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### Spotify: Strategic Plan and Analysis

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# SPOTIFY: STRATEGIC PLAN AND ANALYSIS

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Riley Sletten

BGEN 499

Spring 2021

**Memo:**

There have been no substantial changes to the external analysis. There have been no substantial changes to the internal analysis.

The purpose of this report is to identify and recommend possible strategies for Spotify to build a sustained competitive advantage in the music streaming industry.

## **Strategic Recommendation**

The strategic change recommended to Spotify is to produce original content to be made exclusively available on the Spotify platform. This recommendation will lower Spotify's cost structure and increase differentiation.

## **SWOT Analysis**

### **Strengths**

The strengths of Spotify are its powerful brand name, agile organizational structure, large user base, algorithms, ability to innovate, and flexible financial position.

### **Weaknesses**

The weaknesses of Spotify are its current licensing deals with music rights holders and lack of differentiation in music content.

### **Opportunities**

Spotify has the opportunity to differentiate its product by producing original content to be exclusively available on the Spotify platform. Spotify also has the opportunity to capture users in emerging and existing markets in the music streaming industry.

### **Threats**

The threats to Spotify include the power of music rights holders, who could increase the price of music licensing for streaming, and changes in data collection policies that could restrict Spotify's collection of user data.

## **Industry**

The music streaming industry includes companies that provide access to extensive libraries of music over the internet on the user's device. Companies in this industry create revenue through subscription fees and from advertisements. The music streaming industry is expected to have a compound annual growth rate of 15.4% from 2019 to 2024 (MarketLine, 2020).

### **Industry Attractiveness**

The music streaming industry is moderately attractive due to moderate competitive forces. Competition is primarily driven by the high bargaining power of suppliers, lower costs to switch for buyers, and industry rivalry. Competition is weakened by a low threat of new entrants.

## **Strategy and Operations**

Spotify operates with a broad differentiation generic strategy by offering a wide range of music that appeals to a large market of listeners and differentiates itself by providing personalized playlists and music recommendations to users. The company offers Spotify Free, which is based on ad revenue, and Spotify Premium and HiFi, which are based on subscription fee revenue.

## **Alternative Strategic Options**

The first alternative strategic option for Spotify is to lower its prices to gain new users in emerging markets. The low-cost strategy would set prices below the competition to gain market share. The second alternative strategic option for Spotify is to make purchases music rights to make music exclusively available on Spotify. This option would create differentiation for Spotify by making music exclusive to Spotify.

This report includes an external analysis, an internal analysis, and a strategic recommendation. The external analysis will define the music streaming industry and identify the strategies of the competitors in the industry. The external analysis will also include Porter's 5 Forces analysis and macroenvironmental analysis to identify the opportunities and threats present in the music streaming industry. The internal analysis will identify Spotify's strengths and weaknesses through a VRIO analysis, value chain analysis, and financial analysis. Finally, the report will conclude with a strategic recommendation and implementation plan based on the strengths, weaknesses, opportunities, and threats present for Spotify and the music streaming industry.

## **External Analysis**

### **Introduction**

The global music streaming industry is a growing industry with several competitive players. This report will include an external analysis of the industry that examines the general characteristics of the industry, competition, Porter's 5 Forces, and macroenvironmental factors that impact the industry. Finally, this report will identify the opportunities provided by the growing industry and the threats that are present.

### **Global Music Streaming Industry**

#### **a. Music Streaming Industry Description**

The global music streaming industry includes companies that provide access to an extensive music library over the internet on a customer's computer, phone, or tablet. Companies in this industry provide this service for a subscription fee or for free with advertisements. The formal NAICS industry code for the music streaming industry is 518210 – Data Processing, Hosting, and Related Services. This industry

includes “establishments primarily engaged in providing infrastructure for hosting or data processing services” (NAICS, 2021). More specifically, music streaming companies operate in the segment of the industry that provides specialized hosting for audio streaming.

The geographic scope of this analysis is the global music streaming market. Major global music streaming markets include North America, South America, Europe, Asia-Pacific, Middle East, South Africa, and Nigeria (MarketLine, 2020).

#### a. Key Industry Statistics

Total users in the industry were 400 million in the first quarter of 2020, up 30% from the year before (Mulligan, 2020). The size of the music streaming industry is estimated to be \$16 billion in 2020 and is expected to grow by 6% in 2021 (T4, 2020). From 2019 to 2024, the music streaming market value is expected to have a compound annual growth rate of 15.4% (MarketLine, 2020).

The music streaming industry accounted for 79.5% of all U.S. recorded music revenues in 2019 at \$8.8 billion (Perez, 2020). Of the \$8.8 billion in revenues in the music streaming industry, \$6.8 billion is from paid subscription services.

#### a. Industry Life Cycle

The music streaming industry is in the growth stage of the industry life cycle. The market value of the industry had a compound annual growth rate (CAGR) of 50% from 2015-2019 (MarketLine, 2020). From 2019-2024, the market value is projected to continue to grow at a CAGR of 15.4% (MarketLine, 2020). Total users in the industry were 400 million in the first quarter of 2020, up 30% from the year before (Mulligan, 2020). Continued growth in market value and music streaming users is driven by the increased accessibility of high-speed internet, the growth of smart devices, and consumer demand for a large catalog of instantly available music. Companies in the industry are making investments in their product to capture new users and paying subscribers in the growing industry. Music streaming companies are focusing on their product to improve the customer experience, such as through the addition of podcasts, song lyrics, and music videos to their platforms. Additionally, companies are working to integrate their service with other electronic devices such as wearables and smart speakers (MarketLine, 2020).

#### a. Industry Segmentation

The music streaming industry is broken into two segments: subscription streaming and ad-supported streaming. In 2019, subscription streaming accounted for 86.2% of the market value, while ad-supported streaming accounted for only 13.8% (MarketLine, 2020). The subscription streaming segment accounted for 93% of music streaming revenue growth in 2019 (T4, 2020).

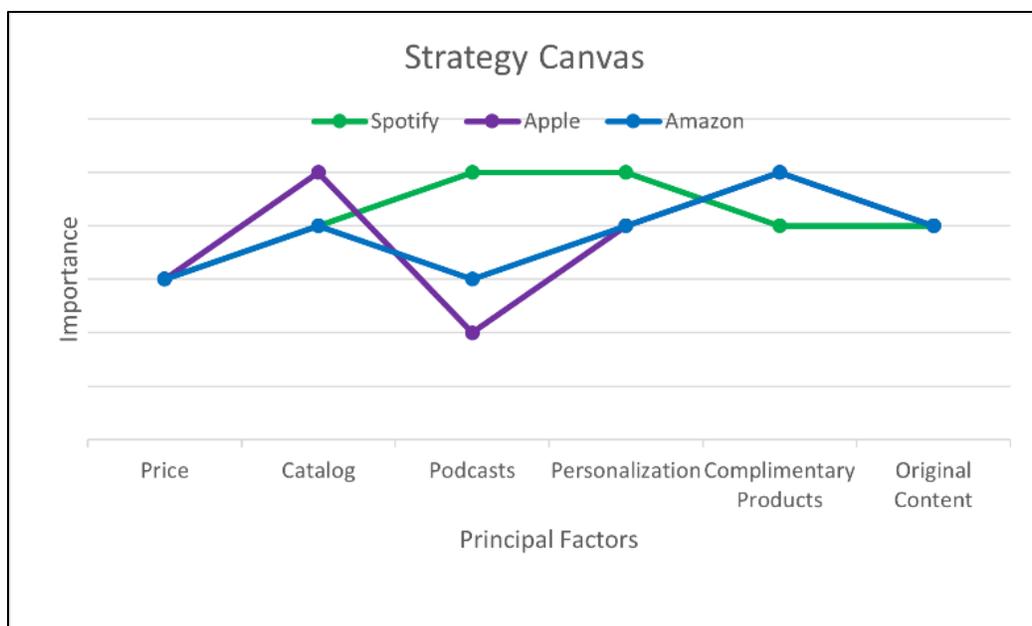
#### a. Strategy Canvas

Companies in the global music streaming industry create value for customers through content selection, personalized experience, and convenience. Companies increase customer satisfaction and build brand loyalty by offering an extensive selection of music, podcasts, and original content. Additionally, several music streaming companies offer complementary products such as smart home devices to work seamlessly with their music streaming service. Finally, music streaming companies aim to create a personalized listening experience through personalized playlists and music recommendations based on past listening.

### **Industry Competition**

The music streaming industry includes several large, multinational companies that represent the majority of market share; however, some companies operate in specific geographic or niche markets. Spotify, Apple Music, Amazon Music, YouTube, and Pandora are five major competitors in the global music streaming market. They hold over 74% of the global music streaming market share (T4, 2020). Companies in the industry do not compete on price, as they all offer their baseline service for \$9.99/month (see Figure 1). A strategy canvas is shown for Apple, Spotify, and Amazon to demonstrate how these companies compete in the industry (see Figure 2). Companies generally compete to gain users through several key factors:

1. Size of the music catalog offered by the music streaming service creates value by appealing to a wide range of listeners;
2. Podcasts provided by the music streaming service on the same app as music create value by added convenience;
3. Personalization of listening experience through personalized playlists;
4. Complimentary products offered by the streaming company to work with their music streaming service;
5. Original content and other exclusive offerings to subscribers;
6. Price for a standard subscription



Spotify uses a broad differentiation strategy. Spotify is hoping to deliver a differentiated product to a large group of customers through personalized playlists and exclusive podcasts. Spotify is the leader in market share in the industry (see Figure 1).

Apple Music also uses a broad differentiation strategy. They also try to bring a differentiated product by having the largest music library and having a seamless connection to other Apple devices and services.

Amazon Music uses a focus differentiation strategy by specifically targeting current Amazon product users and Amazon Prime subscribers. Amazon tries to have a differentiated product through a large music library and exclusive podcasts that work well with Amazon smart devices.

YouTube Music uses a broad differentiation strategy that focuses on users that might already use YouTube extensively and can pair with other YouTube products.

Pandora broad low-cost strategy to target users that do not want to pay for streaming music by giving them ad-supported radio streaming that gives customers customized music suggestions. Pandora was recently acquired by Sirius XM, a broadcasting and satellite radio company.

Figure 1: Financial and Market Share Measures for Key Competitors

	Spotify	Apple	Amazon	YouTube	Pandora
<b>Revenue</b>	7.59B	274B	386B	183B	8B
<b>Net Income</b>	(147MM)	57B	21B	40B	131MM
<b>ROA</b>	-3.93	17.38	7.79	13.49	1.22
<b>ROE</b>	-9.01	73.89	27.37	18.94	N/A
<b>Total Users</b>	271MM	60MM	55MM	20MM	6MM

<b>Market Share</b>	36%	18%	13%	5%	2%
<b>Price</b>	9.99	9.99	9.99	9.99	9.99

Sources: Music Streaming Market Share, 2020 and Mergent Online Company Profiles, 2021

### Porter's 5 Forces Analysis

The global music streaming industry is mostly controlled by several large, multinational firms. These firms have an increasing level of rivalry as there are low switching costs and the companies fight for new subscribers. Suppliers in the market have strong bargaining power, as only 3 large firms control most of the music streaming industry's supply. Buyers in the market have bargaining power through low costs to switch music streaming providers, but no individual customer has the financial power to make a real impact. High capital requirements and low product differentiation in the industry decrease the threat of new entrants to the market. Overall, the music streaming market is attractive to companies that have the capital required to enter the market and can convince customers to switch. The music streaming industry would not be attractive to a firm that does not have the financial power to purchase a large music catalog from suppliers and could not compete with the rivalry of multinational firms.

a. Bargaining Power of Suppliers – Suppliers in the music streaming industry have strong bargaining power but it is beginning to weaken. The strong bargaining power of suppliers hurts industry attractiveness as companies would prefer a lower bargaining power of suppliers. Suppliers in the audio and music streaming industry are the owners of the recording copyright, which could be a label, distributor, or artist. Audio streaming companies pay for a license to play the audio from the owner of the copyright. Additionally, streaming companies pay royalties to the songwriter for when a user specifically chooses to play a song, and different royalties whenever else the song is played (Pastukhov, 2019). The majority of the cost for audio streaming companies is the payments for the rights to play the song from the copyright holder. The three biggest record labels that hold two-thirds of music streaming rights are Sony, Universal Music Group, and Warner Music Group (Pastukhov, 2019). The immense size of the record labels gives them high bargaining power as the supplier of music. However, as the number of users of audio streaming companies has grown the level of bargaining power has decreased for suppliers. Streaming services are the only way for major record labels to effectively distribute their music. However, because the major music rights holders control the majority of all music rights, music streaming companies would struggle to exist without the suppliers. In the podcast streaming space, individual content creators have more bargaining power, such as Joe Rogan, who negotiated for the sole rights of his podcast with Spotify (Steele, 2020). Supplier bargaining power could be further reduced through backward integration, which would involve music streaming companies either creating original music or acquiring the rights to the music,

b. Bargaining Power of Buyers – The bargaining power of buyers in the music streaming market is moderate. This has a neutral impact on industry attractiveness, as companies would prefer a low

amount of buyer bargaining power. First, the bargaining power of buyers increases due to the low cost of switching. Music streaming is based on a monthly subscription model, so a buyer can simply cancel their subscription and switch to a different service. Buyers also have higher bargaining power due to the lack of differentiation and brand loyalty in the music streaming industry. Customers are willing to leave their current service provider for another provider with better service. However, because of the high number of subscribers that major companies in the industry have, a small number of customers switching services is not a large problem. No individual buyers yield the financial power to have much bargaining power.

c. Threat of Substitutes – The threat of substitutes in the music streaming industry is low. This makes the industry more attractive. The music and audio streaming industry meet customer's need for a large music library that is easily accessible. Substitutes for streamed music include downloading individual albums or songs, CDs/records, and radio. Downloading individual songs or buying a CD or vinyl is a viable substitute, but it would be both too expensive and inconvenient to purchase a catalog as large as what is available on music streaming services. Additionally, radio does not give the listener the ability to choose any song in the music streaming library. Substitutes for podcasts include radio and audiobooks. Neither radio nor audiobooks provide the listener with the number of topics and choices as podcasts. Pirating is another potential substitute for music streaming; however, the ease and low cost of music streaming has diminished the need for music pirating.

d. Threat of New Entrants – The threat of new entrants into the audio and music streaming industry is low, which makes the industry more attractive. Due to the high cost of streaming licenses, there are high capital requirements for a new company to build a catalog of music and podcasts to compete with current companies in the industry. Therefore, new entrants would likely need the financial help of an existing company to enter the industry, such as Apple or Amazon in the past several years. Additionally, due to the lack of differentiation in the music streaming market, it would be difficult for new entrants to pull customers from their current service providers. Although brand loyalty in the industry is not high, it would be difficult to convince a customer to switch music streaming service providers without a differentiated product.

e. Industry Rivalry – The rivalry amongst competitors in the music streaming industry is moderate to high, which hurts the industry's attractiveness. The major competitors in the audio and music streaming industry offer a similar experience and have a similar price point. All major competitors can provide a similar catalog of music and podcasts. This, in addition to low switching costs, increases industry rivalry as it is easy for customers to switch services. While the main service of music streaming is similar, industry rivalry also occurs where the major competitors try to differentiate themselves in listening experience and convenience. Audio streaming companies differentiate themselves through integration into the ecosystem of the company's other products, integration into smart speakers and wearables, and subscription bundles. The rising demand for music streaming has companies fighting to lure new

subscribers through these additional services as the cost conditions are similar for each competitor. The cost to exit is low, as there are no large physical assets, which decreases rivalry.

### **Macroenvironmental Analysis**

**Technological:** The expansion of 5G networks and affordable internet access for people in all parts of the world are major trends impacting business in the technological space. These trends are very important for the music streaming industry, as they will give more people access to streaming services. This allows companies to have new customers and subscribers. Additionally, the expansion of home speakers will have an impact on the music streaming industry, as smart speakers give people a convenient way to access their streaming library.

**Social:** A major social trend that has impacted many businesses recently is the switch to work from home for many businesses during the Coronavirus pandemic. This trend could have a major impact on music streaming companies. First, the change to work from home will eliminate the commute for many workers, which is a major usage time for music streaming. This is a threat to music streaming companies; however, the change to work from home could allow workers to use music streaming platforms while they are working. Workers might be more comfortable listening to music in their own homes instead of in the office. According to a Gartner CFO survey, 74% of CFOs plan to shift at least some of their workers to work from home permanently (Castrillion, 2020).

**Macroeconomic:** The Coronavirus pandemic has created several macroeconomic trends such as lower consumer spending, higher rates of unemployment, and near-zero interest rates. It is expected to take until at least 2022 for consumer spending to reach pre-pandemic levels (Mitterling, Tomass, & Wu, 2020). These trends are important for the audio and music streaming industry, as the main customers for the industry have been affected by the pandemic. Lower consumer spending could mean that consumers are cutting back on discretionary items such as subscription services, including audio streaming.

### **Conclusion: Opportunities and Threats**

The music streaming industry is currently in the growth stage and has competitions between established players to gain market share through new subscribers. The market is expected to continue to have double-digit growth in both revenue and users in the next decade as wireless connectivity grows, and the impacts of the coronavirus pandemic are realized. There are several opportunities and threats in the industry. First, companies in the industry have the opportunity to establish themselves as the best music streaming experience in a largely non-differentiated industry. This can be done through personalization and exclusive content, as well as compatibility with other devices to make a better user experience. However, there are threats to the industry as well. The suppliers of music rights are large and powerful, and an increase in prices by these suppliers could hurt profitability. Additionally, the lack of differentiation between products might leave industry players vulnerable to change.

# Internal Analysis

## Introduction

Spotify is a company in the global audio streaming industry. This report includes an internal analysis of Spotify that will identify the company's business model, assess its key resources, capabilities, and core competencies, analyze the company's value chain, and report on the company's current financial position. Finally, this report will identify the strengths and weaknesses of Spotify that affect its strategic position in the audio streaming industry. The strengths of Spotify include its ability to innovate and its current financial flexibility, while its weaknesses include its current music licensing deals with music rights holders.

## Company Strategy & Background

Spotify is a global audio streaming company that provides users access to a library of over 70 million songs and 2 million podcasts. Spotify has the following mission statement: "Our mission is to unlock the potential of human creativity – by giving a million creative artists the opportunity to live off their art and billions of fans the opportunity to enjoy and be inspired by it" (Company Info, 2021: para 1). Spotify's vision is to be "a cultural platform where professional creators can break free of their medium's constraints and where everyone can enjoy an immersive artistic experience that enables us to empathize with each other and to feel part of a greater whole" (Garcia, 2019). Through its corporate value system, Spotify aims to conduct itself as "Innovative, Collaborative, Sincere, Passionate, Playful" (Whatley, 2016). The company's mission statement, vision, and values make it clear that its value proposition is to provide listeners with access to a personalized listening experience that is created through empowering creators.

Spotify is a Swedish company that was incorporated in Luxembourg in 2006 and officially launched in 2008. The company launched in the United States in 2011 and issued an IPO in 2018 to become a publicly traded company. The company currently has 345 million users, 155 million subscribers, and is available in 178 markets (Company Info, 2021: para 2). Daniel Ek is the founder, CEO, and Chairman of Spotify.

Spotify is engaged in a broad differentiation generic strategy. This strategy is evident through its wide range of available audio that appeals to a vast market of listeners. The company seeks to differentiate itself by providing personalized playlists and music recommendations to its listeners. Spotify is strategically interesting in that it has the resources of a large company but the agile organizational structure that allows it to innovate in a way that could drastically change the music streaming industry.

## Business Model

Spotify is a digital audio-streaming service that allows users access to millions of songs and podcasts. Spotify provides users with recommendations to find new artists, songs, and albums through ready-

made and personalized playlists. Spotify operates through Spotify Free, which is based on ad revenue, and Spotify Premium and HiFi, which is ad-free and is based on subscription revenue. Spotify's cost structure is based on payments to music rights holders that allow the company to obtain licenses to stream artist's music, which accounts for about 75% of revenue (Standard & Poor's, 2021). Spotify distributes its service on a global scale through the internet and can be accessed through its web and mobile applications. Spotify targets a broad range of customers, from casual listeners on its free platform to audiophiles on its HiFi subscription package.

Spotify's business model relies on key partnerships with music rights holders and artists. The company must obtain licenses, a key resource, to stream music from the music rights holders and strives to build a relationship with artists based on transparency and fair compensation. The other key resources for the company include its employees, user data, and proprietary algorithms that provide personalized recommendations to customers.

### Assessment of Resource and Capabilities

Spotify has built a competitive advantage in the music streaming industry by providing personalized playlists and music recommendations to its listeners. Spotify can sustain this competitive advantage through its strong brand name, agile organizational architecture, the volume of user data, and proprietary algorithms. These are all valuable, rare, inimitable resources that Spotify can exploit in the music streaming market.

		Valuable	Rare	Inimitability	Organization
<b>Sustained Competitive Advantage</b>	Brand Name	X	X	X	X
	Organizational Architecture	X	X	X	X
	User Data	X	X	X	X
	Algorithms	X	X	X	X
<b>Parity</b>	Audio Content	X			

Figure 1: Spotify VRIO Analysis

### Key Resources:

1. Brand name: Spotify's brand is a valuable resource as it represents the most widely used music streaming service in the world. Spotify's name is globally known for high-quality music streaming and personalized playlists and is a name that users trust (Hensley, 2020). The brand name is also a rare and inimitable resource, as it would be difficult for other music streaming companies to replicate Spotify's brand power in the music streaming industry in a way that would give those companies a competitive advantage. Finally, Spotify has the organizational

ability to leverage its brand name to give it a competitive advantage. Spotify can exploit this resource through the use of personalized marketing campaigns such as Spotify Wrapped.

2. **Organizational architecture:** The Spotify organizational architecture is a valuable resource as it allows Spotify to increase innovation and productivity through its agile structure. The Spotify organizational architecture is based on small, autonomous teams. This resource is also rare because many organizational structures are hierarchical in structure (Bailey, et.al, 2021). Most companies are not structured in a way that encourages innovation through autonomy. Additionally, this resource would be difficult for another music streaming company to imitate. Other companies likely already have an organizational architecture in place, which would be difficult and time-consuming to change to match Spotify's. This organizational structure allows small teams to be agile, quickly innovate, and more productive, which gives Spotify a competitive advantage.
3. **User data:** The user data at Spotify is a valuable resource that allows Spotify to use machine learning and artificial intelligence to give users a personalized listening experience. Unique personalization increases demand for Spotify's service (citation). User data is a rare resource because Spotify has access to more user listening data than any other music streaming company (MarketLine, 2020). It would be difficult for other music streaming companies to gain access to the volume of user listening data that Spotify has. This resource is also inimitable, as it would be very difficult for other companies to copy the user data that Spotify uses as a resource. Finally, Spotify has shown the organizational ability to exploit this resource through the creation of personalized music recommendations that are based on user data.
4. **Algorithms:** The algorithms that Spotify uses, based on artificial intelligence and machine learning, are a valuable resource for Spotify. These create the personalized playlists that give Spotify a competitive advantage. This resource is both rare and inimitable, as other companies do not have access to the same algorithms as Spotify and are unlikely to be able to copy the algorithms that are patented or kept as a trade secret. Spotify has exploited this resource through continued innovation based on its algorithms to improve the Spotify product.
5. **Content:** The content that is available to be streamed on Spotify is a valuable resource as it is what people use Spotify for. However, this resource is not rare, as all major streaming companies have access to mostly the same music and podcast content. The negative impact of this resource not being rare is that Spotify cannot differentiate itself based on the volume or exclusivity of content provided. Spotify can make this resource a source of sustained competitive advantage if it can acquire content that is exclusive from other music streaming companies. Spotify could also make content a source of competitive advantage if they can acquire content from music rights holders at a better price than other music streaming companies. This would lower Spotify's expenses and increase profit.

Threats: A major potential threat to Spotify's long-term competitive advantage is a legal change to data collection policies. Spotify relies heavily on the collection of data from its users. Spotify has recently started to collect data on user's speech that analyzes metadata such as mood, gender, emotional state, and accent (Hendler, 2021). A change in laws that restricts data collection and use would seriously inhibit Spotify's ability to provide a personalized listening experience for its users and would take away the main source of its competitive advantage.

### ***Core Competency***

Spotify's core competency is its ability to give users a personalized listening experience through recommendations and personalized playlists. Spotify has developed this competency through the collection of data from its users and the use of machine learning and artificial intelligence algorithms to recommend music to its users. Personalized recommendations create value for the customer through a more enjoyable listening experience, the ability to discover new music, and readily available, unique playlists. Other music streaming companies offer personalized playlists; however, they are not able to imitate Spotify's ability to give users a personalized listening experience. First, other music streaming companies do not have access to the amount of user data that Spotify has to base its recommendations on to users. A large component of Spotify's recommendation algorithm is based on other listeners with similar tastes. Spotify is the leader in the music streaming industry in the number of global users at 271 million (MarketLine, 2020). Spotify uses its abundance of user data to improve recommendations. At current growth rates, other streaming companies will not be able to match Spotify in the number of users soon. Second, other companies do not have access to Spotify's artificial intelligence, machine learning, and proprietary algorithms. Spotify has protected many of the technologies and techniques used to build its playlists through intellectual property law, trade secrets, and nondisclosure agreements (Patents, n.d.).

Spotify can leverage its core competency to shift into other markets and to improve in the music streaming market. Spotify can use its recommendation algorithms in the podcast market, which could make Spotify the preferred podcast streaming service and give Spotify more users. Additionally, Spotify could improve its standing in the music streaming market by using data on user's listening preferences to create original content. This strategy is similar to the one used by Netflix, which uses data from viewers to make decisions on what type of original content to create (Markman, 2019). This strategy would allow Spotify to make its content a valuable, rare, and inimitable resource that will give it a new source of competitive advantage in the music streaming market.

### **Value Chain Analysis**

#### ***Support Activities***

a. Company Infrastructure - The company infrastructure at Spotify adds value through its agile organizational structure. The organizational units at Spotify are broken down into "squads" of no more

than eight people. Squads are completely autonomous and responsible for a specific product or service. Squads are then grouped in a “tribe,” which is a horizontal grouping based on a broader goal at Spotify. Finally, tribes are organized into “guilds,” which are communities within the companies whose primary goal is to share knowledge across squads and tribes (Mankins, 2017). This organizational structure facilitates learning opportunities and professional development for employees as they work between squads and gain leadership experience in small teams. The use of small, autonomous groups adds value to Spotify through the ability to quickly react to emergent trends and products. The autonomy of squads fosters innovation through the ability to experiment within the squad and take full control of a project. Additionally, Spotify can quickly shift resources between squads to fit their needs.

b. Information Systems - Spotify uses its information systems to add value through the use of machine learning and artificial intelligence that enhance the user experience. Spotify gathers listening data from listeners, which is then fed into a machine learning algorithm that creates a custom playlist for users based on their listening history. Spotify’s information systems contain data on what music listeners like, what songs they skipped, and how long they listened to songs (DiFranza, 2020). The artificial intelligence system at Spotify creates a “taste profile” for each user, which coupled with data on past listening, gives users recommendations for new music. Recommendations have added value to Spotify through the growing popularity of the “Discover Weekly,” “Release Radar,” and “Daily Mix” personalized playlists. Additionally, Spotify makes listener data available to artists to analyze their music, which creates valuable relationships with content producers.

c. Logistics - The logistics activity adds value to Spotify by securing the rights to distribute music in markets that expand Spotify’s global reach. Spotify has recently announced that it will be expanding its service into 85 new markets, which will increase its potential user base by over 1 billion people (Shaw, 2021). This market expansion adds value by allowing Spotify to gain market share in emerging markets with the potential of significant user growth.

d. Human Resources - Spotify’s flexible work model brings value to the company by giving employees the choice to work from wherever they are most effective. Starting in the summer of 2021, Spotify will allow employees to work entirely from home, from the office, or a mix of the two (Golden, 2021). Employees can work from different countries and cities, only limited by time zone differences and labor laws. This HR policy will increase employee satisfaction and productivity, as employees can work from wherever they feel they are most productive. Furthermore, this policy could lead to increased employee retention and help attract talent.

### ***Primary Activities***

e. Research and Development - The research and development activity at Spotify has added value by providing insights into the podcast industry. Spotify has identified the podcast market as a growing market for its users. Spotify has made investments in exclusive podcast rights and podcast production companies. The R&D function continues to add value through its effort to implement its current music

recommendation and discovery technology in the podcast space (Perez, 2021). Improvements to algorithms and artificial intelligence will allow Spotify to identify podcast recommendations for listeners based on past listening and by category.

f. Production - The production activity for Spotify is the activity of users listening to music. Spotify can add value to this portion of the value chain by allowing users to easily switch between a mobile app, desktop website, and smart speakers. Spotify users can stop a song on one device and continue where they left off on another device. Premium users can also listen to a song on multiple devices at one time. Spotify tries to make the use of its app and website pleasant and intuitive. Ease of use is a value-add activity for Spotify in the production area.

g. Marketing and Sales - Spotify's marketing and sales function adds value through the use of personalized marketing campaigns. At the end of each year, Spotify users receive a personalized report on their year of listening, "Spotify Wrapped," which gives users insights on their most listened to artists, tracks, genres, and podcasts. Artists are also given a "Spotify Wrapped" that highlights how many people listened to their music that year. Spotify's personalized marketing campaigns bring value through increased brand loyalty and shareability. The personalized reports build a connection between users and Spotify and give users tangible evidence of the value Spotify gave them. Spotify receives marketing exposure through the shareability of "Spotify Wrapped." Users regularly share their reports on social media to compare listening habits with friends.

h. Customer Service - Spotify can add value to the customer service activity of the value chain through the extensive use of social media in responding to customers. Known as "social customer service," Spotify can quickly respond to and assist customers. Spotify's main goal in social customer service is to have positive interactions with users (Adaptive, 2015). Positive engagement and quick resolution with customers give customers a positive perception of the brand, which adds value for Spotify.

i. Alignment - There are several areas in Spotify's value chain that align. First, the organizational architecture built on agile, autonomous groups aligns with the innovative goals of the R&D team. Additionally, the innovations of the R&D team can be used by the marketing team, such as the insights built into "Spotify Wrapped." Lastly, the troves of user data stored by the information system activity help the R&D and Marketing and Sales activities meet their goals through the use of data analytics. However, there is insufficient alignment between the logistics and production activities. Occasionally, difficulties in securing music rights can cause problems in listening to certain artists or listening in certain geographic locations.

### **Financial Resources**

Spotify has used its financial resources over the past several years to focus on growth in revenue, users, and service. This financial analysis examines Spotify's revenue growth, profitability, efficiency, liquidity, and solvency in relation to peers in the media streaming industry. Spotify has been more efficient in its

use of resources and has shown better growth in revenue than others in the media streaming industry; however, it has yet to show profitability and is in a less liquid financial position (see Table 1).

Table 1: Spotify and Media Streaming Industry Key Financial Ratios

	2017		2018		2019		2020	
	Spotify	Industry	Spotify	Industry	Spotify	Industry	Spotify	Industry
<b>Revenue Growth</b>	38.6%	0.2%	28.6%	9.1%	28.6%	25.1%	16.5%	(13.6%)
<b>Gross Margin %</b>	20.8%	47.8%	25.7%	56.8%	25.5%	50.9%	25.6%	24%
<b>Net Income Margin %</b>	(30.2%)	(12.5%)	(1.5%)	7.8%	(2.7%)	(0.9%)	(7.4%)	(9.3%)
<b>ROA</b>	(9.1%)	6.0%	(0.7%)	6.5%	(0.7%)	2.9%	(3.0%)	(0.1%)
<b>ROE</b>	NM	11.0%	(6.7%)	13.3%	(9.0%)	5.9%	(24%)	(6.6%)
<b>Asset Turnover</b>	1.6x	0.6x	1.4x	0.6x	1.4x	0.4x	1.4x	0.3x
<b>Current Ratio</b>	1.0x	0.8x	1.0x	1.3x	0.9x	3.3x	0.8x	1.2x
<b>Debt/Equity</b>	396.6%	43.1%	NA	26.1%	30.5%	14.3%	21.7%	69.6%

Source: (Standard & Poor's, 2021)

Since 2017, Spotify has continually seen double-digit revenue growth and has kept gross margin consistent. Additionally, from 2017-2019, Spotify showed progress in reaching profitability; however, 2020 resulted in a larger loss than the previous two years. The larger loss can be attributed to larger R&D expenditures, which grew by 36% from 2019 to 2020 (Standard & Poor's, 2021). Profitability dropped across the entire media streaming industry in 2020, likely due to the effects of the Covid-19 pandemic. Compared to others in the industry, Spotify operates more efficiently, shown by a favorable asset turnover ratio. Spotify's current ratio has been worsening since 2017. Both current assets and current liabilities have grown recently, but quicker growth in current liabilities has worsened Spotify's liquidity position. The increase in current liabilities could be caused by the increase in expenses that are required for the company to rapidly grow its revenue. Finally, Spotify has been improving its debt-to-equity ratio since 2017. This change is due to the company paying off long-term liabilities and increasing equity in the company. The media streaming industry as a whole saw a sharp increase in the debt-to-

equity ratio in 2020. Spotify was able to weather the Covid-19 pandemic without taking on more debt to finance its operations, which leaves it in a good financial position compared to its competitors.

In the next several years, Spotify is hoping to continue its trend of revenue growth. I do not expect Spotify to focus on turning a profit in the next several years. Recently, Spotify announced plans to expand into 85 new markets, which gives it access to over 1 billion new potential customers (Kene-Okafor, 2021). The expansion shows Spotify's intention to keep making investments that will grow revenue. Spotify has also heavily invested in podcasts and will likely continue to do so. Finally, Spotify included in its most recent earnings report that average revenue-per-user decreased by 8% year-over-year (Porter, 2021). This trend shows that Spotify is continuing to focus on growing its user base instead of how much revenue they earn from each user, as it employs discounts and low-priced family plans to grow to fuel user growth.

Spotify is in a favorable financial position to pursue its strategic objectives. Spotify was able to make it through the Covid-19 pandemic without taking on more debt, which gives Spotify the capacity to take on debt in the future if it is needed. Spotify has the flexibility to pursue its ambitious growth plans without sacrificing liquidity in day-to-day operations. Spotify has made large investments to grow its user base through expansions into new products and geographic markets. Even though the company has not yet shown profitability, efficient use of its assets has allowed Spotify to stay in a position to keep growing. Spotify's financial position allows it to compete in its industry through growth and continued innovation to differentiate its product.

### **Strengths, Weaknesses, and Conclusion**

Spotify has positioned itself as one of the top competitors in the audio streaming industry through its powerful brand name, agile organizational structure, immense user base, and algorithms that give users a personalized listening experience. Additionally, the company has shown it has the ability to innovate and is in a financial position to act on strategic initiatives. These strengths could allow the company to pursue opportunities that could differentiate its product in the audio streaming industry. Spotify has the opportunity to capture users in emerging and existing markets by potentially providing exclusive content that could lower its cost structure and increase differentiation. However, the company's current weaknesses include its current licensing deals with music rights holders, which could prevent Spotify from creating exclusive content. The threats to Spotify include the strength of powerful music rights holders, who could drastically increase Spotify's cost structure. Additionally, Spotify relies on a trove of user data to provide personalized recommendations to users. A change in data collection policies that may restrict Spotify's collection of user data is a serious threat to the company. Spotify's strong brand name and position as the largest audio streaming provider by the number of users helps the company withstand these threats, as it has built trust with customers and holds a considerable amount of bargaining power with music rights holders. However, Spotify lacks the large ecosystem and financial might to fall back on that its competitors, such as Apple, Google, and Amazon, currently hold.

## Strategic Opportunities

Spotify has strengths built around its respected brand name, agile organizational structure, large user base, and algorithms that give users a personalized listening experience. The weaknesses of the company include its bargaining position relative to the powerful music rights holders and its lack of size and financial resources compared to its competitors. The company has several potential threats to its position at the top of the audio streaming industry, including changes in prices of music rights and changes to data collection policies. Finally, Spotify has the opportunity to capture new users in emerging markets and existing markets by providing its users exclusive content that could lower its cost structure and realize a new area of differentiation. The following are three strategic options that Spotify could pursue to improve performance and differentiate itself in the audio streaming industry.

**Strategic Option 1:** The first strategic option involves Spotify producing original music content to be exclusively available on Spotify. The company currently produces original podcasts that are exclusively available on Spotify. I am proposing that Spotify expand this strategy into the music portion of its business. This option would enhance the company's strategy of broad differentiation in the music streaming industry.

There are several reasons this strategy would benefit Spotify. First, all major competitors in the music streaming industry provide a largely homogenous music product as most music is available on all music streaming platforms. As evidenced by the VRIO analysis of Spotify's resources, music content is a valuable resource, but it does not give Spotify a competitive advantage. This strategy would provide Spotify with a valuable source of differentiation if it could produce quality content that is exclusive to the Spotify platform. Additionally, Spotify's strengths provide an environment to make this strategy successful. Spotify would be able to use its agile organizational structure, large user base, and algorithms to produce content that would be tailored to what listeners are demanding. The content would also have the Spotify brand name behind it, which already has the trust of customers. This would diminish Spotify's weaknesses and threats presented by the power of its main suppliers of music rights.

However, there are several potential drawbacks to this strategic option. First, it would likely be opposed by its current suppliers of music. Additionally, this strategic option would likely take a large investment to create quality original music content and the company is not guaranteed to succeed in this endeavor.

**Strategic Option 2:** The second strategic option involves Spotify lowering its prices to gain new users in emerging markets. Currently, all major music streaming companies are similarly priced. By lowering its prices, Spotify would be able to gain market share in developing music streaming markets. This would be a shift from the company's current broad differentiation strategy into a low-cost strategy.

This strategy would allow Spotify to act on the opportunities presented by emerging markets by becoming the leader in those markets. Spotify currently has a source of competitive advantage in its large user base, which it uses to gather user data to fuel its music recommendation algorithms. This

strategic option would allow the company to further enhance the network effects provided by its large user base. With an even larger user base, Spotify could continue to gain insights that would allow it to provide a more personalized listening experience.

This strategy, however, would further diminish the thin margins that Spotify has in the music streaming industry. Lower prices for its service would likely lead to less revenue-per-user and push the company further away from profitability. The low-cost strategy could be opposed by both investors, who could see less return on their investment, and artists, who could see less income from their work. Additionally, there is a possibility that this strategy could start a price war amongst the competitors in the music streaming industry.

**Strategic Option 3:** The third strategic option is to make large-scale acquisitions of music rights to make the music exclusively available on Spotify. This strategy would include similar goals to the first strategic alternative. This strategy would involve Spotify acquiring music rights holders or the rights to individual catalogs of music. This option would enhance the company's strategy of broad differentiation in the music streaming industry.

This strategic option would be a vertical integration strategy for Spotify, as the company would acquire an upstream input for its product. Again, as evidenced by the VRIO analysis of Spotify's resources, music content is a valuable resource, but it does not give Spotify a competitive advantage. Spotify would be able to make the music it acquires exclusively available on its platform, which would make its audio content a new source of competitive advantage. Additionally, this strategy could lower Spotify's cost structure if it is not purchasing the licensing deals to music from the primary music rights holders.

The strategy would likely be opposed by music rights holders; however, Spotify could use its leverage as the largest music streaming company and one of the music rights holders' main sources of revenue to strike a deal with the companies. The strategy could also lead to a bidding war with competitors who have more financial resources than Spotify.

### **Strategic Recommendation**

The strategic option that I recommend Spotify to pursue is for Spotify to produce original music content the company can provide exclusively on the Spotify platform. This strategy would allow Spotify to increase differentiation through exclusive content which would bring more customers to the company and increase revenue. Additionally, the strategy would decrease Spotify's reliance on the major music rights holders and decrease its cost structure. While this recommendation involves a significant risk of damaged relationships with music rights holders and a large time and financial investment, I believe Spotify's strengths will allow the company to successfully implement the strategy. The main change to the company's products and services would be the availability of music that is only on Spotify. Spotify would need to create a new division for music production, which would take significant labor, time, and

financial investment. This strategic option would help Spotify realize its strategic goals of broad differentiation in the music streaming industry.

The low-cost strategic option would allow the company to establish itself as the leader in new markets and realize more positive network effects of a large user base. Additionally, this option involves less financial investment and less risk of ostracizing its main suppliers than the other alternatives. The low-cost strategy, however, would be a major strategic shift that would likely not be supported by shareholders or content creators, who are both key relationships in Spotify’s business model.

The strategic option to purchase music rights could provide Spotify with a source of differentiation and would take a smaller investment of time and internal resources than the first strategic option. This alternative, however, brings on the risk of creating a bidding war for music rights with other competitors in the industry that could ultimately increase Spotify’s cost structure.

**Implementation Plan**

The implementation of the strategic recommendation involves the creation of a new division in the company to produce original content. The new division will be a significant investment of financial resources, time, and talent. The new division will work with R&D to create an algorithm based on user data that will help create successful original content. The goal, and break-even point, of this division, is to create original content at a cost less than what it costs to acquire music rights. The creation of a production division will impact the logistics function as music streamed on the Spotify platform will be internally sourced instead of from music rights holders. The company will also use a significant marketing campaign to increase awareness of its new original content.

**Balanced Scorecard**

	<b>Objective</b>	<b>Measure</b>	<b>Target</b>	<b>Initiative</b>
Financial	Improve Gross Profit	Gross Margin Ratio	Increase Gross Margin Ratio to 40% by 2021	Produce original content at a cost less than the amount currently paid to music rights holders. Responsibility of CEO and chief of new production division.
Customer	Produce original content that appeals to customers.	Percent of content listened to on Spotify is original content.	Increase amount of original content listened to on Spotify to 10% of all content consumed by 2024.	Launch original content in key markets based on user tastes and preferences by 2022. Responsibility of chief of new production division.
				Launch original content in all markets by 2023. Responsibility of chief of new production division.

Internal	Develop algorithm to create original content	Percent of original content is added to user playlists.	75% or original content meets streaming targets.	Allocate 25% of research and development expenditure to development of efficient original content production processes. Responsibility of chief R&D officer.
Learning and Growth	Create innovative production division for original content.	Percentage of new company hires in production division.	25% of new company hires are in production division.	Global search for top talent in production industry. Responsibility of chief of HR.
		Percentage of top performers moved to production division.	25% of internal transfers are to production division.	Identify candidates for internal transfer. Responsibility of chief of HR.

Spotify  
Pro Forma Income Statement  
(in Millions USD)

For the year ended December 31, 2020

	2020	2021	2022	2023	2024
<b>Sales Revenue</b>	9,671	11,122	13,346	16,015	18,417
Cost of Goods Sold	(7,198)	(8,341)	(9,342)	(10,410)	(11,050)
<b>Gross Profit</b>	2,473	2,780	4,004	5,605	7,367
Research and development	(1,027)	(1,112)	(1,335)	(1,602)	(1,842)
Sales and marketing	(1,263)	(1,446)	(1,735)	(1,441)	(1,658)
Other Operating Expenses <sup>1</sup>	(542)	(596)	(656)	(721)	(794)
<b>Operating Income</b>	(359)	(374)	278	1,841	3,074
Finance income/(costs)-net	(511)	(1,011)	(761)	(511)	(511)
<b>Income Before Taxes</b>	(870)	(1,385)	(483)	1,330	2,563
Income Tax (expense) benefit <sup>2</sup>	157	249	87	(239)	(461)
<b>Net Income</b>	(713)	(1,136)	(396)	1,091	2,102

Assumptions:

<sup>1</sup> Other operating expenses will grow at 10% per year based on past growth trends.

<sup>2</sup> Income tax (expense) benefit is calculated at 18% of Income Before Taxes.

Income Statement: The implementation of the strategic recommendation to create original music at Spotify to be offered exclusively on the Spotify platform will lead to several changes in the company's income statement. Sales Revenue is projected to increase by 15% in 2021 before increasing to a 20% growth rate in 2022 and 2023 as the company offers more exclusive content. As more exclusive content is produced, Spotify will rely less on powerful music rights holders and will be able to decrease its Cost of Goods sold to as low as 60% of sales revenue in 2024. The exclusive content will lead to increased costs in sales and marketing, which will grow by 13% in 2021 and 2022. Finally, finance costs will

increase in 2022 to service the increased debt the company will take on to finance the strategic initiative.

Spotify					
Pro Forma Balance Sheet					
(in Millions USD)					
As of December 31, 2020	2020	2021	2022	2023	2024
<b>Assets</b>					
<b>Current Assets:</b>					
Cash and cash equivalents	1,413	1,696	2,035	2,442	2,930
Trade and other receivables	569	626	688	757	833
Short term investments	731	658	592	533	480
Other current assets <sup>1</sup>	190	228	274	328	394
<b>Total Current Assets</b>	<b>2,903</b>	<b>3,207</b>	<b>3,589</b>	<b>4,060</b>	<b>4,637</b>
<b>Non-Current Assets:</b>					
Lease right-of-use assets	545	572	601	631	662
Property and equipment-net	384	422	465	511	562
Long term investments	2,795	3,075	3,382	3,720	4,092
Goodwill	903	993	1,093	1,202	1,322
Intangible assets	119	238	476	952	1,904
Other non-current asset <sup>2</sup>	114	125	138	152	167
<b>Total Non-Current Assets</b>	<b>4,860</b>	<b>5,426</b>	<b>6,154</b>	<b>7,168</b>	<b>8,710</b>
<b>Total Assets</b>	<b>7,763</b>	<b>8,633</b>	<b>9,743</b>	<b>11,228</b>	<b>13,346</b>
<b>Liabilities and Equity</b>					
<b>Current Liabilities:</b>					
Deferred revenue	466	583	728	910	1,138
Accrued fees to rights holders	1,553	1,864	1,677	1,510	1,359
Trade and other payables	783	940	1,128	1,353	1,624
Other Current Liabilities <sup>3</sup>	757	833	916	1,008	1,108
<b>Total Current Liabilities</b>	<b>3,559</b>	<b>4,218</b>	<b>4,449</b>	<b>4,780</b>	<b>5,228</b>
<b>Non-Current Liabilities:</b>					
Lease liabilities	708	743	781	820	861
Bond payable	-	1,000	1,000	1,000	520
Other Liabilities <sup>4</sup>	54	59	65	72	79
<b>Total Non-Current Liabilities</b>	<b>762</b>	<b>1,803</b>	<b>1,846</b>	<b>1,891</b>	<b>1,460</b>
<b>Equity:</b>					
Capital Stock	-	-	-	-	-
Paid In Capital	5,625	5,930	7,162	7,180	7,180
Retained Earnings (deficit)	(4,038)	(5,174)	(5,569)	(4,479)	(2,377)
Other Capital <sup>5</sup>	1,855	1,855	1,855	1,855	1,855
<b>Total Equity</b>	<b>3,442</b>	<b>2,611</b>	<b>3,448</b>	<b>4,556</b>	<b>6,658</b>
<b>Total Liabilities and Equity</b>	<b>7,763</b>	<b>8,633</b>	<b>9,743</b>	<b>11,228</b>	<b>13,346</b>

#### Assumptions:

- <sup>1</sup> Other current assets will grow at 20% per-year based on past growth trends.
- <sup>2</sup> Other non-current assets will grow at 10% per year based on past growth trends.
- <sup>3</sup> Other current liabilities will grow at 10% per year based on past growth trends.
- <sup>4</sup> Other non-current liabilities will grow at 10% per year based on past growth trends.
- <sup>5</sup> Other capital is assumed to stay constant .

Balance Sheet: The implementation of the strategic recommendation to create original music at Spotify to be offered exclusively on the Spotify platform will lead to several changes in the company's balance sheet. First, the company will see a large increase in intangible assets. This represents the rights to original music that is produced by the company. Spotify will also see a decrease in the amount of Accrued fees to rights holders, as the company is now offering more original content and paying less to rights holders. Finally, the addition of a music production division will be financed by a \$1 billion bond initially, and any additional capital needed will be provided by the issuance of more stock. In 2023, the company will begin to reduce its retained deficit and will be able to pay off a significant portion of the bond in 2024.

#### Pro Forma Ratios

	2020	2021	2022	2023	2024
<b>Gross Margin %</b>	25.57%	25.00%	30.00%	35.00%	40.00%
<b>Net Income %</b>	-7.37%	-10.21%	-2.97%	6.81%	11.41%
<b>ROA</b>	(0.09)	(0.13)	(0.04)	0.10	0.16
<b>ROE</b>	(0.21)	(0.43)	(0.11)	0.24	0.32

#### Risk Assessment and Contingency Plan

There are several risks involved with the proposed strategic plan. First, there is the risk that it costs more to produce original music than it does to purchase music streaming rights. Spotify can manage this risk by creating a detailed cost plan when creating the music production division. Additionally, Spotify can reduce costs by sharing scale efficiencies with the rest of the company. If this risk occurs, Spotify could use variance analysis to identify the source of higher-than-expected costs.

The second risk is that the music that Spotify produces is not successful. To manage this risk, Spotify can work with the research and development team to identify the key traits in successful music to help with music production. If Spotify's original music is not successful, they can minimize damage by reducing the expenses associated with the unsuccessful music such as advertising and promotion.

The third risk that Spotify faces is that music rights holders will stop doing business with Spotify or increase music licensing costs for the music that Spotify still licenses from the music rights holders. To mitigate this risk, Spotify should preemptively negotiate with music rights holders in an effort to establish licensing rates before Spotify starts creating original content. If this risk does occur, Spotify can minimize damage by negotiating with music rights holders to keep doing business, even if it is at a higher cost. Spotify needs to keep other music on its platform to stay competitive in the industry.

### **Conclusion**

The report provides a strategic recommendation to Spotify based on the company's strengths and weaknesses and the opportunities and threats in the music streaming industry. Spotify currently has valuable and rare resources that provide sustained competitive advantage for the company; however, the company provides music content that can be found on any other music streaming service. An investment in the production of original music content will help Spotify create a differentiated product and a new source of competitive advantage.

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