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Legal and Profitable? Spotify: The Challenges of an Online Music Service (Teaching notes)

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Summary

Sector	Music industry; information and communication technology (ICT)
Geographical context	Several countries
Company	Spotify is a music streaming service founded in Sweden in 2006. The company has experienced incredible growth since it was founded. It now has a presence in 58 countries and 75 million active users, 20 million of whom are paying subscribers.
Topic of the case	Spotify: its origins, its difficulties monetizing music to adequately compensate rights holders and turn a profit as well as its strategies for achieving its compensation and profitability goals, against the backdrop of a music industry undergoing profound transformation.
Main actors	• Spotify founders, Daniel Ek and Martin Lorentzon. • Music rights holders (composers, producers, record companies). • Internet users and Spotify customers. • Spotify's legal and illegal competitors.
Main themes	• The crisis in the music industry. • New approaches to consuming music online. • Internet strategies and business models. • Online respect for intellectual property laws and regulations. • The monetization of music and culture and free availability on the Internet. • The Internet generation (digital natives).

[1] Translation from the French by Rhonda Mullins of TN #5 40 2015 014, "Légal et rentable? Spotify : les défis d'un service de musique en ligne."

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These teaching notes are intended to be used as the framework for an educational discussion. As such, they represent an illustration of one type of pedagogical solution and in no way exclude other solutions. Deposited under number 5 40 2015 014T with the HEC Montréal Case Centre, 3000, chemin de la Côte-Sainte-Catherine, Montréal (Québec) Canada H3T 2A7.

1. The Spotify Case

1.1 Type of case and objectives

The Spotify case is a real case, pulled together from public information. It is an analytical case that sets out the facts and events related to Spotify, against the backdrop of a music industry in crisis. The case lends itself to 1) business model analysis, 2) strategic analysis, 3) considering organizational performance, 4) considering the monetization of music and the culture of online music consumers, and 5) searching for solutions to problems of corporate profitability and compensation to music rights holders. It goals are in-context analysis and development of judgement and critical thinking.

The case is interesting because of the original nature of the Spotify business model and the variety of the themes addressed, such as questioning the traditional operation of the music industry with the advent of the Internet and digitization; new modes of consumption and new habits developed online; respect for intellectual property laws and regulations online; the monetization of music and the culture of getting things for free online. Furthermore, ethical questions can be raised about the role Spotify plays in the culture of getting things for free that has developed online and that makes it difficult to monetize music.

1.2 Case summary

Spotify is an on-demand music streaming service founded in Sweden in 2006, in a music industry in crisis. Spotify legally offers online music consumers access to a repertoire of over 30 million songs, a number that varies by country where it is available. Its mission is to allow people to listen to the music they want, when and where they want it. To accomplish this, the company offers a legal alternative that is superior to music pirating, via a simple, clear and quick-to-use platform, making listening to and legally sharing music easier than ever. Its service falls within the *freemium* model: users can access it free in exchange for being exposed to ads a few minutes every hour, or pay $9.99 per month to access it without ads, without interruptions and with a certain number of benefits in terms of the quality of the music files and their availability online and offline. Spotify has seen meteoric growth since it was founded: it has a presence in 58 countries and 75 million active users, 20 million of whom are paying subscribers. Despite this, the company has not yet turned a profit. Plus the compensation it pays to rights holders for the use of their music has been criticized as being insufficient. However, this problem is not exclusive to Spotify; it affects most businesses that try to monetize music online.

The case begins with a presentation of Spotify's context – a music industry in crisis, which, since the end of the 1990s, has been profoundly transformed. It explains that the difficulty of monetizing music is something the entire industry faces, confronted with the culture of getting things for free developed by Internet users via illegal music file sharing platforms. In this context, Spotify is a legal solution to music pirating, which adequately meets the expectations of Internet users while complying with legal imperatives that govern its use, but that does not manage to sufficiently monetize this music with Internet users. As a result, the compensation paid to rights holders is insufficient, and the company has not turned a profit.

The case shows the paradox facing Spotify, stuck between consumers who have limited ability to pay for music and who are always threatening to move to illegal and free alternatives for consuming music if the price for accessing music legally were to increase, and, on the other hand, the music rights holders who expect more substantial compensation for the use of their music on legal platforms like Spotify.

Nonetheless, given the context, Spotify is doing well. The company is carving out an enviable position for itself in the highly competitive market of online music, thanks to differentiators related to price, technology performance, integration with social networks and its consumption logic, which fits with the habits younger consumers have developed when it comes to music. It has customers participate in value creation, which reduces its operating costs, for example, for promoting its repertoire and developing applications to exploit it, as well as building loyalty among customers and engaging them. Finally, it is able to leverage advertising and establish commercial partnerships that earn it a slim but not negligible portion of its revenue and help expand its reach beyond markets it normally targets to attract new customers.

1.3 Data sources

Four data sources were used to put together the Spotify case. Each piece of information used to build the case had to be confirmed by at least two different sources. First of all, news documentation up until September 2015 was consulted, either periodical articles, case files or media interviews with Spotify founders, employees and observers.

Second, available archives were consulted until September 2015. Public information, often backed by numbers, about Spotify and the companies the service is compared to (Apple, Rdio, Deezer, Pandora, Kkbox, Tidal, WiMP), was collected. This information was provided by the companies themselves via their websites or reported by newspapers and magazines (*The Guardian*, *Bloomberg Business*, *The Wall Street Journal*, etc.) or by firms that prepare statistics on private companies (Statista, PrivCo).

Third, studies of the sector and the digital music market Spotify is part of were consulted. Specifically, studies conducted by the International Federation of the Phonographic Industry (IFPI), the Observatoire de la culture et des communications du Québec (OCCQ) and Nielsen Soundscan were used.

Finally, Spotify's online activities were directly observed until January 2015, through the company's website and its associated Facebook and Twitter accounts.

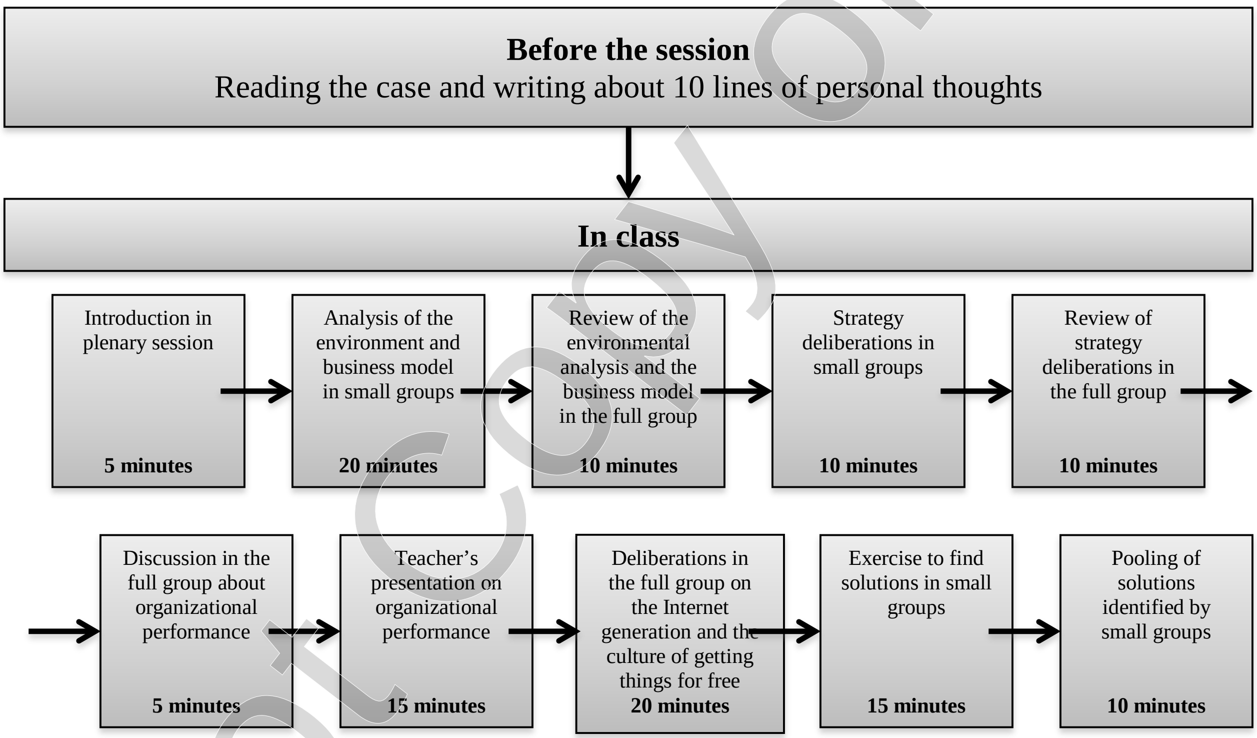
1.4 Target market and user courses

This case is suitable for bachelor's level students and for graduate level courses. Because of its topical nature and versatility, the case will be appreciated by all types of students, regardless of whether they have management experience or have completed their undergraduate studies. However, this case is likely to be enjoyed more by students who already have an interest in or knowledge of new communication and information technologies, strategy, management or cultural industries. Essentially, the Spotify case is useful for analyzing the impact of the Internet and content digitization on business models, success factors of strategies used in such a technological context, the behaviours and expectations of online consumers, their culture of getting things for free and even ethical aspects of certain modes of legal dissemination of music.

2. Case Presentation Strategy

Given how rich in information this case is, there are a number of strategies for presenting it. The following strategy is for a 120-minute session. The proposed strategy includes preparation activities before the session, strategic analysis activities in smaller groups, interspersed with full group discussions, and an activity to find and propose solutions.

Figure 1: Strategy for working with the Spotify case for 120 minutes



2.1 Before the session

Given the nature of the case and the amount of information it contains, it is essential that students read and prepare before coming to class. To encourage student engagement, we suggest asking them to write around ten lines on the strategic aspects that struck them the most with the Spotify case. The goal is not to offer an analysis, but rather an observation, a comment or a conclusion relevant to the subject studied in the course. This exercise prepares students for in-class discussions. Having to write ten lines forces students to go beyond simply reading and gets them more involved in the case. In our experience, this effort prepares and motivates students. Students enjoy the exercise and prefer it to an academic analysis. For more information on the effectiveness of this teaching method, please see:

- SARDAIS, Cyrille and Eric BRUNELLE (2011). "Le blogue comme carnet d'apprentissage", in *Leaders et Leadership*, JFD éditions, 447 p.

It is also a good idea to offer students a few conceptual and theoretical tools to guide them in their preparation and their case analysis. A more exhaustive bibliography for the teacher is provided at the end of this document. However, because of the issues involved in presenting the case that we outline below, we recommend the following reading:

- OSTERWALDER, Alexander and Yves PIGNEUR (2010). *Business Model Generation: A Handbook for Visionaries, Game Changers, and Challengers,* Wiley, 288 p.
    - Chapter 1: "Canvas" (pp. 14-55).
- ANDERSON, Chris (2009). *Free. The Future of a Radical Price*, Hyperion, 288 p.
    - Part 2: "Digital free" (p. 75).
    - Part 3: "Freemium tactics" (pp. 245-250) and "Fifty business models built on free" (pp. 251-254).
- JOHNSON, Gerry, Richard WHITTINGTON, Kevan SCHOLES, Duncan ANGWIN, and Patrick REGNÉR (2013). *Exploring Strategy* (10th edition), Pearson, 816 p.
    - Chapter 2 "The environment"
    - Chapter 3 "Strategic capabilities"

2.2 During the session

As an entry point to analyzing the case, we suggest starting the session with questions to break the ice. The goal of this large-group discussion is to stimulate the class and prepare for open discussion. It identifies problems observed in the Spotify case and in the music industry in the age of the Internet and digitization. After this introduction, four thematic discussions in small and large groups will follow: 1) analysis of the Spotify business model and environment; 2) discussions about the Spotify strategy; 3) analysis of Spotify's organizational performance; and 4) discussions about the Internet generation and the culture of getting things for free. Finally, an activity to find and suggest solutions will end the session. For each of the themes addressed, these teaching notes offer one or more questions for students, one or more bibliographical references when applicable and responses or analysis.

A) Introductory questions with the full group (5 minutes)

- **Did you know about Spotify before reading the case? If you did, what did you think of it? If you didn't, what caught your attention?**
- **What struck you the most in reading the Spotify case?**
- **What do you think of the online service?**

We suggest the teacher write on the board issues and observations raised by the students in their own words. Here are a few examples of possible comments:

- It's good to see a company offering free legal access to music.
- The music industry is in crisis. I'm not sure whether Spotify will ever make money.
- It's a shame Spotify isn't profitable in spite of its popularity. I wonder how the company can become profitable.

- The amount paid to music rights holders is pathetic, and that concerns me. I get the sense that one day, no one will be able to afford to make music.
- Spotify's web platform is particularly well designed. The functionality is well thought through and easy to use.
- There are a lot of free music sites, so I don't know whether I would be willing to spend money for a site like Spotify. But since it's legal, I prefer to use it and stick to the free offer.
- Spotify is an interesting alternative to iTunes, but we will have to wait to see if it remains so with the arrival of Apple Music.
- It's great to see a company that is trying to respect the copyright of songwriters.

It is always surprising to see that students' comments normally point to the industry's main issues and challenges, even though they are expressed in their own words. However, for the time being, they do not need to come up with every issue. The goal is not to identify all the issues and challenges, but to introduce the subject, get students emotionally engaged, create a trail for making connections later on and prepare students for the more rigorous analysis that will follow.

After noting around ten comments on the board, the teacher can continue by having the students form small groups.

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B) Analysis of Spotify's environment and business model (30 minutes)

To facilitate large group discussions that will follow and ensure that students are all actively learning, we recommend putting students in groups of four. Being in a small group actively engages students and stimulates them more. It also allows students to review and remember the facts of the case. Given the amount of information presented in this case, this refresher will improve discussions later on.

Questions for small groups:

- **To better understand Spotify, describe the different aspects of its model using Osterwalder's and Pigneur's business model template.**
- **Identify aspects of Spotify's environment (political, economic, social, technological and legal).**

Allow around 20 minutes for students to complete the template and analyze the environment. After 20 minutes, we suggest a review in the full group to reconstruct it and for students to share observations. This review in the full group generally takes less time. Allow around 10 minutes. **Appendices 1 and 2** of these teaching notes contain an example of the completed PESTL template and table.

C) Discussion about the Spotify strategy (20 minutes)

After studying Spotify's business model and environment, it is interesting to continue the discussion and ask questions about the company's strategy. As with the analysis of the business model, it is a good idea to have students form small groups again to conduct a strategic analysis of Spotify's strengths, weaknesses, opportunities and threats (SWOT). This analysis allows students to make a judgement about the company's strategies.

Questions for small groups:

- **Describe Spotify's strengths and weakness, what distinguishes it from the competition, the opportunities and threats in its environment (SWOT analysis).**

Allow the groups around 10 minutes for this exercise. Given the learning objectives for the case, we do not suggest doing a review in the full group to complete the SWOT table, but instead generating a dynamic discussion about specific questions related to Spotify's challenges and the company's strategies for dealing with them. You can do a review if you like, however. To help prepare, the teacher can refer to aspects of the SWOT analysis presented in **Appendix 3** of these teaching notes. Once the students have answered this question, the teacher can continue the session with a few questions in the full group, for a discussion of around 10 minutes.

Questions for the full group:

- **Compared with illegal, free platforms, what are the advantages that prompt Internet users to subscribe to Spotify?**
- **What are Spotify's advantages over other legal music streaming services** (see Appendix 1 of the case: Comparison of the Main Online Music Streaming Services)**, but also compared with online sales platforms such as iTunes? How can the company better leverage these competitive advantages?**
- **Could the company consider other advantages that would enable it to reach more customers or charge them more to subscribe?**

With respect to illegal platforms, the following advantages or strengths of Spotify could be pointed out: the legal nature of its offer, its ability to offer added value over piracy, in particular in terms of the speed and performance of its system, the volume and diversity of its musical repertoire, its accessibility and ease of use.

In terms of legal offers, Spotify's competition is made up of music streaming services that are similar to its own, on the one hand, such as the French Deezer, its main competitor in France, and the American Pandora, which still outperforms Spotify in the U.S., as well as Rdio, KKBOx, WiMP, Tidal and, most importantly, since June 2015, Apple Music. Because of its dealings with record companies, its availability in 110 countries (compared to 58 for Spotify), its 800 million users via iTunes and greater risk tolerance afforded by its position in the Apple family, Apple Music presents a serious threat to Spotify. On the other hand, there is iTunes – which differs substantially from Spotify in how its users listen to and buy music, in that it is based on a logic of ownership – which also offers Spotify serious competition. However, Spotify differentiates itself on a number of levels. The students may even be able to identify and analyze Spotify's competitive advantages from aspects of the case and the comparative table of the main music streaming services. As an example, here are a few of Spotify's competitive advantages compared with iTunes and other music streaming services:

- *Price*

Spotify distinguishes itself on price. Its free offer is highly competitive and sufficient to satisfy certain music lovers. In fact, 75% to 80% of Spotify users are happy with it. This gives the company a distinct advantage. A number of music services offer free trials, which expire after a week or two (with the exception of Apple Music whose free trial offer lasts for three months). Spotify's free offer involves advertising, but can be enjoyed in the longer term. As for the paying offer, it is highly competitive with iTunes and its albums at $9.99. In fact, with Spotify, the same amount of $9.99, payable monthly, provides unlimited access to over 30 million titles via a Spotify player.

- *Technology performance*

Daniel Ek is obsessed with continually improving the system's speed and performance to differentiate Spotify from other online music services. As described in the case, Daniel Ek combines a number of technologies to achieve an ongoing reduction in the time between click and sound. This influences consumers' perception of Spotify's performance and how instantly they can access music, giving the service a competitive advantage.

- *Social integration*

Spotify's social aspect gives it a substantial advantage. Facebook's integration to Spotify gives the music service greater prestige among millions of Facebook users to win new customers and build loyalty among existing customers. Other music services have also established such integration partnerships with Facebook, but according to Facebook vice-president Dan Rose, Spotify has two advantages over other services. The first is that Spotify is the platform that has taken the social aspect the farthest, beginning when it was first designed. The second is that the company's business model is a perfect fit with the type of discoveries Facebook was designed to enable. If Facebook users see that their friends are listening to a song, an album or an artist that they want to hear too, it is easy to do with Spotify.

- *Joint value creation and commercial partnerships*

In addition to its competitive advantages, joint value creation with consumers and commercial partners are two of the company's strategies for growing and diversifying its clientele, increasing revenue and standing out from the competition. Joint value creation with consumers allows Spotify to reduce some of its operating costs but more importantly to build loyalty among customers and engage them. As for its commercial partnerships (see Exhibit 2 of the case: Spotify's Commercial Partnerships), they increase the company's revenue while allowing it to win customers they would not have reached otherwise. The fact that it offers a logic of consumption (access to a repertoire of music rather than ownership of the music) that is different than that offered by iTunes and other online music sales platforms and that this logic of consumption better meets the needs of Internet users also helps differentiate Spotify.

D) Analysis of Spotify's organizational performance (20 minutes)

Students often criticize Spotify and its strategies by pointing to the fact that the company has not turned a profit or generated earnings. This criticism is apt because in spite of overwhelming success in terms of number of users, the company is not yet profitable. Are Spotify's strategies effective? In light of the analysis of Spotify's strategies, it may be of interest to ask about the notion of organizational performance in this context. To this end, the teacher can use the following reference:

- RICHARD, Pierre J., Timothy M. DEVINNEY, George S. YIP and Gerry JOHNSON (2009). "Measuring Organizational Performance: Towards Methodological Best Practice", *Journal of Management*, Vol. 35, No. 3, pp. 718-804.

Questions for the full group:

- **Is Spotify performing?**
- **What criteria can we use to assess Spotify's performance?**

Richard et al. (2009) point to the multidimensional aspect of organizational performance through an inventory of studies on the subject. Since the model the authors present is simple and related to our objectives, we suggest that after allowing for a brief discussion of around five minutes in the full group on the above questions, the teacher summarize the students' answers by presenting the authors' model, which summarizes organizational performance based on the three following criteria:

a) The company's performance in its market.

b) Its financial performance.

c) Its return on investment.

Follow-up question:

- **Given the three criteria for evaluating organizational performance, what can we conclude about Spotify's performance?**

This question makes it possible to tease out the complexity of evaluating the performance of companies in the digital music industry. To help the teacher prepare, here are a few avenues for answers and analysis, drawn from section 6, The Problem of Monetizing Music, of the Spotify case. The teacher should allow 15 minutes for this presentation.

a) Spotify's performance on the market

This aspect of performance makes it possible to place Spotify in the context of other online music services and to draw comparisons. Exhibit 1 of the case, Comparison of the Main Music Streaming Services, will be useful at this stage.

Compared with other music streaming services, Spotify is fairly well positioned in its market. It has a presence in 58 countries, and 75 million active users, including 20 million paying subscribers. While this is limited compared with the 250 million Pandora users, the only music streaming service that outperforms Spotify worldwide, 27% of Spotify's users pay for a subscription to use its service, compared with 1.2% for Pandora. Spotify performs as well as Deezer, for example, which has only 16 million users for a presence in 180 territories. It will be interesting to compare Spotify's performance with that of Apple Music, once the service, which was launched in June 2015 and had 11 million users in September of the same year, is well established on the music streaming market. Apple Music's availability in 110 countries, its access to 800 million iTunes users and its well established ties to record companies are likely to undermine Spotify's position.

If we expand the Spotify market to the digital music market in general and, therefore, music downloading services, Spotify pales in significance worldwide compared with iTunes. The music download service is available in 147 countries, offers a catalogue of 37 million titles (compared with Spotify's 30 million), has 800 million users registered with a credit card and has sold 35 billion titles, or the equivalent of 4.9 songs for every person on the planet.

Nevertheless, in certain countries, music streaming services are more popular than downloading music tracks and albums, such as in Sweden, France and Italy. The most telling example is that of Sweden, where 94% of revenue from digital music comes from music streaming services, mainly Spotify.

Spotify, therefore, is showing very strong performance on the music streaming service market, in first or second place worldwide, depending on the criteria, as well as solid performance on the digital music market in general.

b) Spotify's financial performance

This aspect of Spotify's performance offers a chance to calculate Spotify's costs and revenues and understand its deficit.

Spotify's revenues have grown every year since it was founded, but the company has not yet turned a profit. In fact, Spotify's revenue was 747 million euros in 2013, an increase of 73.6% over the 430 million euros it earned in 2012. However, its losses also increased 16.4%, from 80 million euros in 2012 to 93 million euros in 2013, according to Spotify's most recent consolidated financial statements. **The company is therefore performing well in the sense that it is growing, but is not performing well in the sense that it is running a deficit.**

This deficit is largely attributable to Spotify's cost and revenue structure. In 2013, 91% of Spotify's revenue came from its paying subscribers, which represented only 22% of users. If Spotify had more paying subscribers, its revenue would be substantially higher. In good years and bad, the 75% to 80% of users who do not pay to access the 30 million songs available on Spotify earn it less than 10% of its annual revenue through advertising.

In comparison, across the music industry (figure 6 in the case study), the share of revenue related to users of the free offer of music streaming services tends to be higher and far exceeds 10% (figure 7 in the case study). Spotify's proportion of paying subscribers is therefore fairly weak when compared with that of other music streaming services. Its financial performance is therefore also weak on the music streaming service market.

c) Return on investment

For venture capital investors, Spotify still has not generated an attractive return. Since its beginnings, the company has accepted almost $300 million in outside capital, but has not made a profit. In fact it has accumulated losses of over $200 million, according to PrivCo, which studies private company performance.

However, investors seem to believe that the company – which is less than 10 years old, has not stopped expanding since its beginnings and has had revenue growth every year – shows promise, because they continue to invest in it.

It would be a better investment if it could grow the number of paying subscribers and, in turn, its revenue. But it would have to be a significant increase in gross revenue for the company to manage, with its 30% margin, to pay for its costs while making up its accumulated deficit.

Spotify is currently not producing a very good return on investment. It needs sustained, even accelerated, growth to offer a solid return on investment.

E) Discussion about the Internet generation and the culture of getting things for free (20 minutes)

Section 2, Spotify's Origins, of the Spotify case deals with the generation that grew up with Napster, "the generation of 18 to 30 year olds who don't believe in paying for music, and who think that it should circulate freely on the Internet." Judging from the commercial partnerships Spotify enters into, this generation is its main target market. A discussion in the full group about this generation could shed light on the Spotify paradox of impressive market performance and weak financial performance.

This discussion will be of particular interest to students, since most of them probably belong to this Internet generation. Teachers should be aware that students may react emotionally and have a hard time being objective. This is because the discussion confronts them with their own behaviour and expectations with respect to online music.

Questions for the full group:

- **Describe the Internet generation's expectations with respect to music.**
- **How does Spotify meet these expectations and how has this response fuelled its success?**
- **How has Spotify's response to the expectations of this generation been part of its difficulty achieving profitability and adequately compensating music rights holders?**

The Internet generation and music

This question will get students to describe the Internet generation's expectations with respect to music, which they will have read about in the recommended sections of the book by Chris Anderson (2009), but above all to question their own expectations, since most of them are part of this generation. Here are a few examples of possible answers to the question:

- Instantaneity: ability to get music with the click of a mouse, without waiting.
- Accessibility: having access to music anywhere, at any time.
- Diversity: finding all music, all genres and all artists, in one place.
- Flexibility: being able to listen to music on all platforms, online and offline.

- Free: not having to pay for the music they listen to.

After noting around five comments on the board, the teacher can ask students to consider the impact of the Internet generation's expectations on the music industry and remind them of their background reading of Anderson's work (2009). We present the broad strokes here to help teachers prepare. Chris Anderson is talking about the Internet generation, which is a large proportion of online music consumers, a generation born starting at the end of the 1980s and "[raised] online simply assuming that everything digital is free" (2009, p. 10). He argues that we need to move toward this generation and what they expect from the Internet to propose business models based on free access. This is why the business models emerging from the music industry and those that have the most success are those that incorporate the free aspect and that give customers the sense that they are getting music for free.

To find out more about the Internet generation, the teacher can refer to the following work, specifically the first pages of chapter 6 "Pirates" (pp. 131-132):

- PALFREY, John and Urs GASSER (2008). *Born Digital: Understanding the First Generation of Digital Natives*, Basic Books, 288 p., Chapter 6: "Pirates" (pp. 131-132)

Palfrey and Gasser (2008) argue that the Internet has an anti-commercial culture. Commercial sites didn't find a place on the Internet until the mid-1990s, and the Internet generation grew up with this philosophy. When they pay for content on the Internet, young people from the Internet generation find obvious advantages: ease of access, greater security and other added value. The authors emphasize the added value this generation expects when it comes to music, i.e., flexibility, mobility and instantaneity: "music, for them, exists in a digital format they can download from the Internet, move around, and share with their friends and relatives" (p. 131).

Spotify's response to this generation

Once the Internet generation is better understood, the teacher can establish with students how Spotify responds to the needs and expectations of this generation, enabling such strong market performance. Answers to what Spotify does to meet the abovementioned expectations could be gathered from students, and the teacher could draw parallels with students' answers about the issue of expectations. We draw your attention to the following aspects of Spotify's response to this generation's expectations:

- Spotify is available on all platforms (computers and mobile devices)
  - Meets the expectations of <u>accessibility</u> and <u>flexibility</u>
- Spotify has a large repertoire of music (30 million titles)
  - Meets the expectation of <u>diversity</u>
- Spotify demonstrates technologically efficient (constant reduction of time between click and sound)
  - Meets the expectation of <u>instantaneity</u>
- Spotify gives Internet users the option of free access to its repertoire (free package in exchange for being exposed to ads).
  - Meets the expectation of getting things for <u>free</u>

With respect to Spotify's response to the expectation of getting things for free, the teacher can ask students to briefly identify the business model Spotify corresponds to among the different models that include providing things for free presented in the excerpts from Chris Anderson's book (2009).

As a response, Spotify's free model corresponds to the three-part or two-sided markets proposed by Anderson (2009), according to which content is given away, but access to the audience is sold to advertisers. This free service is offered to Internet users without limitation or constraints other than being exposed to advertising and not being able to listen to music offline or on mobile devices. As for the Spotify business model, it falls within the *freemium* model, according to which a basic service is offered for free, but *premium* services are also available for a charge. The payment of these *premium* services by certain customers subsidizes those who do not pay.

The teacher could conclude from students' answers that Spotify's fairly specific adaptation to the expectations of the younger generation of Internet users in large part explains the company's market success.

The paradox between this generation's response and Spotify's profitability

We suggest that the teacher then take the class discussion further. It may be appropriate to have students note that in return for responding to the expectations of the Internet generation, in particular when it comes to getting things for free, the company is depriving itself of revenue that could ensure its profitability and better compensation for music rights holders.

They can then note, as indicated in the case, that over three quarters of Spotify users are content with its free offer and that less than a quarter pays to access the service. Yet in 2013, the 22% of Spotify users who paid to access the service accounted for 91% of its revenues. In other words, 78% of users brought in a meagre 9% of revenue, very little given the number of customers who actually benefit from the service. This model, which meets the expectations of Internet users in terms of getting things for free, is also behind Spotify's inability to turn a profit.

Furthermore, it may be useful to show that the low proportion of paying users has an impact on Spotify's revenue and, as a result, on what is paid to music rights holders for the use of their music. While Spotify's free offer comforts Internet users in their idea that "everything that is digital is free," it also reduces compensation to music rights holders, particularly compared with compensation from the sale of music files, on iTunes, for example.

To conclude this section on the Internet generation and move the discussion toward a consideration of ethics, the teacher can ask these follow-up questions:

Follow-up questions:

- **Spotify was created in response to the expectations and behaviours of the Internet generation. Is Spotify responsible for fuelling these consumer expectations and behaviour?**
- **Is it fair to say that this type of company is responsible for the difficulties the entire music industry has monetizing the use of music?**
- **What would be fair payment to music rights holders by Spotify?**

Spotify's role in its difficulties achieving profitability and compensating rights holders

To help the teacher prepare, here are a few avenues for discussion and analysis. Spotify obviously plays a role in perpetuating the idea that anything found on the Internet is free. A large proportion of Spotify users settle for the free offer, proving that it has sufficient benefits and not enough constraints for users to turn to the paying subscription. And yet, by not increasing the proportion of paying subscribers, Spotify cannot increase its revenues and pay music rights holders more. So it is contributing to the difficulty of monetizing music in the digital world.

However, it is important to point out that Spotify is at the centre of a battle among a number of opposing forces. On the one hand, there are consumers of music via the Internet, an unstable clientele with little loyalty that is always looking for ways to get more for less. To court them, Spotify is up against not only its legal competitors, but also, and primarily, illegal, free sites where music files can be shared and listened to, which music fans can turn to if Spotify upsets the delicate balance between their willingness to pay for music online (or be exposed to ads) and the benefits they derive from it.

On the other hand, there are music rights holders and the lobby groups that defend them, which ask to be compensated fairly for the use of their music on Spotify. For many of them, even if Spotify makes consuming music legal on the Internet, the company is participating in one of the scourges behind the crisis the music industry is in: the culture of getting things for free. So the teacher can weigh the pros and cons of Spotify's free offer and its benefits for achieving the company's objectives of profitability and compensating rights holders, to evaluate the ethical impact of this offer on the industry as a whole and the role the company should play or the ethical responsibility it should have to show that music has value and that those who create it should be paid fairly.

Fair payment?

The Spotify case compares compensation for works sold in MP3 files, on iTunes for example, with the compensation for works heard via streaming. From it we understand that compensation associated with music streaming is much lower than other forms of compensation for music, and one can expect students to understand from this that compensation should be higher. But how high? Answers may vary, and there is no right answer at the moment, since the music rights holders and online music services cannot agree on what is fair compensation.

Students may have differences of opinion on this. Some will be concerned that failure to pay for music could destroy the music market, innovation and musical and artistic creativity. Others can argue that music should be free and insist that the industry develop revenue models other than those based on the sale of music. The discussion of this topic often generates emotional reactions from students, and while this makes it possible to understand the adversity and complexity facing Spotify, the teacher may want to recall the foundations of the legal system Spotify is operating in.

The teacher could first establish the principle that music rights holders must be compensated for the use of their music, whether it is heard on CD or via the Internet. Otherwise they cannot create new music. Creators have to be able to make a living from their art to dedicate themselves to it. Without compensation for music, its creation will stop. National and international intellectual property laws and regulations support and assert this principle.

Without offering a full account of copyright, the teacher could point out that in every country, creators of musical works are protected by legislation that gives them rights over their works: moral rights and economic or property rights. Moral rights allow creators of a work to claim responsibility for its creation and retain a certain amount of control of uses of their work that could affect their honour and reputation. Economic rights give creators of the work the right to benefit from its commercial exploitation. In greater detail, legislation gives creators exclusivity over the right to produce or reproduce, to execute or present in public and to publish their work. Anyone who wishes to use a work, to the extent that exclusive rights are granted to its creator, must obtain permission to do so. This authorization is given to the user in exchange for payment of a set amount or revenue generated from this type of use.

International agreements harmonize these principles among countries, such as the Berne Convention for the protection of literary and artistic works. Furthermore, these principles apply on the Internet, but the control of the circulation of musical works is difficult to enforce, because of the digitization of music and the ability to disseminate digitized content on the web in a fraction of a second. In fact, once digitized, these works are dissociated from the media on which they were once consumed, which companies restrict access to, something that is more difficult to do with virtual media, which can circulate and be shared freely with no financial compensation.

To explore these questions in greater depth, the teacher can refer to the following resources:

- CURIEN, Nicolas and François MOREAU (2006). *L'industrie du disque, Paris, La Découverte*, collection "Repères," 121 p. Chapter 1: "L'organisation de la filière et les acteurs" (pp. 5-22)
- LAFRANCE, Daniel and Serge PROVENÇAL (2010). *L'édition musicale. De la partition à la musique virtuelle*, Austin (Québec), Éditions Berger, 284 p.
  - Chapter 3: "Le droit d'auteur" (pp. 64-99)
  - Chapter 8: "L'économie numérique et l'édition musicale" (pp. 217-229)
- MOSER, David J. and Cheryl L. SLAY (2012). *Music Copyright Law*, Boston (MA), Course Technology PTR, 304 p.
  - Chapter 1 : "What Is Copyright?" (pp. 1-11)
  - Chapter 14 : "Copyright and Digital Technology" (pp. 249-269)
  - Chapter 15 : "The Online Music War" (pp. 271-293)

F) Conclusion: solutions for the future of Spotify (30 minutes)

Despite its undeniable successes; despite the fact that it has been able to navigate the maze of copyright and agreements to make music available online to build a musical repertoire of over 30 million titles; despite the fact that its offer is valued by over 75 million regular consumers, who help create value and associate themselves with brands to generate revenue, visibility and new customers; despite the fact that it has differentiated itself from intense competition; almost a decade after it was founded, Spotify still has not reached one of the goals of any company: profitability. And it has been accused of not sufficiently compensating for the use of the resource that is its reason for being, music. What should it do?
As a conclusion, we suggest getting students to propose solutions. Experience has shown that in

spite of a thorough analysis, a good critique of the industry and the accurate identification of the company's and music industry's challenges, it is particularly difficult for students to find solutions. This activity allows them to go further in their discussions. Through this step, we hope to make students understand the complexity of the company's situation.

This is why we suggest returning to small groups. The teams will have 15 minutes to come up with a list of solutions. To make this activity more interactive and engage students, we suggest creating a competition among teams. Students could be asked to play the role of consultants. They will have to convince us to hire them to help implement the proposed solutions.

Question:

- **What should the company do to achieve profitability and better compensate rights holders?**

Given the difficulty certain teams have with this activity, we suggest using the following approach if needed. To fuel discussions about possible avenues Spotify could use to become profitable, it may be helpful to tell students to begin their discussion with a comparison with iTunes and other music streaming business models, to ask themselves what should be retained from these models, particularly those that are profitable (iTunes is profitable and Deezer is profitable on the French market). For example, Deezer imposes more limitations on users of its free offer: Deezer's free offer is only available via computers, whereas Spotify's free offer is available on mobile devices. These limits no doubt help generate a higher rate of paying users for Deezer (38%, compared with 25% for Spotify) and, in turn, increase its profitability in France. Should Spotify adopt this practice? Are there reasons why this practice could not benefit Spotify in the same way?

The following table presents some of the options that Spotify could consider to become profitable and better compensate rights holders (**Table 1**). This list should not be considered restrictive, because students may come up with original solutions not considered here.

Table 1: Examples of options Spotify could consider to become profitable and better compensate rights holders, associated benefits and risks

Option	Potential benefits	Potential risks
Increase the proportion of paying subscribers by adding limitations to the free offer.	Increased revenue	Loss of subscribers
Increase the proportion of paying subscribers by eliminating the free offer.	Increased revenue	Loss of subscribers
Increase the price of subscriptions	Increased revenue	Loss of subscribers
Focus more on joint value creation with consumers in terms of promoting the service and exploiting the repertoire.	Reduction in certain costs for promoting the service and exploiting its repertoire and, therefore, increased profit margins.	Increase in certain management costs; risk of inconveniencing customers with repeated invitations for joint value creation.
Focus more on commercial partnerships.	Reach new clienteles and increase revenue.	Risk of altering the Spotify brand image.
Increase the contribution to right	Agreement with rights holders	Increase in the deficit and

Option	Potential benefits	Potential risks
holders (e.g., increase payment of 70% to 80% of its revenue to rights holders).	(particularly the most popular ones), making it possible to increase the number of titles in the repertoire and better position it compared with other music streaming services.	accumulated losses.
Reduction in infrastructure costs (e.g., closing certain national offices and centralizing activities, salary cuts, etc.).	Reduction in certain costs and therefore an increase in the company's profit margin.	Risk of losing skilled employees for less skilled employees; risk of a drop in the quality of the service; risk of doing a disservice to the particular aspects of the service in each country.

At the end, the teacher will give each team two minutes to share the solutions identified with the rest of the class. The class can question groups about each of the scenarios proposed. This will shed light on the complexity of finding *the* solution that will allow Spotify to pursue its mission of offering people the ability to listen to the music they want, when and where they want, while turning a profit and ensuring fair compensation to rights holders.

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Appendix 1
Example of a Completed PESTL Table

Political	• Resistance of music rights holders' lobby groups in certain countries when Spotify entered their country • Lack of government control over the illegal music offer and difficulty eliminating it
Economic	• General drop in global sales of CDs • Major drop in global revenue in the music industry • Increase in the global market value of digital music • Low price charged to consumers to access digital music • Small share of revenue from digital music paid to music rights holders • Intense legal and illegal competition in the digital music market
Social	• People are listening to more music than ever (in spite of the drop in sales) • Pervasiveness of music piracy worldwide • Major paradigm shift among the clientele and their consumption behaviour. The younger generations (large and future clientele) believe that everything online is free and want free stuff, instantaneity, accessibility, diversity and flexibility
Technological	• Rapid technological development in the telecommunications industry and digitization of products and services • Intense technological competition, which creates constant pressure to improve
Legal	• Ability for consumers to get around legal constraints and pirate music. Importance for Spotify to offer consumers something better than illegal platforms to encourage them to consume music on legal platforms. • To be a legal service, Spotify must respect copyright and sign agreements with music rights holders for the works it makes available. Resistance of certain rights holders.

Appendix 2
Example of Completed Business Model Template by Osterwalder and Pigneur

Key partners	Key activities	Value proposition	Customer relationship	Customer segmentation
Music rights holders and other intermediaries in promoting and marketing music Advertisers and sponsors Clients (joint value creation) Social media (Facebook and Twitter) Commercial partners and advertisers Venture capital investors	Acquisition of music repertoires Contract negotiations with music rights holders Creating and sharing playlists, social media networking, blogs, forums Relations with advertisers and sponsors Investor relations	Two subscription plans, one of them free Added value over pirating Legality Demand-centred Diversity of users Experience Joint value creation Sharing Discovery Accessibility Instantaneity	Personalized Instantaneous Real dialogue	Customers in 58 countries Two levels of willingness to pay Customers with different musical tastes “Social” customers, i.e. already present on social media, active on blogs and discussion forums Some customers familiar with pirating
	Key resources		**Channels**	
	Music IT Human resources (technological, marketing, legal, etc.) Consumer data Social networks		Social networks (Facebook and Twitter in particular) Website, translated in languages of countries where the service operates Blog and forum	

Structural costs	Revenues
Acquisition of the repertoire, negotiation of contracts, royalties paid to rights holders Human and material resources required for developing and maintaining the on-demand music streaming service and underlying infrastructure Promotion, marketing and maintenance of relationships with consumers and the development of commercial partnerships	Recurrent revenue: subscription and ad revenue Venture capital investment and sponsors

Appendix 3
Example of Completed SWOT Table

Strengths	**Weaknesses**

• Legality of the offer.
• Ability to offer added value over pirating:
  o Fast, high-performance computer system.
  o Large music repertoire.
• Accessibility and ease of use.
• Integration to social media.
• Joint value creation with consumers.
• Advertising and commercial partnerships in place.
• Respond in line with needs of online music consumers, who are looking for free music, instantaneity, accessibility, diversity, flexibility.
• Few constraints/limitations imposed on customers.
• Presence in 58 countries.
	• Low proportion of paying subscribers (25% or less).
	• Lower revenue than costs/Inability to turn a profit.
	• Low and not very attractive compensation for rights holders.
	• Inability to provide investors a return on investment.

Opportunities	**Threats**
• Digital music market growing and shifting, chance to evolve in it. • Ability to win more customers and expand on other markets. • Ability to attract customers to Spotify's paying subscription. • The young clientele is attracted to a service like Spotify, which meets its needs. It is a growing clientele. • A number of companies are inclined to establish commercial partnerships with Spotify (Reebok, Volvo, Ford, Coca-Cola).	• Music rights holders can refuse to make their music available on Spotify or end their agreements with the company if they believe they are not being paid enough. • Spotify customers could move to legal music streaming services that compete with Spotify or even illegal platforms if the cost of their Spotify subscription were to go up. • Strong competition in the digital music market. The loss of customers or a reduction in its repertoire could be fatal for Spotify. • Unfair competition of illegal music streaming or downloading platforms, which governments have little control over.

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