

# Spotify in 2020: Can the Company Remain Competitive?

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Before streaming music, many consumers may have been using file sharing services Napster, LimeWire, Pirate Bay, and other companies to download music. Using these services, cost the music industry billions each year by downloading and redistributing music (what we know as *music piracy* and, in legal terms, copyright infringement). According to the Recording Industry Association of America (RIAA), piracy of recorded music has cost the recording industry billions in lost revenues and profits (2020). It is estimated that the U.S. economy loses \$12.5 billion in total output as a consequence of music theft, and approximately 71,000 jobs in the U.S. economy are lost.

Daniel Ek, one of the two founders of Spotify, has not only transformed himself in the last 14 years, his transformation is also reflective of his beloved offspring—the world’s fastest growing streaming music service—*Spotify*. Ek and Spotify came to revolutionize the music industry, Daniel Ek knows well that to remain competitive, the company needs to differentiate its products and services. In the race to remain competitive, Spotify paid more than \$340 million just in the past year acquiring podcast companies. Streaming services and the subscription market will continue to grow from approximately \$8 billion in 2019 to over \$17 billion by 2024. Spotify has entered a race where the pace is quickening with Spotify’s average monthly users growing faster over the last three quarters but also other music services adding podcasts and retooling themselves to remain strong rivals.

Spotify’s growth strategies include an ad-based business model allowing for both a free and paid subscription, global expansion into different markets

exponentially growing its number of subscribers, multiple acquisitions that add new competencies and capabilities, and brand-name partnerships with industry leaders such as Disney, Xbox, and Samsung among others. Spotify’s ongoing transformation is based on the rapid adoption of streaming music and subscription services and its leverage with smartphones, tablets, smart TVs, and high-speed internet access. As early as 2015, digital streaming became the primary revenue stream for recorded music, surpassing physical format sales of CDs.

Spotify knows its user’s preferences perhaps better than subscribers themselves. The company relies on its analytical capabilities to create a competitive advantage. Through the use of analysis, machine learning algorithms, and its vast amounts of data, subscribers are presented with personalized playlists and other recommendations. The use of AI has also created value for artists allowing them to understand and visualize (through Spotify graphs) user engagement, monthly/daily listeners, metrics, and demographic details. An added advantage of using data analytics is being able to customize specific ads to different regions.

## Company History

Founded in 2006, Spotify took the streaming music industry by surprise with its unprecedented growth in the last six years. Daniel Ek and Martin Lorentzon founded Spotify as a small startup in Stockholm, Sweden. Their startup music platform was in response to a growing piracy problem in the music industry. Ek and Lorentzon knew there had to be a

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better way for artists to monetize their music and give consumers a legitimate and simpler way to listen to music. In 2008, Spotify transformed music listening when it launched its streaming service, offering listeners access to a library of music rather than making users pay for downloading albums or tracks. The music industry, which had been suffering from spending declines, resisted this new business model of offering “unlimited access,” and favored the current digital download model used by Apple iTunes. Spotify began by offering its free subscription by invitation only as a way to manage growth; paid subscriptions were open to everyone. At the same time, Spotify also announced licensing deals with music labels.

In early 2009, Spotify opened its free registration tier to the public in the United Kingdom only. Due to a surge in registrations following the Spotify mobile app’s release, Spotify closed its open registration in late 2009 and returned to invitation only. In 2010, Spotify integrated with Shazam to figure out who was singing a particular song and would then populate a playlist. Spotify was launched in the United States in July 2011, allowing users a six-month free ad-supported trial period to listen to unlimited music. By 2012, the trial period expired, and users were limited to ten hours of music each month and five-song replays. By March of 2012, Spotify removed all limits and introduced its free ad-supported tier.

In 2014, Spotify pushed its two-sided business model by offering a free ad-supported service to attract new users with the goal of converting them into paid subscribers. The company was able to convert 10 million users to premium subscribers from its approximately 40 million active users. At about the same time, music artist Taylor Swift pulled her music off Spotify, claiming a rapid decline in sales.

In 2017, the company announced expansion plans to move to the United States in lower Manhattan, New York City, adding approximately 1,000 jobs. In November 2018, Spotify announced a total of 13 new markets in the MENA region (the Middle East and North Africa), including a new Arabic hub and several playlists.

Spotify’s success has also seen a few bumps along the way. Taylor Swift was one of the first artists to speak out against the company and its unfair compensation to artists, calling the music platform an “experiment.” Three years later, the feud between Spotify and Taylor Swift ended, and the artist put

her music back on the platform. Jay Z, a hip-hop music mogul, also claimed unfair compensation to artists and launched Tidal in 2016 as his own music platform, becoming Spotify’s competitor. Other artists who kept their music off Spotify included The Beatles, Adele, and Pink Floyd.

## Growth Year by Year

By March of 2011, Spotify had a customer base of 1 million paid subscribers across Europe, and by the end of September of 2011, the number had doubled. By August of 2012, the company reported 15 million active users, of which 4 million were paid subscribers. By 2013, the company reported 20 million active users with one million customers in the United States. The growth for Spotify has been exponential year after year reaching 286 million users, this includes 130 million subscribers across 79 markets, with 50+ million tracks, 1 million+ podcast titles, and 4 billion+ playlists as of March 2020.

## IPOs Are Too Expensive and Cumbersome

On February 28, 2018, Spotify filed a Direct Public Offering with the SEC. Barry McCarthy, Chief Financial Officer of Spotify, stated in an interview with the *Financial Times* that the company opted for a Direct Public Offering (DPO), also known as a *direct listing* instead of an IPO because “the U.S. initial public offering market is broken.” A DPO is a way for companies to become public without a bank-backed initial public offering. Spotify opted for what they called a free-market approach by selling shares directly to the public without paying an underwriter. The financial benefits for Spotify were savings in underwriter fees and avoiding the IPO discount.

## Growth through Acquisitions

Spotify has strengthened their competitive position through a series of targeted and timely acquisitions. Each acquisition has resulted in a stronger competitive position and new market opportunities. A list of Spotify’s acquisitions between 2013 and 2020 are presented in Exhibit 1.

**2014–2016.** In March 2014, Spotify acquired The Echo Nest. The Echo Nest was a music intelligence and data platform for developers and media companies. The company developed and personalized music

shows and its loyal audiences. To round off the year, the company acquired SoundBetter, a music production marketplace where people in the music industry collaborate on projects and distribute music tracks for licensing. SoundBetter brought with it a strong reputation and commitment to support all creators worldwide; the company joined Spotify with 180,000 registered users in 176 countries.

**2020.** Spotify's latest acquisition was Bill Simmon's *The Ringer* in February 2020. The Ringer was a creator of sports, entertainment, and pop

culture content. The addition of *The Ringer* expanded Spotify's content offering and audience reach. This acquisition is one more example of Spotify's growth strategy.

## Growth through Partnerships

Spotify's Partnerships have also strengthened the company's competitive position by expanding its market access and strategic collaborations mostly through bundling of services. A list of Spotify's partnerships between 2011 and 2020 are presented in Exhibit 2.

### EXHIBIT 2 Spotify's Partnerships between 2011-2020

Company	Year	Company Collaboration Scope
Facebook	2011	Integrated into the Facebook page, users can listen simultaneously with friends.
Shazam	2011	Leading mobile discovery company
SoundHound	2011	Sound and discovery search company
Coca-Cola	2012	Global partnership to share music with consumers around the world.
Harman	2014	Premium global audio and Infotainment group.
BandPage	2014	Artists and groups engage directly with fans
Sony	2015	Added to Sony PlayStation 3 & 4 and Xperia Consoles
Starbucks	2015	Integrated into Starbucks App
Uber	2014	Riders can listen to their playlists while riding in an Uber
Adidas	2015	Integrated into the Adidas Go app where streaming music was fused with fitness metrics.
Tencent	2017	Spotify and Tencent acquired shares from each other
Microsoft	2017	Provide access to streaming music
South by Southwest	2017	Access to SXSW genre-specific curated playlists on Spotify hub
Waze	2017	Users can access Spotify playlists from Waze navigation
WNYC Studios	2017	Podcast available through Spotify
Discord	2018	Users can highlight and share music
Hulu	2018	Premium bundle of music and TV
Ellen DeGeneres	2018	Create opportunities for undiscovered talent
Samsung	2019	Spotify preinstalled in new Samsung devices
AT&T	2019	Collaboration allows AT&T Unlimited & More customers to choose Spotify Premium as an entertainment option.
Xbox	2019	Spotify can be played in the background while playing videogames
Bouygues Telecom	2019	In France, Spotify and Bouygues offered a six month free trial for customers of Bouygues.
Magalu Conecta	2019	Brazilian customers of Magalu Conecta were offered a free four-month trial of Spotify premium.
Vodafone	2019	Eligible Vodafone Australian users received a free 30-day trial of Spotify premium added to their mobile plan.
Disney	2019	Disney Playlists on Spotify aimed at boosting family memberships
ESPN	2020	Spotify created music and podcast playlists for viewers to watch after <i>The Last Dance</i> docuseries of former Chicago Bulls player Michael Jordan.
The Joe Rogan Experience	2020	Popular podcasts in diverse topics such as neuroscience, sports, comedy, health, and ever-changing culture.

Source: Various Spotify press releases. <https://www.businesswire.com/portal/site/home/>.

first time a six months trial of Spotify premium. The company also entered into partnerships with French company Bouygues Telecom Broadband company; customers on mobile tariffs of > 1GB could add Spotify Premium to their existing mobile plan. A second partnership included Brazilian Magalu Conecta, a country top retailer that offered technical support, cloud storage, phone protection, and Wi-Fi spots; customers received a free four-month Spotify Premium trial. The last global partnership was with Vodafone, Australian largest mobile network; customers received a free 30-day trial of Spotify Premium.

To boost family membership, Spotify and Disney entered into a partnership that would create a Disney Hub with Disney playlists with liked soundtracks from Disney, Pixar, and Marvel movies, Star Wars instrumentals, classics, sing-alongs, and more.

**2020.** On May 1, 2020, Spotify, ESPN, and Netflix teamed up to curate podcasts around Netflix's *The Last Dance* docuseries of former Chicago Bulls player Michael Jordan. The partnership built on every brand's respective strengths, and for Spotify, it was on content curation and playlists. Spotify's latest partnership was with "The Joe Rogan Experience," a podcast with a loyal and engaged fanbase around the world. The podcast debuted on September 1, 2020.

The many strategic acquisitions and partnerships Spotify formed strengthen the company's competitive position as the most significant and leading music streaming global platform. Through market penetration, the company has been able to grow its number of users. Economies of scale are evident as new users and artists are added. Product development is also part of Spotify's growth strategy and can be seen in the latest acquisitions of Podcast companies.

### Spotify's use of Big Data

Spotify is continuously looking for new "habits in their streaming intelligence" to learn more about how people stream. The company calls this "understanding people through music." The company's use of innovation and technology creates superior products and services to meet the growing demand of existing and potential subscribers. Spotify introduced Spotify.me, a data analytics program to capture a subscriber's listening habits. The captured data allows the company to generate content that users consider in line with their tastes, creating a unique user experience, and keeping users engaged. Spotify's

use of artificial intelligence and machine learning algorithms has been a driving force behind the company's success.

It all began in 2012 with the company's "Discover" feature, which started as a playlist of a user's favorite artists and soon became a sort of recommendation engine. In 2019, Spotify updated to "Discover Weekly," a feature that creates custom playlists unique to each listener's activity, which is curated by machine learning algorithms. The algorithm further analyzes other users' playlists to find common music themes and use that information to develop new playlists. Users also have a "taste profile" of microgenres that are used to further customize playlists. It is not only about what music users listen to, it is about the user's interaction with the song. Spotify's program is able to recognize if a user changes the track within 30 seconds giving it a thumbs down and removing it from the playlist, or, if a user adds a song to a playlist and listens to the entire song, the song is aligned with the "user's taste," a factor that helps the algorithm develop the user's overall taste profile.

Aside from "Discover Weekly," Spotify also uses a function called "Daily Mixes," these are playlists separated by genres that the user gravitated towards and includes songs the user either saved or added to a playlist, are written by the same artist, or are from new artists or albums the user does not know of yet. Spotify algorithms change the songs of these playlists as well as introduce a few extra new songs.

Not only does Spotify use analytics to understand a user's music tastes, they also use data to improve customer experiences. The data generated by consumers is used for ad campaigns and to better target consumers. The company uses what they have learned from users to develop ads that strategically target an ideal audience. The company has seen the impact of using listener data to develop ad campaigns that increase their sales and user engagement. Some examples of successful ad campaigns include a display ad in Williamsburg, New York, where the company used listening history to develop funny ads, the first ad, read "Sorry, Not Sorry Williamsburg, Bieber's hit trended highest in this zip code." This ad was displayed in a "hipster area" known for its notoriously high concentration of music snobs. Some popular campaigns included holiday ads, a set of 2018 Goal ads, and a set of "meme-inspired" ads.

As of April 2018, Spotify announced that free users would have access to explore 15 of Spotify's

Podcasts can be managed in three distinct sections: episodes, downloads, and shows. The Episodes tab allows users to find or resume podcasts. The downloads tab serves as a repository for downloaded podcast episodes that users can listen to them offline. The shows tab allows for users to quickly manage podcasts they follow.

The company launched 78 Originals & Exclusives (“O&E”) podcasts globally and completed its latest acquisition of The Ringer; The Ringer is a platform rich in popular sports and media podcasts. Gimlet was acquired by Spotify in early 2019; they are a Swedish digital media podcast network that focuses on narrative podcasts. The company brought with it a dedicated I.P. development team, production, and advertising capabilities. Parcast is a premier storytelling-driven podcast studio based in Los Angeles, California popular for Unsolved Murders, Cult, Serial Killers, and Conspiracy podcasts. Spotify acquired Parcast in the second quarter of 2019.

Spotify now has over 1 million podcasts available on its platform, with more than 70 percent powered by Anchor. Anchor is a podcasting platform that has added its suite of tools for podcast creation, distribution, and monetization to Spotify’s community of more than 200 million users. Anchor joined Spotify in early 2019 after discussions of joining forces and the similarities of their company mission statements: “to *unlock the potential of human creativity.*”

Spotify experienced a shift in listening patterns in the first quarter of 2020 due to COVID-19, but the company remained excited about its growth trajectory and adoption of podcasts at a global level. The company saw an increase of 3% from Q4’19 to Q1’20 in podcast engagement, and consumption continued to grow at triple-digit rates year after year. Spotify positioned itself to become the premier producer of podcasts and the leading platform for podcast creators.

## Spotify’s Web Image Matters

Spotify takes the design of their website very seriously. The company believes in *designing for belonging*. The company knows that millions of people around the globe open Spotify, so its focus is on localizing content. People in India can easily find Bollywood in India, Malay Pop in Malaysia, and Sertanejo in Brazil. While playlists may share a theme, they feature different songs in different parts of the world, so happy songs in the United States are different from

those in Taiwan. Every word on Spotify is also translated into the local language(s) whenever possible. Spotify wants to “look just right” no matter where users access the app. The company spends time making sure users relate with the images, they focus on the emotional content of images, the approach to cultural sensitivities, and how they handle image localization. It is about the Spotify experience of allowing people to feel that they belong.

Music unites people and yet it is highly localized and a personal experience; therefore, Spotify’s focus is on delivering a country-to-country, culture-to-culture, and person-to-person unique experience that varies but is equal in measure. A group of editors works together to minimize localization challenges. The Spotify relevance starts with translating the experience into the appropriate language(s), followed by using the same or different images based on the country. Connections are created when users open Spotify and find images that are relevant and resonate with them. For Spotify, representation matters, this could be the connection to a particular playlist and added users.

## Royalties, Artist Compensation & Spotify

Spotify was created in response to protect artists from piracy and to compensate them for their work. But the road to a business model that makes sense for Labels, music producers, and recording artists has been challenging.

As of December 31, 2019, Spotify had paid more than \$16 billion in royalties to labels, publishers, and collecting societies for distribution to songwriters and recording artists, an increase of 30 percent from 2018. Spotify has become the biggest driver of growth in the music industry, and the biggest source of overall music revenue in many places.

**Performance Royalties.** Performance royalties are payments made to a songwriter or publisher for a public performance. Public performance refers to playing a song on the radio, television, in bars, nightclubs, concerts, and other public places. The Performance rights organizations collect the songwriting royalties from music users and distribute them to the legal owners. These organizations include ASCAP in North America and SACEM internationally.

**Mechanical Royalties.** A mechanical royalty is earned through the reproduction of a copyrighted

## Spotify's Financial Performance

Despite the global uncertainty around COVID-19 in the first quarter of 2020, Spotify met or exceeded its forecast. With more than €1.8 billion in liquidity, the company remained optimistic about its underlying growth. Figure 3 shows Spotify's first quarter of 2020 growth by region. Monthly active users (MAUs) grew faster in first quarter 2020 than it did in first quarter 2019, with growth in North America showing a second consecutive quarter growth followed by Europe, Latin America, and the rest of the world. Exhibit 4 was a snapshot of the company's user and financial metrics. The decline in first quarter 2020 of MAU's was traced back to the COVID hard hit markets like Spain and Italy.

Car, Wearable, and Web platforms dropped by double digits. However, TV and game console use increased over 50 percent over the same period. Ad-supported MAUs in the United States game consoles were a top two or three platform in consumption in March and April 2020. While Car and Commute consumption had changed dramatically due to an increase of work-from-home, there was an increase in podcast listening. Two in five people surveyed in the United States stated they listened to music to manage stress, which explained the increase in podcasts related to wellness and meditation.

**Monthly Active Users (MAUs).** Total MAUs grew 31 percent year-over-year to 286 million between 2019 and 2020. Spotify's first quarter 2020 was the third consecutive quarter, with growth above 30 percent. North America region showed accelerated growth, with the United States being the best performer. Europe grew by 35 percent, Latin American region by 22 percent, and the Rest of the World by 17 percent—see Exhibit 4.

**Premium Subscribers.** At the end of first quarter 2020, Spotify had 130 million premium subscribers globally; this is an increase of 31 percent Y/Y. The Spotify Family Plan was a driver for this increase. Spotify Kids, a stand-alone app designed for children, was launched in eight additional markets: Australia, the United Kingdom, Mexico, Brazil, Argentina, the United States, Canada, and France. The Duo Plan, premium plans for two people, was further introduced in three more markets: Canada, France, and Japan. This plan already existed in 23 markets (Exhibit 4).

**Revenue.** Total revenue of €1,848 million grew 22 percent Y/Y in first quarter 2020. Premium revenue grew 23 percent Y/Y to €1,700 million, which was in

### EXHIBIT 4 Summary User and Financial Metrics for Spotify Technology S.A., Q1 2019, Q4 2019, and Q1 2020

USERS (M)	Q1 2019	Q4 2019	Q1 2020	% Change	
				Y/Y	Q/Q
Total Monthly Active Users ("MAUs")	217	271	286	31%	5%
Premium Subscribers	100	124	130	31%	5%
Ad-Supported MAUs	123	153	163	32%	7%
<b>FINANCIALS</b>					
Premium	€ 1,385	€ 1,638	€ 1,700	23%	4%
Ad-Supported	126	217	148	17%	(32)
Total Revenue	€ 1,511	€ 1,855	€ 1,848	22%	0
Gross Profit	373	474	472	27%	(1)
Gross Margin	24.7%	25.6%	25.5%	—	—
Operating (Loss) Income	€ (47)	€ (77)	€ (17)	—	—
Operating Margin	-3.1%	-4.1%	-0.9%	—	—
Net Cash Flows (used in)/from operating activities	€ 209	€ 203	€ (9)	—	—
Free Cash Flow	173	169	(21)	—	—

Source: Spotify Technology S.A. Announces Financial Results for First Quarter 2020. <https://investors.spotify.com/financials/press-release-details/2020/Spotify-Technology-SA-Announces-Financial-Results-for-First-Quarter-2020/default.aspx>.

line with expectations. Ad-supported revenues grew 17 percent Y/Y but fell short of expectations, according to the company, this decline was a result of COVID-19. Ad-supported revenues of €148 million were below the company forecast by more than 20 percent. March 2020 saw several previously booked businesses cancel and buyers pulling back, leading to this decline.

**Gross Margin.** Gross margin finished as 25.5 percent in quarter one, exceeding company expectations. The driver of this performance was the core royalty component due to product mix. Spotify renewed its global licensing partnership with Warner Music Group. This renewed partnership covered existing countries and a few additional ones, it was not expected that this deal would impact music economies. Premium gross margin increased to 28.3 percent in quarter one 2020 from 27.4 in quarter four 2019. Ad-supported gross margin declined to 6.6 in quarter one 2020 from 11.6 in quarter four 2019.

**Operating Expenses/Income (loss).** Operating expenses totaled €489 million in quarter one, an increase of 16 percent from quarter one 2019 but below expectations.

At the end of quarter one 2020, Spotify had €1.8 billion in cash, cash equivalents, restricted cash, and short-term investments on its balance sheet and no indebtedness.

In the race for market domination, Spotify has been busy hiring talent, making acquisitions and forming partnerships, and as CEO Daniel Ek stated in a Feb. 5, 2019 interview, “the company is focused on its goal of being the world’s No. 1 audio platform.”<sup>1</sup> Reid Hoffman, founder of LinkedIn and partner at Venture Capital firm Greylock Partners described Spotify’s growth as “blitzscaling,” a term coined by Hoffman that typically applies to young companies but as Hoffman stated, “Spotify isn’t acting its age.”<sup>2</sup>

## ENDNOTES

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<sup>1</sup> As quoted in “Why Spotify Is Still Sprinting for Maximum Market Share,” *Billboard*, March 4, 2020, [www.billboard.com/articles/business/streaming/9325846/spotify-strategy-market-share-analysis](http://www.billboard.com/articles/business/streaming/9325846/spotify-strategy-market-share-analysis).

<sup>2</sup> As quoted in “Why Spotify Is Still Sprinting for Maximum Market Share,” *Billboard*, March 4, 2020, [www.billboard.com/articles/business/streaming/9325846/spotify-strategy-market-share-analysis](http://www.billboard.com/articles/business/streaming/9325846/spotify-strategy-market-share-analysis).