and analytics on Spotify, for example.

The big wins will be tougher, but still achievable. By sheer scale, Spotify now has real clout within the music industry. It could exert that influence to solve some of those thorny problems specific to songwriters and publishing – from participating in initiatives to set standards to exploring (for example) whether technologies like blockchain can really help in this area.

It's not as simple as "paying songwriters more money" – in some countries, as seen with the new US royalty rates, that decision is out of Spotify's hands in any case – and the risk of going public is that the company will be constantly weighing up the demands of publishers and PROs against the likely response of investors.

Much of the progress Spotify can make in this area will happen behind the scenes – some of it is happening already – and it will rarely make headlines. But Spotify has the potential to be a leader in ensuring songwriters feel the full benefit of the streaming-fuelled industry upsurge.

EXTRA REVENUE FOR ARTISTS

Right at the end of his keynote session at our NY:LON Connect conference in New York this



month, Spotify's chief marketing officer Seth Farbman set a fair few minds racing with an off-the-cuff answer to a question about the company's recent partnership with Chinese tech giant Tencent.

Farbman's first answer was a careful parry – "It remains to be seen..." – but pressed on what interests him in Asia more generally, he pinpointed the tips economy that has emerged in live video and messaging apps.

"I love the concept in Asia and China in particular where it's micro-payments, where you like something [...] This sense that when you receive something of value, you can immediately recognise the value of that content or artist by giving them a little tip or something," he said.

"One thing that does is it starts to create a bond. So how do we connect artists and fans in ways that they're more aware of one another, where you can feel the impact of fandom if you're an artist, and get that satisfaction back if you're a fan? I think that's done in Asia much better than it is in the rest of the world, so that's something we're watching carefully."

In the list of bold bets that **musically**

- would love to see Spotify make as a public company, exploring new revenue streams for artists looms large. "Creator tips" is one of the most intriguing, given Spotify's billing relationship with more than 70m subscribers.

Whether it's tips like the model used by the Asian apps (not to mention Twitch, YouTube and now Facebook, too – the latter is introducing the idea for live-streaming gamers) or something more like a Patreon/Drip model where superfans pay a dollar or two extra a month for exclusive content and access to their favourite musicians, there's potential here.

That said, tip economies tend to be strongly tied into social communities, and that's an area where Spotify has reined in its efforts in recent years – indeed, "having another crack at social" is another on our bold-bets list.

Whether it's superfan tips or top-up subscriptions, or simply putting more welly behind its existing features for ticketing and merchandise, Spotify has the potential to become a platform driving a bunch of different income streams for artists, rather than just their recorded royalties.

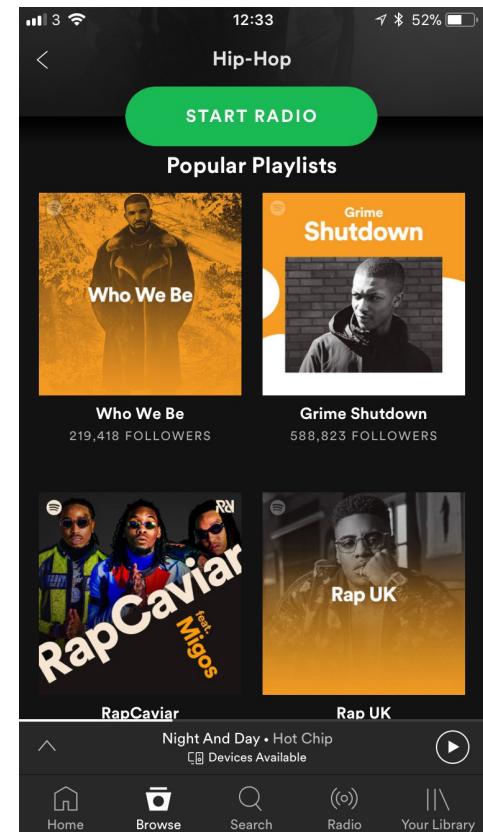
WITH POWERFUL PLAYLISTS COMES GREAT RESPONSIBILITY

"I'm not a gatekeeper. I don't want to be called that. I feel like the gatekeeper era is over," Tuma Basa told Billboard in July 2017.

"I consider myself a facilitator. My job is not a bouncer to keep people out or to kick people out, it's to get people in. It's to get the right people in and to keep the party popping."

Basa's comments are a good microcosm of Spotify's corporate awkwardness acknowledging the power wielded by its own brand playlists and playlists.

Its ability to break new tracks and artists through carefully planned campaigns moving up its playlist ecosystem is a key



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part of Spotify's pitch to labels, as is the way personalised playlists like Discover Weekly and Release Radar pipe music into the right ears in a way that traditional broadcast radio couldn't match.

At NY:LON Connect, Farbman was challenged about comments suggesting Spotify's playlists were a truly democratic system. "Maybe more like a republic than a democracy," he admitted. "Our intentions are always democratic and absolutely inclusive, but you have to have somebody running the show every now and again."

When you're running the show for playlists that have huge local and global clout, you should expect (and welcome) intense scrutiny of how you exert that power.

How do indies fare against majors on the big playlists? How fair is the pitching system to get label-owned playlists onto Spotify's Browse section? What is Spotify really looking for when deciding what to playlist? And how is the intersection between commercial and production music really playing out on the big mood playlists?

These and other questions will continue to pepper Spotify, and the more transparent the company can be about how its playlists system is evolving, the better - the same applies for Apple Music and other services, of course.

On the positive side, Spotify used its Echo Nest acquisition to great effect in pioneering personalised playlists at scale - Discover Weekly, Release Radar and Daily Mix. There's much more to come from the teams behind these features.

(As **music:ally** went to press, meanwhile, Spotify's latest product experiment was revealed: a standalone Stations app on Android, which focuses on radio-like

stations and - potentially - playlists.)

FINDING THE NEXT 'DESPACITO'

You're quite possibly bored with reading about 'Despacito' now, but the global success of Luis Fonsi and Daddy Yankee's hit last year said a lot about two streaming services in particular: YouTube and Spotify.

Thanks to the analysis of 'Despacito' we all know that Mexico and Brazil are now two of Spotify's top markets by stream volumes - all those artists with Mexico City and São Paulo in their top-listener cities were another clue, of course.

Spotify's growth in Latin America has already helped to reshape the global music market, as former Sony Music executive Juan Paz - now at management firm M3 Music - made clear at NY:LON Connect.

"You guys will see more of our music in your charts more and more! And if you want to see your music in the charts, and you don't have a great marketing campaign in Mexico and Brazil, it's going to be tough," he said. "The biggest numbers are coming from Latin America."

There are plenty more listeners to scrap for in Latin America, so Spotify's job is far from done there. But as the company goes public, a key question for its executives and investors alike is where the next 'Despacito' will come from, in terms of high-volume and under-monetised emerging markets.

As things stand, Spotify is unavailable in some of the most prominent examples: it's not in China, Russia or India, and the company has yet to launch anywhere in Africa or the Middle East. Entering (through launch or acquisition) or avoiding these

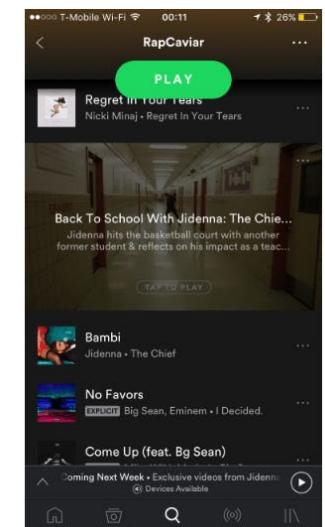
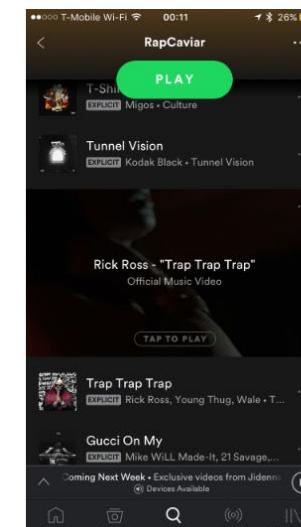
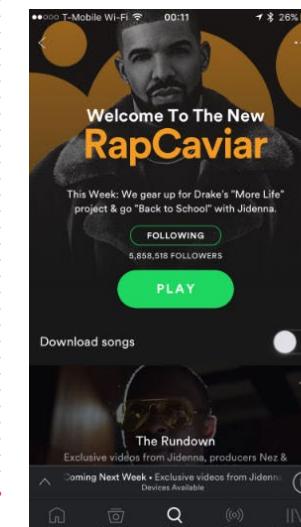


markets will be a key strategic decision.

Seeing how the company adapts its pricing and even its product for some of these territories will be very interesting: on the latter

with little impact. Spotify then pivoted towards commissioning its own short-form shows with a focus on music.

Some of them were inventive and



count, see what YouTube (with YouTube Go) and Facebook (with Facebook Lite) has done in some emerging markets, for example.

Meanwhile, a decision to swerve certain territories will be just as significant, opening up opportunities for local players (and perhaps some of those global rivals) to take the lead instead.

NAILING VIDEO...

It may be harsh to describe Spotify's video strategy thus far as a series of flops. Perhaps more a series of experiments that haven't yielded a clear and successful path forward for the company.

Its first approach involved licensing in content from multi-channel networks (MCNs) in the YouTube world,

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interesting, but they too didn't appear to create a widespread shift in perceptions of Spotify as an app that's watched, rather than just listened to.

Cue a third way under a new original-content boss, former MySpace Music and Maker Studios executive Courtney Holt, which is currently focusing more on creating videos to be integrated into Spotify's big playlists like RapCaviar.

It's early days on that front: Spotify's challenge is still to convince its users that it's more than an audio app. There are other experiments that it could try, though.

Music videos, for example. Spotify (like the vast majority of audio streaming services bar pre-Tidal WiMP) hasn't gone down the road of licensing a catalogue of music videos and going toe-to-toe with YouTube. A strategy that could certainly appeal to rightsholders keen for Google's service to get more competition.

Alternatively, Spotify could look to the 'stories' format on apps like Snapchat and Instagram (and now YouTube with its Reels)

and explore its potential for musicians, sharing ephemeral videos on the platform, delivered to the fans who follow their profiles. The company could even experiment with artist-driven livestreams, if it has the appetite.

It may not: these could be seen as distractions from its core business. But if they're possible answers to the question of "What does video mean on Spotify?" they will be worth considering, and perhaps – although this may be more difficult as a public company – quietly experimenting with.

... AND ADVERTISING

Spotify is overwhelmingly a subscriptions business rather than an advertising business when it comes to revenues. In 2016, it generated €2.64bn from premium subs, and just €295m from ads. They're growing at similar clips – 52.3% and 50.3% respectively that year – but advertising remains just over 10% of Spotify's annual revenues.

The strategic importance of Spotify's free, ad-supported tier is about more than revenues, of course: it's the company's funnel, so strongly defended by its execs down the years against critics from the most senior label bosses to Taylor Swift.

Spotify's latest licensing deals may open up the potential for new releases to be windowed to its premium tier for limited periods, but the free tier lives on. The challenge now is to make it pay off with more revenues, as well as a steady flow of upsold subscribers.

Here too, the company's efforts tend to be less reported beyond the marketing and advertising industry trade press. A recent interview with Spotify's global head of ads monetisation Brian Benedik, for example, outlined the company's progress in capitalising on the trend for programmatic (software-driven) advertising.

"Marketers are moving so much money to programmatic. We've seen that channel explode. We've seen brands [come to Spotify] that have never invested in audio because we've made it programmatic-enabled," he told AdExchanger this month. "Everything we've built, whether it's audio, video or display, we've made programmatic-enabled."

Spotify's recent Sponsored Songs experiment with playlists; its recent announcement of a new Spotlight multimedia format for news, podcasts and audiobooks; its work encouraging brands to create their own playlists – albeit with the sensitivities around perceived endorsements by the artists within them that this brings... Plans to make more of ads are afoot.

Spotify is one of a number of firms in our space – YouTube and Pandora are also prominent – that is making the case for there being much more revenue to unlock from the advertising world.

No conference will be complete in 2018 without at least one panelist citing the billions in radio advertising that are ripe for shifting to streaming services – an argument that carries particular weight in the US, where recording artists don't get performance royalties for terrestrial radio plays.

Spotify's task in 2018 is to speed up that

shift while also grappling with the fact that video ad formats are often seen as more likely to benefit – and that Google (including YouTube) and Facebook (including Instagram) seem in prime position to capitalise.

ACCESS TO PLATFORMS AND DEVICES

It's been a while – mercifully – since we've seen a widely shared "Spotify killer" headline hailing the launch of another streaming service as an existential threat to the Swedish firm.

Apple Music, for example, hasn't turned out to be a Spotify killer: it has carved out its own healthily growing audience of subscribers without having a noticeable impact on Spotify's rate of growth.

(In fact, as we noted recently, Spotify is averaging 2m net new subscribers a month compared to Apple Music's 1m. But our view remains that it's the 3m between them – plus those being added by Amazon and other services, that's the positive story for the industry.)

But yes, existential threats. The mere existence of music streaming services from Apple, Amazon and Google isn't the knife in Spotify's back that lazy headlines have implied in the past. But the platforms and devices owned by these companies are most certainly a headache that has been driving more of Spotify's lobbying focus.

Smart speakers are far from a dominant mode of music listening, even if (as recent reports suggested) one in six Americans now owns an Echo or Google Home, with 18m devices sold in the US alone over 2017's holiday season. Exciting, but still a niche compared to the number of people streaming music to smartphones, or even to computers.

Spotify's encroaching danger, though, is that the three most popular smart speakers in the West for the near-to-medium future

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are made and controlled by Amazon, Google and Apple. The two absolutely dominant smartphone/apps ecosystems are controlled by Google and Apple.

From voice-based music-recommendation algorithms to in-app purchases, Spotify's big-tech rivals are gatekeepers sitting between the service and its listeners. Ensuring fair treatment is a key business priority for the company, and its lobbying efforts on both sides of the Atlantic have adapted accordingly.

music:ally expects to hear more from Spotify (and fellow pureplays like Deezer, Pandora and SoundCloud) on fair access to platforms in the year ahead.

That said, in Europe particularly the prevailing political winds seem to be blowing in the pureplays' favour: Google has already been hammered by Brussels for the way its own

comparison-shopping service was ranked in its search results compared to independent rivals.

It's noticeable that Google has been swift to integrate Spotify into its Google Home speaker. Keen oversight from regulators and energetic lobbying efforts from Spotify and co should keep the big-tech platforms as open as possible. This isn't an existential threat just yet.

THE 'P' WORD

Profits! A subject on which Spotify's senior management has been very clear all the way along its first decade: profitability is not the priority in the company's growing years.

"The question of when we'll show a profit actually feels irrelevant. Our focus is entirely on growth. It is priority one, two, three, four and five," said Ek in April 2012. It's also



something explicitly set out in the company's annual financial results.

"We believe our model supports profitability at scale. We have already proven that we've created real value for our users, and we know that the more time people spend with our product, the more likely they are to become paying subscribers. We believe we will generate substantial revenues as our reach expands and that, at scale, our margins will improve. We will therefore continue to invest relentlessly in our product and marketing initiatives to accelerate reach."

The vision is at least clear and unwavering, but as a public company, Spotify will find its path towards profitability under even more intense a microscope from investors and analysts as well as journalists.

How much scale will tip the company into the black, if 70m paying customers isn't enough scale? How will moving parts like Spotify's reworked licensing terms with labels and its higher payouts to US publishers affect these dynamics? How much investment counts as relentless?

Should Spotify consider raising the price of a music subscription as Netflix has, or add additional tiers with extra functionality and/or quality (again, as Netflix has) to improve those

margins? Does Spotify have its own (non-licensing) costs under control?

These questions and more will be fired at Spotify in quarterly, public earnings calls, rather than piecemeal in irregular media interviews and conference sessions with its execs.

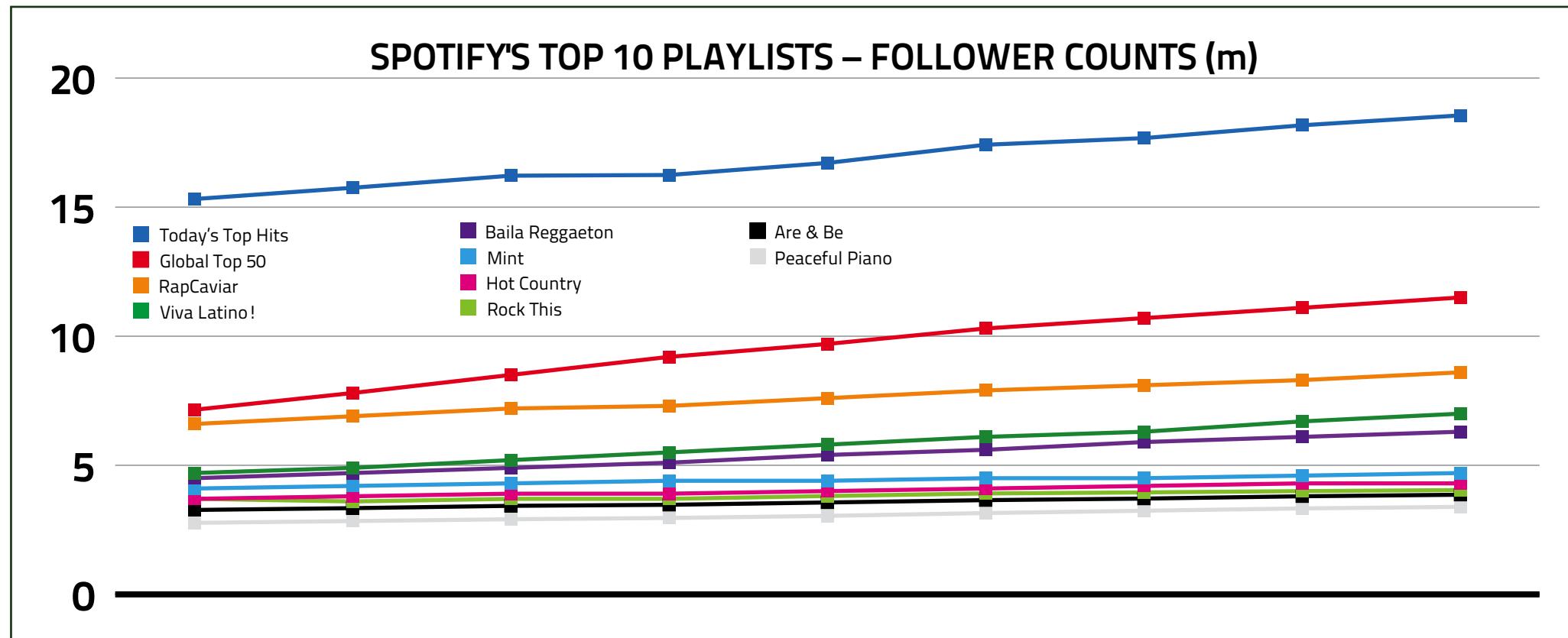
Spotify was far from profitable in 2016, although its 2017 financials have not yet been published. But once it's public, the central question of whether a pureplay streaming service can turn a profit – particularly in a market stalked by big-tech rivals who can soak up losses from their other businesses – will be in the spotlight, like clockwork, every three months.

That's why going public isn't the end of the story for music rightsholders as well as for Spotify. The three major labels and indie representative Merlin could cash out by selling their shares, but they have a big stake in Spotify's survival beyond that: a healthy, competitive market of tech-giant-owned and pureplay streaming services alike.

We'll all be watching Spotify's long-awaited graduation from private to public company with a mixture of excitement and trepidation. How it fares will have a significant impact on the next decade of music streaming – and the music industry itself. :)

Playlists on the rise

Spotify's biggest in-house playlists are growing steadily, as this data for the last nine months of 2017 from analytics platform Chartmetric shows.



There was lots of talk within the industry about the scale and clout of Spotify's own-brand playlists in 2017. But what does that scale actually look like?

music:ally used analytics service Chartmetric to plot the follower growth of the 10 most-popular Spotify playlists by followers

over the final nine months of 2017. Data wasn't available for some of them for the full year, if you're wondering.

Today's Top Hits remains the 900lb gorilla in Spotify's playpen, growing from 15.3m followers at the start of May to 18.6m at year-end – just over 21% growth by this metric.

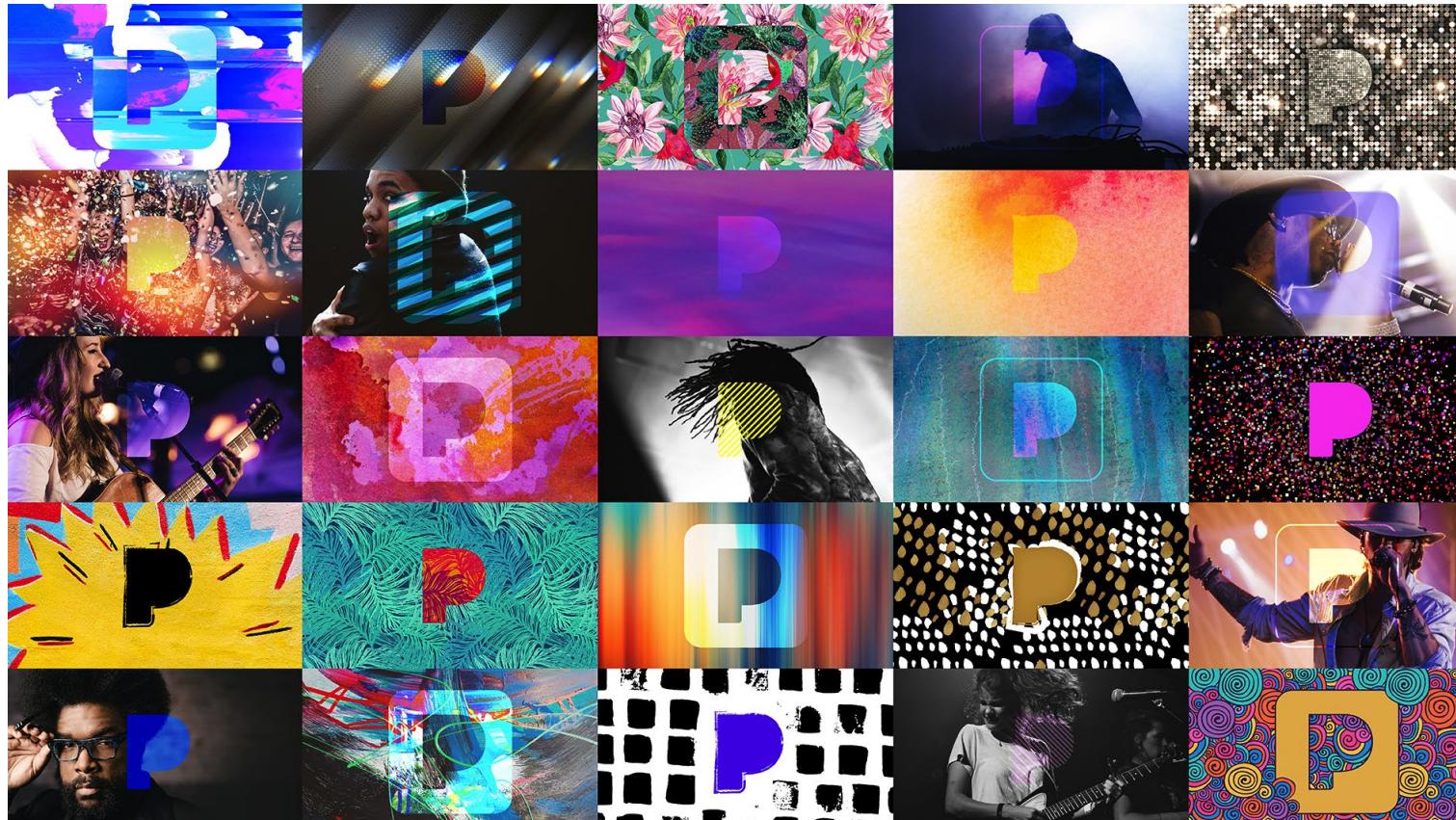
The sharpest growth by percentage came

from the Global Top 50 playlist, which added 4.4m followers to end the year with 11.5m – more than 61% growth.

In the year of 'Despacito', it's also notable that among the big genre-specific playlists, it was Viva Latino! and Baila Reggaeton which showed the sharpest growth by percentage – up by 50% and 41% respectively.

Despite perceptions that Spotify is a much happier hunting ground for hip-hop, R&B, pop and EDM than for guitar-based genres, note the presence in the top 10 of Hot Country and Rock This – the caveat being that follower counts are not always an indication of the volume of streams being driven by a playlist. :)

SPOTIFY IN 2018



Seven lessons from Pandora's IPO

Pandora is the most prominent pureplay streaming service to have gone public. What can Spotify learn from its experience?

Neil Glover of Ernst & Young told music:ally that we need five or even 10 years to properly understand the impact that going public has on a company. Pandora's IPO happened in June 2011, making it a useful subject for analysis, and a source

- of potential lessons for Spotify's life as a public company.

THE FIRST DAY MAY BE AN OUTLIER

- When Pandora went public, it debuted with

- a guide price of \$16 a share, which surged to \$20 a share after the markets opened, giving the company a valuation of \$3.2bn. Trading peaked at \$26 a share, before falling back to \$17.42 by the end of day one.

- The following day, the stock dropped to 17% below the original price, and it has been

a bumpy ride ever since, taking in highs (a price in the upper thirties in early 2014) and lows, with the stock currently trading at \$4.49 a share.

This is a marathon, not a sprint. Pandora went public a month before Spotify launched in the US, sparking an initial 6% drop in Pandora's share price, before it recovered later in the day.

More recently, Apple Music caused similar wobbles, while Pandora's \$90m settlement in 2015 with major lawsuits over pre-1972 music saw its shares drop by 20%. Spotify will be experiencing life at the mercy of the markets, too: its own announcements and those of rivals will have a measurable impact on its stock.

PUBLIC DOESN'T GUARANTEE PROFIT

This is an obvious point: public companies aren't necessarily profitable companies. Twitter and Snapchat are proof of that, but so is Pandora. The quarterly fiscal scrutiny of a public company's growth can be unforgiving.

Pandora's first partial fiscal year as a public company, which ended on 31st January 2012, saw it generate \$240m of revenues, with a net loss of \$16m. In its next fiscal year those figures rose: \$417.1m of revenues and a \$38.1m net loss, before Pandora switched to a calendar-year for its financial reporting.

The company's annual revenues rose sharply to \$920.8m in 2014, then \$1.16bn in 2015 and \$1.38bn in 2016. While its net loss dipped to \$30.4m in 2014, it shot up again to \$169.7m in 2015, and then \$343m in 2016.

(In the first nine months of 2017, Pandora reported \$1.07bn of revenues and a net loss of \$473.6m, with the fourth

quarter results yet to be published.)

Several years after an IPO, growing losses send out negative messages about the company, and it is no surprise that Pandora has seen several changes in management since 2011 – and regular scrutiny of its strategy and business model. Talking of which...

NO ONE IS PERMANENT – NOT EVEN YOUR FOUNDER

Someone comes up with the idea for a company. They make the leap of faith to set it up and go out to convince investors to back it. They pour their heart and soul into getting it off the ground.

It takes over their lives. They become the public face of the company. For many, they are the company. It's their vision and their steely belief that is driving it forward. But the company can and will exist after them and their early management team.

Pandora was founded by Tim Westergren and he lived and breathed the company for years. But he was never irreplaceable – and nor were the CEOs appointed to head the company.

Having helped to take Pandora public, Joe Kennedy announced plans to step down in March 2013, with Brian McAndrews confirmed as his replacement that September. Two and a half years later, McAndrews stepped down, “passing the baton on to Tim” as Westergren returned as CEO to pilot Pandora’s path towards on-demand subscriptions.

In June 2017, the hammer dropped again as Westergren, president Brian Herring and chief marketing officer Nick Bartle simultaneously left the company, with Westergren replaced on an interim basis by CFO Naveen Chopra.

Joe Kennedy



One \$480m SiriusXM investment later, former Sling TV boss Roger Lynch took the hot seat.

The hard lesson in business is that you might build the company and define its vision, but that is no guarantee of a long-term future leading it once public.

PUBLIC COMPANY, PUBLIC ATTACKS

Pandora’s IPO made it a lightning rod for criticism from some parts of the music industry, with the memory of Last.fm’s \$280m exit to CBS in 2007 still fresh in many people’s memories.

“I don’t like Pandora, they are gaming the DMCA [...] I don’t see them as a business partner [...] They are a business partner of SoundExchange, not a business partner of UMG,” said Universal Music’s digital boss Rob Wells at the Music Matters conference in May 2011, ahead of the IPO.

Brian McAndrews



By October 2012, Live Nation’s Irving Azoff was lambasting Pandora’s efforts to lower its royalty payments.

“It’s horseshit,” he said at TheWrap’s annual media conference. “The market cap for Pandora is like \$1.8bn. That’s roughly the market cap of Live Nation, and they are whining about wanting to pay artists less.”

The following month, 125 artists signed an open letter to Pandora opposing its moves to try and get Congress to lower its royalty rates – despite its users and revenues booming. “Why is the company asking Congress once again to step in and gut the royalties that thousands of musicians rely upon?” they wrote. “That’s not fair and that’s not how partners work together.”

By 2013, Pandora was fielding brickbats from Pink Floyd (“You don’t hear grocery stores complain they have to pay for the food they sell”) and David Lowery (“Why doesn’t Pandora get off the couch and get an actual

business model instead of asking for a handout from congress and artists?”) while Westergren was railing against “a deliberate and orchestrated campaign funded by the RIAA”.

In truth, Spotify has experienced all this well before going public: when Taylor Swift has suggested you don’t value music; when Thom Yorke has called you “the last desperate fart of a dying corpse”; and when the National Music Publishers’ Association’s boss sees your legal arguments about mechanical licensing as triggering “a fight with all songwriters”... You’re probably well prepared for what’s coming up as a public company.

ACQUISITIONS CAN BE A MIXED BAG

Spotify has a decent record with acquisitions even before going public.

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Snapping up The Echo Nest for €49.7m in March 2014 is widely acclaimed as a bargain, given that company's influence on Spotify's product development since.

Acquisitions of other startups like Tunigo, Soundwave, SonaLytic, Mediachain, MightyTV and most recently Soundtrap have suggested a forward-thinking approach to adding talent and tech to Spotify's team.

Pandora's experience shows that while going public may bring more capital to the acquisitions pot – admittedly not so much a consideration with a direct listing – flashing the corporate credit card can be a mixed bag.

Pandora's acquisition of analytics firm Next Big Sound in May 2015 is seen as a good move, as part of the wider trend that has seen streaming services build or buy proprietary analytics dashboards (see also: Apple and Semetric a few months earlier).

Pandora's \$450m acquisition in October 2015 of ticketing firm Ticketfly fuelled bullish talk of a truly "full-stack" service, yet by September 2017 the division was sold off to Eventbrite for just \$200m – a strategic U-turn with a very public price.

One lesson for Spotify: perhaps don't go down the road of buying a local radio station in order to benefit from a legal loophole that lowers your royalties, as Pandora did with South Dakota station KXMZ-FM in 2013. The backlash was immediate from the rightsholders and the deal left a lingering aftertaste of distrust that took a few years to dispel.

LICENSING WON'T BE LESS OF A HEADACHE

Spotify's latest set of direct licensing deals with major labels helped to position the



Tim Westergren

company for going public, complete with lower revenue-share commitments. The company has bought itself some time free of post-public questions from analysts about the progress of its next set of renewals.

Pandora's experience shows that for a public company, licensing is hammered out under even more scrutiny, with sometimes-competing stakeholders complicating the situation. The more rightsholders celebrate a licensing deal, the greater the risk that it might spook the markets.

Fast forward a couple of years, and we'll be seeing headlines about how Spotify's renewals with Universal, Sony or Warner have affected its share price – a blunt, and not necessarily fair, verdict on the company's dealmaking.

The more positive lesson from Pandora, though, is that deals can be done under this spotlight. Under Westergren's last term as CEO, the company managed to strike the direct licensing deals with labels, as well as



Roger Lynch

publishers, required to propel its move into on-demand streaming subscriptions.

Despite having that Greek chorus of analysts looking for evidence that rightsholders were going to screw Pandora, the company got its deals done with – given that historic criticism from some labels and publishers – a minimum of fuss.

PUBLIC COMPANIES CAN BE ACQUISITION TARGETS

An obvious point but one that's worth keeping in mind. For years, there has been the odd rumour that Spotify was an acquisition target – for Facebook or Google usually, although Tencent was also mooted as a potential acquirer before it agreed a pre-public stock-swap with Spotify instead.

Spotify may be going public, but that doesn't mean it won't be snapped up by an even bigger fish at some point. In July 2016, the Wall Street Journal reported that Pandora

had turned down a \$3.4bn acquisition offer from Liberty Media, the majority shareholder in SiriusXM.

That never came to pass, but in 2017 there were constant rumours that SiriusXM and/or Liberty were mulling an approach for Pandora – hardly dispelled by their CEOs' penchant for talking down the company's existing business model, like a pick-up artist insulting (or "negging") an object of their affection.

In May, an agreement for a \$150m strategic investment from investor firm KKR was swiftly replaced by the \$480m injection from SiriusXM, with the latter company's CEO, chairman and CFO joining Pandora's board in the process.

The lesson: Spotify going public isn't the end of the story, it's just a new chapter – and one in which, if the company struggles to deliver on its promises of profitability as its model scales, it may well find itself in need of new investment and/or a willing acquirer a few years down the line. :)

SPOTIFY IN 2018



Spotify's first decade... in the words of its CEO

Daniel Ek doesn't often give interviews, but when Spotify's CEO does talk publicly, his words travel far. Here are some of the notable quotes from the streaming service's founder



NOV. 2008

"Instead of legislation, we realised that the way to stop people consuming content through P2P networks is to create a better product. We also realised that music today is more about access to music than actually owning music. The model of buying and owning music is dead."

- Ek bullishly setting out his access-over-ownership stall in his first interview with *music:ally* in November 2008, as Spotify launched in the UK.

MAR 2009

"We could have had better timing, but I like downturns. It gets you focused."

- Ek to the Financial Times, as Spotify reached the milestone of 800,000 users.

JUNE 2009

"It's sad that the one dominant player, iTunes, doesn't care about the music industry. We want to be the second company that writes huge cheques to artists."

- Ek addressing music publishers, with one of his first public broadsides at Apple – who Spotify was about to tangle with over the approval process for its first iOS app.

OCT 2009

"The industry needs to think outside of the box and realise that the new business model in music is a mix between ad-supported music, downloads, subscriptions, merchandising and ticketing where the user comes first and where the key to monetisation comes from portability and packaging access rights."

- Ek marks the first anniversary of Spotify's launch by looking ahead to music as a "\$40-50bn industry".

FEB 2010

"The music industry is currently worth \$17bn (£10.8bn); it's going to be \$40bn or \$50bn soon. There will only be four or five players left in a few years. If that's the case, we will end up with a company worth tens of billions."

- Ek in an interview with the Telegraph. An accurate prediction: Spotify's most recent valuation in late 2017 was \$19bn.

MAR 2010

"The most important thing when it comes to the US launch is that we want to build the best product possible and get all our ducks in the row with the publishers. In Europe, we're sort of used to doing a deal with a collecting society and a couple publishers. But here you have to strike deals with 5,000 publishers or more. And then the collecting societies. And then the labels. It's a huge task."

- Ek's words from SXSW 2010 would come back to haunt him, given Spotify's recent legal troubles around mechanical licensing with publishers in the US.

JUL 2010

"Music needs to be like water. It needs to be ubiquitous. We need to understand that this is not about MP3 files anymore; the MP3 file has become the URL and, through that unique identifier, I can send you something and you'll be able to know what it is and listen to it."

- In 2017, this just seems logical. It's important to understand how disruptive it was seven years ago, though.

JUL 2010

"Will we launch there this year? Yes, we think that's possible. But if for whatever reason we cannot launch the service that we envisage, then we will wait."

- Ek talking about Spotify's ambitions to launch in Japan. The company ultimately launched in Japan in 2016.

DEC 2010

"Music on the web will probably surpass the popularity of photos."

- 500m daily active Instagram users in 2017 suggests this trend hasn't quite come to pass. Then again, perhaps "Spotify streams of 'Despacito'" versus "Instagram likes of Kim Kardashian's bum-champagne photo" is the right metric here (1.8bn versus 977k, since you ask).

MAR 2011

"More than ever, we're seeing the power of our freemium model, with the vast majority of subscribers upgrading after having first used the free service, and the ratio of paying subscribers to active free users now 15%."

- Ek celebrating Spotify's first 1m paying subscribers. That 15% conversion rate looks

SPOTIFY IN 2018



low in 2018, though: based on its latest public stats – more than 140m active users and 70m subscribers – it's up to 50%.

MAY 11

"No it ain't true. Media these days are funny. Soon I'll be reading that Spotify is launching a space rocket..."

- Ek debunking reports in 2011 that Spotify was signing deals with Hollywood studios to add movies to its service. It never did "do a Netflix". Well, not yet.

OCT 2011

"My whole life changed. Before Napster, I didn't listen to The Beatles. I didn't listen to all the guys that are my favourite bands now."

- Ek telling Wired about the impact the original Napster had on his music habits.

NOV 2011

"We've already become the second biggest digital revenue source

- for all the labels in Europe behind iTunes. And we've paid out more than \$150m to the music industry so far."
- Another stat that looks almost quaint now. By September 2016 – its last public figure for this metric – Spotify had paid out \$5bn.

DEC 2011

"The interesting thing with Spotify is that it is entirely democratic because we don't promote a single artist or do anything else. Actually, the only thing we have here is we have apps now that help curate. Spotify itself does nothing to promote a particular type of music."

- Different times. In 2018, Spotify's promotional heft – through its playlists, its video content and its on- and off-platform artist-marketing partnerships – is considerable.

JAN 2012

"Google said come back when you have a degree."

- How different would the story of music



streaming be if Google had reacted differently to the 16 year-old Ek's application for an engineering job?

JAN 2012

"Imagine if this was three times as fast or truly understood my intent. It's probably the biggest threat to Google; it's a whole new way of interacting."

- Ek talking about Apple's Siri voice assistant in 2012, in comments that still ring true in the smart-speakers era now.

FEB 2012

"Do you really want to hold back your album from people who are finally paying for music again? If you think that by doing so you're getting them to buy your album on a CD, or as an album download, again, there's absolutely no evidence to back that theory up."

- Two years before Swiftgate, Ek was arguing against holdbacks on Spotify. Without parallel worlds, such evidence is still impossible to nail down.

APR 2012

"The question of when we'll show a profit actually feels irrelevant. Our focus is entirely on growth. It is priority one, two, three, four and five."

- Ek has been fielding questions about Spotify's losses for years. He can expect to continue fielding them on a quarterly basis once Spotify goes public.

NOV 2012

"I can tell you it will take you 200 song listens before you make the same amount of money [as a download]. But because the consumption behaviour is entirely different, and the revenue then

- increases in perpetuity, it's not even a question of if this model is better, it's just when in the lifecycle it's better."
- As neat an encapsulation of Spotify's defence against per-stream figures as Ek has ever managed.

NOV 2012

"Next 3 years will see 2bn smartphones =>50% listen to music = trillions of plays = huge opportunity for musicians. If those happen on legal services the overall music industry will be far greater than it is today."

- Ek's tweet was a little ambitious in timescale: global music revenues fell in 2013, 2014, before growth restarted in 2015.

DEC 2012

"At Spotify, we think of ourselves as punks. I don't mean the kind of punks that are up to no good, but the punks that are up against the establishment. We're really punks because we're restless, and because we really hate it when people tell us 'this is just the way it is'."

- This is a chord. This is another. This is a third. Now form a global distribution platform to stream the bands...

DEC 2012

"The big paradigm of sites within music discovery has been editorial versus the algorithms. But the more we thought about it, actually they're not mutually exclusive. You can marry them together."

- This is received wisdom now, but in 2012, "humans versus algorithms" was still a regular debate – and Spotify was early to focus on the combination of the two.

MAR 2013

"Unlike everyone else you might read about like Google and Apple — they have tons of businesses that they want to be in. For us that's our business, we don't have anything else [...] We wake up, eat, sleep thinking about this, and these bigger companies don't."

- This has always been a strong point for Spotify – its laser-focus on music – and also an Achilles' heel: it isn't backed by a massive advertising, devices or retail business.

SPOTIFY IN 2018

JUL 2013

"Love how streaming is bad for artists, now is changed to streaming is bad for new artists. I wonder what next one is..."

- As this tweet shows, Spotify's first five years taught Ek plenty about media cycles.

AUG 2013

"I think a lot of people just look at the financials and say: 'Oh wow, losses, that's really, really bad.' That's not at all how we see it, we see that we've actually now proved our business model."

- The Wall Street Journal quizzed Ek about Spotify's profitability.

SEP 2013

"Jobs was a brilliant guy... but he was also very famous for saying constantly that something was wrong and then six months later doing it himself."

- Ek knew Apple would ultimately enter the subscription space, despite Steve Jobs' famous "You don't want to rent your music" quote from 2003.

SEP 2013

"Buying sports cars, going to expensive nightclubs, spraying people with champagne and things like that: what I learnt is that it wasn't for me and, in fact, I feel pretty empty after doing that."

- It's true that Spotify has never felt part of the 'tech bro' culture that has afflicted certain Silicon Valley startups.

NOV 2013

"The music industry was in the shitter. What did they have to lose? On top of that, I literally slept outside their offices, coming in week after week, hammering them down argument by argument."

- One of the bluntest Ek quotes on-record about the state of the music industry when Spotify started courting labels in its early days.

NOV 2013

"Why are we releasing albums the same way as we did 10 years ago? Music is no longer restricted by the format it's on. We make



audio records alone when they could be audio-visual-interactive. That's what I find interesting: What's the future of the album? That's something we've only begun to touch."

- This is arguably something Spotify still hasn't made much headway on by 2018, although it is doing more with video - and recently with looping clips as song artwork.

OCT 2014

"Because of how we published that, it started creating a dialogue between the artists and the industry, and as a side consequence, as streaming became such a massive part of the revenues, labels seemed to change how they started paying out to artists... instead of once a year, they started paying out much more frequent."

- Ek on Spotify's decision to make stream counts public, while announcing its average per-stream payout - thus giving artists two ends of an equation with which to ask labels some hard questions if they were unhappy with their royalties.

NOV 2014

"Our free service drives our paid service... more than 80% of our



subscribers started as free users. If you take away only one thing, it should be this: No free, no paid, no two billion dollars."

- In the wake of Taylor Swift pulling out of Spotify, Ek was defending the company's freemium model yet again.

MAY 2015

"Spotify now represents half the global market in streaming dollars, but we're also growing our market share. Streaming is the growth in music, and Spotify is the growth in streaming."

- Bullishness at a press launch. Although from the industry's perspective, 2018 - where Apple, Amazon and others are also growing well - is a healthier competitive market.

MAY 2015

"The old-world analogues, the radio and the record stores, are converging more. Soon, there will only be listening, and it will be everywhere."

- Nobody talks much about Spotify in comparison to download stores in 2018, but the comparison with radio is an increasingly key point for the company - particularly as it defends its free, ad-supported tier.

MAY 2015

"To challenge the status quo you need to be willing to be misunderstood for long periods of time. But true rebels hate their own rebellion."

- Punks again!

JUNE 2015

"The only case where we would be interested in selling the company is if someone would offer the possibility of a larger platform."

- An intriguing interview quote that (briefly) seemed like a "come and get us" message to Apple, Google or Facebook. Now, though, Spotify is committed to going it alone.

JUNE 2015

"In the future, people will listen to more music from a bigger variety of artists, and I fundamentally think that is a great thing for culture and society. And if we build the revenue model around freemium, the music industry will be much larger than it's ever been before, more artists will be able to make a living by being artists, and more people will listen in turn, and we will have this wheel where we explore better culture in the world."

- An interview with music:ally in which Ek - perhaps not entirely deliberately - may have anticipated the 'Despacito'-led global success for Latin American artists in 2017.

JUNE 2015

"We believe in the business model of Spotify, and believe that ultimately we'll become profitable at some point. The reason why we're not now is that we keep investing in growth. If we think

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there's 10x potential yet to be unlocked, why wouldn't we invest in that growth rather than optimise for short-term profitability? That was one of the problems the early leaders in this space like Rhapsody had: they stopped investing before this was really beginning to play out."

- Another year, another question about profitability (admittedly from us).

JUNE 2015

"If we're able to transition the traditional radio behaviour online, you're looking at a music industry that's much larger than it's ever been. If you do that, and also add subscription to the mix, especially at Spotify's conversion rate you'd be looking at a music industry that would be \$100bn to \$160bn in size."

- Again, Ek's focus on Spotify as a competitor to traditional radio has been increasingly prominent.

JUNE 2015

"Oh ok"

- Ek tweeted this, then swiftly deleted it, on the night Apple Music was unveiled to the world.

AUG 2015

"Why does the general assumption on the internet seems to be that whatever a fancy designed blog/site posts is true?"

- Ek predicting fake news (possibly).

SEP 2015

"The middle of America found out what Spotify was, so we had a big success. I wish we could have gotten that attention in a better way than pissing off Taylor Swift."

- A part-rueful lookback at the impact of Swift's pullout. She'd return to Spotify in June 2017.

JUNE 2016

"Not going to sell, no. My biggest advice for entrepreneurs is don't ever sell... The number one advice I tell everyone is 'don't sell', because that's the biggest problem we have. All these things could grow gigantic if you just kept the course and kept doing what you're doing."



- Ek was thinking specifically of startup founders in Europe with this advice, given on-stage at the Brilliant Minds conference that he co-founded.

NOV 2016

"It was like switching out the engines mid-flight. I remember the day we turned on this free service, had we probably gone on for about six more months, I think we might have died as a company. That was a defining moment and that was as late as 2013."

- Ek looking back on Spotify's decision to launch a free tier on Android and iOS for the first time in December 2013. At the time, few outside the company had a clue about just how seismic a shift this was.

NOV 2016

"I change jobs every two years. I started as the janitor, then I became the product guy, then I became the HR person, then I became the content person who negotiated all the deals."

- In 2018, how will Ek take to the role of CEO of a publicly-listed company?

NOV 2016

"I used to think that people who went and picked up their kids from daycare were losers and were checking out too early. That's the honest truth. Whereas today I have a totally different appreciation for how and why that is important and which a rich life/work balance is super-important."

- Aged 33, Ek admitted he was "semi-boring" but much more attuned to the needs of his colleagues.

JAN 2018

"#MeToo is a real thing. Personally, I highly recommend and support all the women that are coming forward with these stories and I'm appalled at how widespread this is. It's giving me room to think and reflect on the fact that we have a lot to do as men: what kind of work environments and the level of standards we're setting."

- After janitor, product guy, HR person and content dealmaker, perhaps Ek's next role will focus on Spotify's company culture, and wider diversity issues?



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