

Influence of Spotify's Services on Its Revenue

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Abstract. This paper delved deep into the factors contributing to Spotify's profitability, examining how it consistently outperforms international mainstream competitors to maintain its leadership in the music streaming market. This analysis begins with a review of existing research that unveiled the underlying logic of Spotify's business model, centered around its dual service offerings: a free, ad-supported tier and a Premium, subscription-based model. Each service plays a crucial role in attracting a diverse user base and converting consumers to Premium service. The work further explored how internal strategies, such as Spotify's marketing strategies on its Premium, foster revenue streams. The conclusion emphasizes that the synergistic relationship between the two service models fortified Spotify's market position. Additionally, a SWOT analysis is conducted to outline Spotify's future potential for development, identifying its strengths, opportunities, weaknesses, and threats. This comprehensive approach illustrates the roadmap Spotify may take in an ever-evolving industry landscape, armed with insights to sustain its competitive edge.

Keywords: freemium, Spotify, Apple Music, Revenue Model

1. Introduction

Music, an activity to relax and enrich life, has prevailed for a long time. Although people do not know when music emerged because there are no fossil records of singing, archeological evidence shows a continuous record of musical instruments dating back to at least 30,000 years [1]. Thus, music is an ancient capacity rather than the recent creation of a single intelligence [2]. In the hundreds of years since the birth of recording technology, music has been recorded through the phonograph, vinyl record, tape, and CD [3]. Still, considering their cost and high barriers, these recordings only dominated the market in the emergence of digital music. Digital music, which appeared in 2004, is considered a premier example of digital innovation, providing the music industry with new disruptive business models and new digital music products and services for consumers [4]. The ubiquitous evolution of digital music, especially streaming services, has created an apparent and drastic shift in how consumers and producers view and use the music industry [5]. Music streaming is the dominant format in the US, with 83% of revenue coming from the format in

2023, and Spotify is the platform for about a third of all music streaming listeners worldwide. It gains the largest market share, with Apple Music in second place [6].

This data and information made us wonder what contributes to Spotify's success. This work hypothesizes that Spotify's combination of Ad-supported service and Premium fosters its success, making it the top music streaming platform. To be clear, success is defined as revenue, and the work will compare Spotify's revenue with Apple Music's to substantiate the beneficial influence of Spotify's services.

Many early research studies have discussed the combination of free and premium services, the advantages and challenges companies face implementing the combination, and how companies earn by converting consumers from freemium to Premium. However, only some have analyzed the underlying logic of Spotify's service in the context of the music market and why such a service is so successful in the music market. Our research fills this gap, helping the public better understand Spotify's services and operating logic.

2. The service of Spotify

2.1. Ad-supported and premium service

Spotify offers two main services to meet users' preferences and needs. The first is the Ad-Supported, a free music and podcast experience. This option allows users to enjoy a vast music library and diverse podcast content at no cost, with advertisements interspersed during playback. These ads help Spotify sustain its free service and allow users to discover new brands, products, or services.

The second service is Premium, a Premium paid subscription that caters to users. With a Premium subscription, users are free from ads, enjoying a completely uninterrupted music journey. Additionally, Premium provides significantly enhanced audio quality, supporting lossless and high-resolution audio options, making every note more vibrant. Moreover, users can download their favorite music to their devices for offline playback, ensuring unlimited access anytime and anywhere, even without an internet connection—ideal for travel, commuting, or any scenario with limited network access. Lastly, Spotify Premium leverages advanced algorithms and technology to offer highly personalized music recommendations tailored to users' listening history, preferences, and the latest trends, ensuring every click brings discoveries and delights.

Based on this service model, Spotify mainly gains revenue from advertising and subscription fees [7]. Advertisers primarily provide advertising revenue. Spotify collaborates with various advertisers (such as brand, technology, service, entertainment, and media companies) to offer brands dedicated advertising channels. Sometimes, it also provides customized advertising content for brands, offering them an opportunity to enter the public eye. In this way, it can increase brand exposure and leverage consumers' herd mentality and pragmatic psychology to enhance brand awareness and sales. Advertisers pay advertising fees in return, achieving a win-win situation with Spotify. Considering the timing of Spotify's release, the free piracy model provided a substitute for more secure ways to listen to songs without paying for them [8]. This has brought a lot of users to Spotify. In fact, most frequent users of music apps prefer a pure listening experience without ads. Spotify's Premium service differs from its Ad-Supported version in that paying subscribers enjoy an ad-free experience and access to higher-quality, lossless music, providing a unique and exclusive membership service for paying users. While subscription prices remain relatively stable, Spotify steadily increases subscription revenue, which has become Spotify's primary and most significant source of revenue income.

2.2. Free to fee: freemium

Some people may argue that free services (Ad-supported services in Spotify) do not play a significant role in Spotify's operational mechanism, given that the growth in subscription numbers is a crucial factor in Spotify's profitability. However, Ad-supported services are a vital link in increasing subscriptions. Generally speaking, consumers tend to favor products and services that are available for free. Apart from eliminating monetary costs, free products also eliminate the need for trade-offs and reduce consumers' psychological costs [9]. Imagine encountering two product salespeople on the street: one who only introduces products and prices and another who introduces products and invites you to try them for free. Which one would pique your interest more? In our daily lives, free services are ubiquitous, such as free tasting in bakeries and test drives in car dealerships. Such service models garner more favor and trust from consumers, attracting more customers and increasing revenue.

2.3. Premium: student plan and family plan

In many fields, many preferential policies exist for student groups and families, such as student discounts in many restaurants and high-speed rail tickets, and student discounts and family package discounts in tourism. Student groups and families are two very important consumer groups. Spotify has also provided preferential strategies for these two groups, a business means for Spotify to attract users.

The student plan is designed for students who are receiving higher education. With lots of time on their hands and little money among those [8], the students plan to encourage more students to use Spotify's premium model. Spotify offers students without financial resources a 50% discount on its student plan while providing them with all premium features. The family plan is a preferential strategy proposed for families as consumption units. This plan allows up to six family members living at the same address to share one account, with a monthly fee of \$15.99. This payment method greatly reduces the cost of listening to music for families, as the expense that six people would share is now borne by one person. This achieves low-cost, high-efficiency family sharing, which can meet the various music needs of family members. At the same time, it can attract users of different age groups in a family, especially the less represented user groups in the past, such as the elderly, to expand the software's audience.

Through these two preferential plans, it is easy to see that Spotify has grasped the key to developing the software, which is to retain users while continuously attracting new ones. While ensuring a vast music resource library and high-quality lossless music, Spotify has designed many strategies to attract users, which can not only continuously attract users but also ensure its profitability while providing preferential services.

3. Financial analysis

3.1. Revenue model

Spotify's revenue mainly comes from two services: Ad-supported experience and Premium subscription through consumer payments and advertisement income. Figure 1 shows that from 2020 to 2023, Premium service contributed to most of Spotify's average revenue, about 90%. Spotify's revenue is growing steadily and proportionally. As a result, Spotify needs to focus on increasing its

subscription numbers to generate more revenue, and Spotify achieved this by converting consumers from Ad-supported services to Premium services.

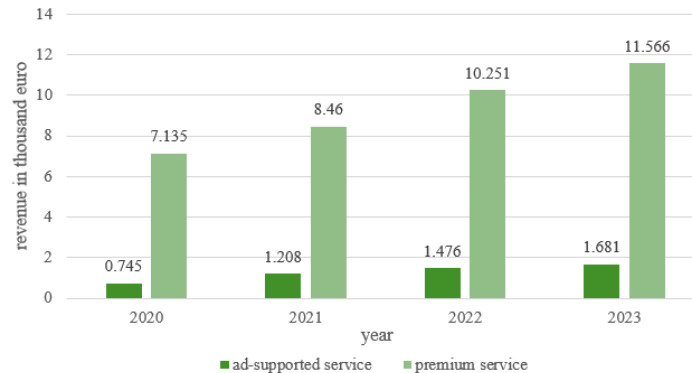


Figure 1. Revenue generated by Spotify's two services from 2020 to 2023

3.2. Conversion rate

Unlike platforms that only offer Premium services like Apple Music, Spotify has access to many potential user groups. Ad-supported service is freemium for Spotify. The appeal of the Ad-supported model for Spotify is that it can generate high traffic volumes and provide direct access to potential paying customers without making heavy investments in marketing promotions [10]. One key challenge for companies that utilize the freemium model is determining how to increase the number of customers who purchase the Premium version in the presence of the free version [11]. The freemium model will likely only succeed if a company can convert an adequate fraction of its free customers to paying customers [10].

Therefore, streaming services may decrease the utility of the free version to incentivize users to adopt the profitable paid channel [12], as users may become dissatisfied with the free version's value [13]. In the case of Spotify, the fault of freemium is an advertisement that users have to encounter. [9] discussed several ways for companies to encourage freemium users to become Premium users, such as price promotion and marketing communications.

That is what Spotify implements. Spotify keeps reducing its Premium average revenue per user in exchange for its total increase in revenue [14] by offering more discounts, like different Premium plans. As shown in Figure 2, an overall decreasing trend exists on ARPU from 2015 to 2023 even given that the Premium price is increasing in this period. Recent fluctuations are explained by the movement of foreign prices [15], but a huge decrease from 2015 to 2018 features a change in Spotify's strategy. Since 2013, Spotify maintained a family plan; in 2014, Spotify launched a student plan; in 2020, Spotify launched a Duo Plan, allowing two individuals to use Premium service at a much lower price, reducing the average revenue per user. Besides, consumers can get gift cards for Spotify Premium service from Amazon or Best Buy at \$99 for an annual plan [16]. All these discounts help Spotify to attract consumers to convert from Ad-supported services to Premium subscriptions, generating more revenue.

Second, Spotify keeps offering advertisements to its Ad-supported service users. The research found that one of the most common advertisements in Spotify's Ad-supported service is Spotify's Premium service [14]. The company also uses email as a personalized marketing tool to reach users and promote new releases or discounts. To underline the advantages of Premium service, Spotify has

set free-use time for Premium Service. According to Hamari, J Hamari, J, when consumers experience a high-quality service, they may find using a free one more convenient and manageable [17]. These service providers can be considered to create a "demand through inconvenience effectively" [18]. Therefore, more consumers will keep their Premium service, becoming part of the revenue generator.

Spotify uses these strategies to convert consumers from Ad-supported services to Premium services. As Spotify said, "Our Ad-Supported Service serves as a funnel, driving more than 60% of our total gross added Premium Subscribers..." [19], rapidly growing its revenue.

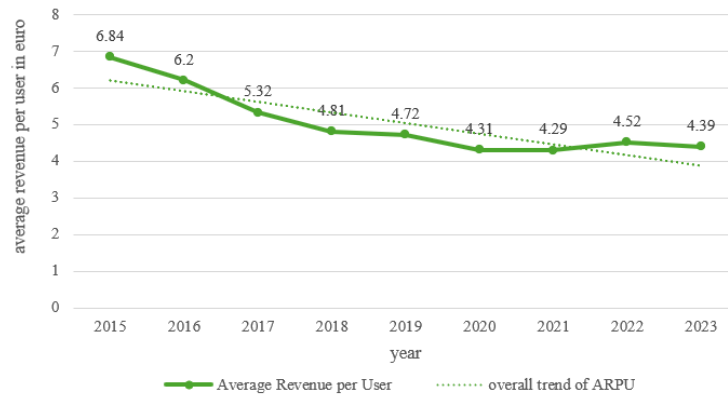


Figure 2. Premium Average Revenue Per User (ARPU) of Spotify from 2015 to 2023

3.3. Comparison with Apple Music

To have a clearer position of Spotify in the music streaming market, the work makes a comparison with Apple Music, the second largest music streaming platform globally. Apple Music service only contains a Premium subscription. At the same time, it also provides free use of the Premium service, which means that its retention rate is not the major factor contributing to the difference [17]. Therefore, considering our hypothesis that Spotify's combination of two services contributes to its success, Apple Music is certainly losing out to Spotify in terms of revenue. Because Apple Music lacks freemium service, it originally attracted fewer consumers, thus having a much smaller consumer pool than Spotify.

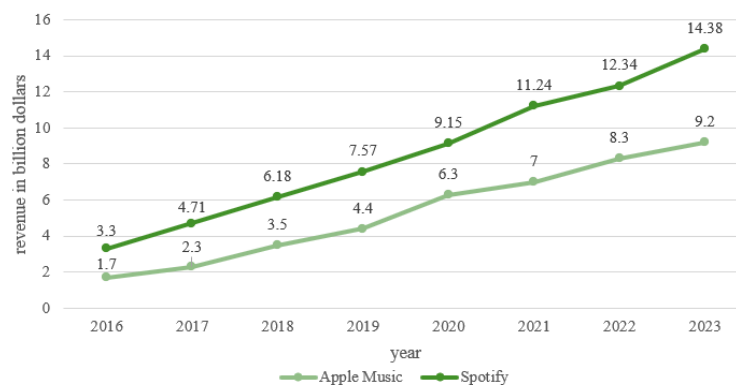


Figure 3. Spotify and Apple Music revenue comparison from 2016 to 2023

From Figure 3, Spotify always earns a higher revenue than Apple Music. More importantly, Spotify made revenue more rapidly, with a difference of 1.6 billion dollars in 2016, while it was 5.18 billion dollars in 2023. The enlarged difference can be attributed to the effect of Ad-supported services. Therefore, it is clear that the combination of Ad-supported service and Premium service provided by Spotify makes it the company that makes the most revenue compared with other companies like Apple Music.

4. SWOT analysis

4.1. Strength

Other than the strengths of freemium and Premium, which center on user experience and boost revenue, provided by Spotify [20], Spotify still has other strengths that help it maintain its market-leading position.

Spotify's broad international music library is one of the keys. The stage offers an endless music collection worldwide, traversing different classes and dialects. This worldwide music catalog requests assorted groups of onlookers, making Spotify a, to begin with, select for music partners to cover distinctive societies and locales. Whether clients seek out standard melodies or specialty music, Spotify's comprehensive music library guarantees they discover what they are trying to find.

Spotify's effective personalized recommendation system is additionally a huge strength. Utilizing progressed calculations and data analytics, Spotify cares about personalized playlists and prescribes tracks based on the individual's tuning in propensities. This personalization upgrades the user experience by recommending unused music to clients they might like, expanding user satisfaction and engagement and getting more clients utilized to the way this music is experienced. Spotify Wrapped is a yearly highlight advertised by Spotify that provides clients a personalized rundown of their listening habits over the past year. It incorporates points of interest such as the foremost, as often as possible, tune in to melodies, specialists, classes, and the full-time through tuning into music. At the beginning of December 2020, Spotify had a 21% increment in versatile app downloads, much appreciated by Spotify Wrapped [21].

Finally, Spotify's global brand presence is an imperative victory. Spotify has built a solid, recognizable brand that interfaces with clients worldwide. Its notoriety for innovation and user-friendly highlights has positioned Spotify as a pioneer within the music streaming industry, reinforcing its competitive advantage.

4.2. Weaknesses

However, Spotify faces a few weaknesses, one of the foremost eminent being the large costs related to copyright and authorization. The company's royalties for the utilization of its melodies are tremendous. Although it has diminished permitting costs through bargains with record names, it is concerned that rivals may pay more for a more extensive extend of clients. Most of Spotify's income is apportioned to paying royalties to specialists, record names, and other rights holders, affecting its profitability. These large working costs are a diligent challenge for Spotify because it looks to adjust user growth with financial sustainability. For example, Spotify paid more than \$9 billion in royalties and more to the music industry in 2023, the platform's highest payment to date. Another weakness is Spotify's continuous battle with profitability. Digital streaming is related to a more prominent difference and assortment of fabric than other music markets [22]. Whereas the company incorporates an expansive client base, the fetched structure related to content licensing and the

freemium demonstration has made it troublesome for Spotify to benefit reliably. This money related challenge may constrain Spotify's capacity to contribute to modern innovations or extend its administrations.

4.3. Opportunities

Spotify is poised to tap into numerous opportunities that could fuel its growth trajectory. A key avenue for this expansion lies in venturing into new markets, especially in areas where music streaming is just beginning to take off. By establishing a presence in these burgeoning regions, Spotify stands to boost its user numbers and secure a leading position ahead of its rivals gaining momentum. Using its well-known brand and diverse library of songs, Spotify is expanding into developing countries such as India and Africa. Their strategy for acquisition is proactive, enabling them to venture into new sectors and swiftly increase their market share. An additional opportunity exists to expand its content options beyond music. As of now, Spotify has started to investigate this with its speculation in podcasts and other shapes of sound substance. By proceeding to include distinctive substance sorts, such as audiobooks or elite artist content, Spotify can draw in a broader group of onlookers and make extra income streams.

4.4. Threats

However, Apple Music, Amazon Music, and Tencent Music are the three main competitors of Spotify, excluding other smaller-scale companies. All these streaming services are expanding globally. Compared to its competitors, Spotify's popularity stems from its focus on user experience and inexpensive cost [20]. Tencent owns QQ Music, Kugou, Kuwo, and WeChat, which have 615 million users and 120 million paying users [23]. Another critical risk is the potential for copyright disputes. As Spotify's commerce depends intensely on music substance, differences over royalty payments or licensing agreements seem to disturb substance accessibility. Such disputes may harm Spotify's connections with craftsmen and names, adversely affecting its brand and user satisfaction. The firm must diminish the fetched on their eminence and enhance the user experience to remain steady within the competition.

5. Conclusion

Spotify's ad-supported benefit is significant in drawing in numerous clients, viably serving as a door to change them into premium endorsers. This technique has permitted Spotify to construct a considerable client base and create critical income through its premium service. Spotify's income execution has beat other music-spilling stages, counting competitors like Apple Music. However, one confinement of this investigation is the need for more comprehensive information on Apple Music, which confines the capacity to create a point-by-point comparison between the two stages. To assist in reinforcing its market-leading position, Spotify ought to center on extending into modern markets, expanding its content offerings, and driving advancement. These steps will improve Spotify's competitive edge and dominance within the worldwide music streaming industry.

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