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Spotify: Face the Music (Update 2019)

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By March 2019, Ariana Grande's new album *Thank U, Next* had been streamed 2 billion times on Spotify,[1] not even two months after it had been released. Such figures were becoming increasingly less bewildering. After all, it was Grande's third album to reach 2 billion streams on the platform, and she was not alone. Global superstars such as Ed Sheeran, Drake and Justin Bieber routinely accrued hundreds of millions or even billions of streams of their hit songs.

Indeed, for many music fans, streaming had become *the* way to consume music, revitalizing an industry that was seeing growth rates in double digits for the first time since the 1990s. With its 96 million paid subscribers and 200 million total users, Spotify was at the top of the pile. Moreover, after a decade of Spotify struggling to find a path to profitability, operating losses had shrunk to $48 million in 2018, down from $378 million in 2017, while revenue had shot up to $5.26 billion.[2]

Despite the encouraging data, Spotify's stock had been on a downward slope. Spotify was engaged in a bitter rivalry with Apple Music, which had become a success on its own and had reached 56 million subscribers by the end of 2018.[3] Apple CEO Tim Cook claimed that Apple Music was already the top streaming service in the US music market, which was the largest in the world by revenue. Apple had announced plans to create a cultural one-stop shop that would include music, video, books and even video games. Likewise, the retail giant Amazon was already bundling music streaming with its own retail and video-streaming services.

Direct competitive threats were not the only issue for Spotify. Artists were criticizing it more for the low royalties Spotify paid since the rates were now even lower thanks to the new deals signed with the major music publishers in 2017. While those low rates were helping Spotify's quest for profitability, they risked alienating artists. Spotify's bottom line remained vulnerable. The company had just filed an appeal to the Copyright Royalty Board in the United States, hoping to prevent an increase in those royalties it paid that were independent of its deals with the majors.[4]

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Spotify's response seemed puzzling at first: less music. In February 2019, it announced it had bought two podcast companies for $340 million.[5] Spotify CEO Daniel Ek stressed the importance of that nonmusic gamble, saying that "audio—not just music—would be the future of Spotify."[6] But at that time podcasting was a very small market. Could Spotify work its magic twice, growing podcasting as it had done with music streaming? Would this be enough to strengthen its position in a market that was becoming more and more competitive?

The History of the Music Industry

The Music Industry Before the Digital Era

In 1999, the recorded-music industry was at its peak. With $38 billion in global revenues,[7] it was riding a wave of growth as more convenient playback media such as the CD had replaced vinyl records and cassettes. Playing CDs combined the accessibility of a small and cheap cassette player with much higher sound quality and fidelity.

Recorded music came into existence with the invention of the phonograph by Thomas Edison in 1877, which enabled sound to be reproduced using an engraved cylinder, the "record." Recorded music would become popular throughout the 20th century with the emergence of mass media such as the radio, which brought music to millions of homes. Music enthusiasts wanted a way of listening to their favorite songs without having to wait for them to be broadcast again on the radio or television, and sales of recorded music exploded.

Soon, a new business model emerged where recording companies, called "music labels," contracted artists to produce music for them. These labels acted as both producers and publishers, coordinating and handling the recording, manufacturing, promotion, marketing and distribution of music. The finished records were sent to final distributors (from small music stores to nationwide chains or department stores or eventually even online retailers such as Amazon), which sold them to the final customer.

Recorded music was published in albums of several tracks (usually around 10). Some would-be hit songs were released as singles, which could be sold for a lower price and were also used for promotional purposes, but the transition to compact disc (which had very similar production costs regardless of the length of the recording) reduced the sales importance of the single.

By 1999, this business model had remained undisturbed for decades. Eventually, the market had become concentrated in the so-called "big five" major labels: EMI, Sony Music, Universal Music Group, BMG, and Warner Music Group. These larger companies often also acted as the publishers of smaller independent companies, which lacked the capacity to develop effective distribution and marketing arms. This increased the major labels' market share even further.

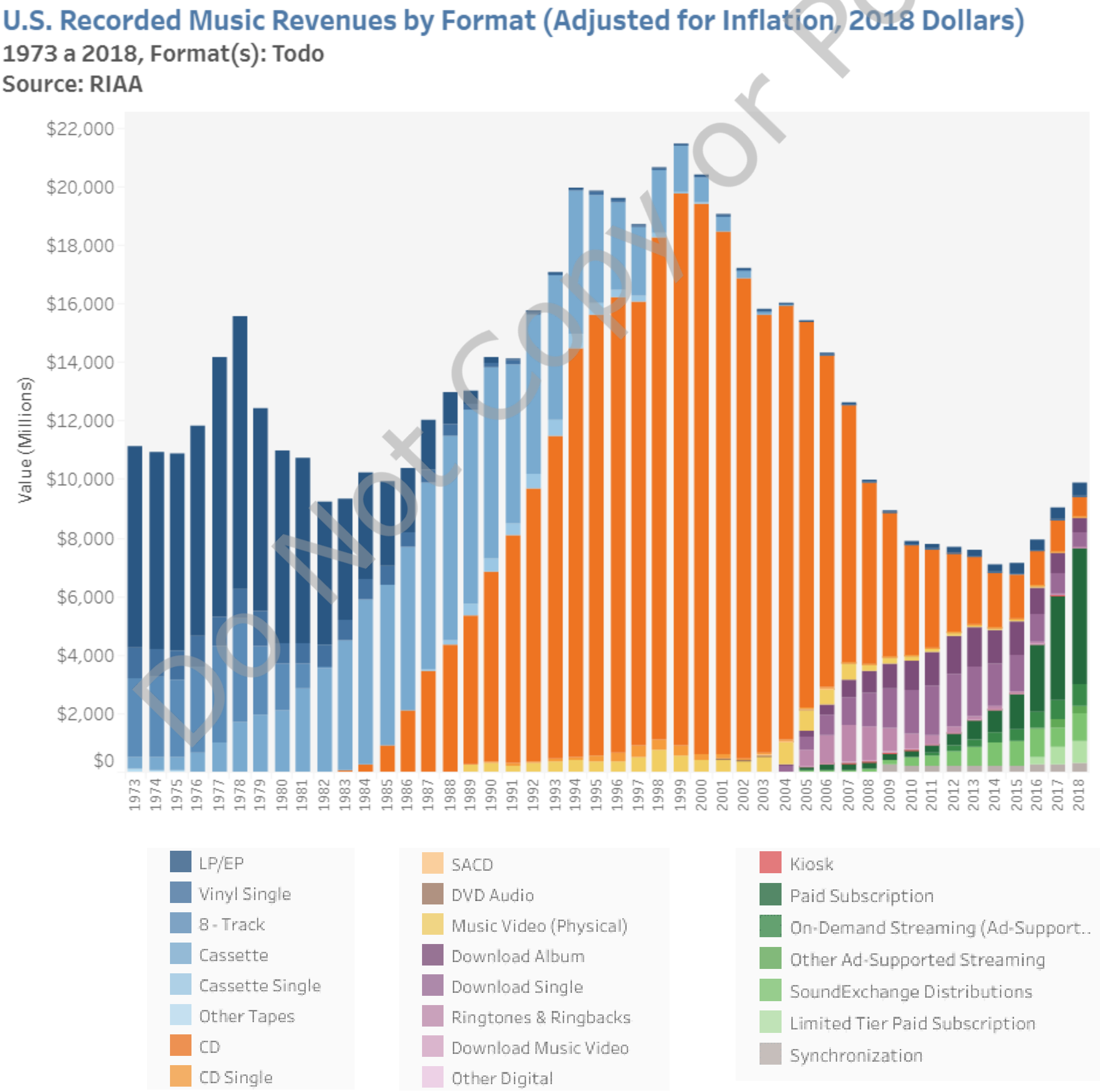
However, in June that year, 1999, while the recording industry was enjoying its best year ever, a group of entrepreneurs launched the file-sharing service Napster. The service allowed users to share files easily through the Internet and became the first step that would unravel the entire industry as it had been understood up to that point.

The Digital Medium and the Rise of Music Piracy

Two years later, in 2001, Judge Marilyn Hal Patel ordered an injunction against Napster, after the Recording Industry Association of America (RIAA) brought a suit against the company.[8] Napster users had been using the service to share music in digital format illegally. In just two years Napster had amassed 60 million users, who were swapping more than 165 million songs a day without paying artists or labels.[9]

Music sales had been falling dramatically, which had prompted the RIAA to start an intense campaign against music piracy. Yet, despite its efforts, sales would continue in free fall for years to come, reaching an all-time low of less than $16 billion in 2011.[10] In a little more than a decade, the music industry had been cut in half. **Figure 1** shows the dramatic drop in music spending per capita throughout the first decade of the 21st century, compared with the previous state of the industry.

Figure 1
US Recorded-Music Revenue, 1973–2018 (in 2018 Dollars per Capita)



Source: "US Sales Database," RIAA, https://www.riaa.com/u-s-sales-database/, accessed May 2019.