

# The Daily: Why Spotify is struggling to monetize, remembering audio ads, and Netflix lowers ad prices

Audio

On today's episode, we discuss how Spotify added a record number of users, the impact of its price increase, and the latest on its podcast business. "In Other News," we talk about how good people are at recalling audio ads and some adjustments to Netflix's ad tier. Tune in to the discussion with our analyst Daniel Konstantinovic.

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## Episode Transcript:

Marcus Johnson:

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Daniel Konstantinovic:

It's a different thing to go into a new market and say, "Here is a huge personal music library." And another thing to try and develop a media format into something that audiences are willing to pay for and listen to ads through.

Marcus Johnson:

Hey gang, it's Monday, August 14th. Daniel and listeners, welcome to the Behind the Numbers Daily, an eMarketer podcast made possible by Awin. I'm Marcus, and today I'm joined by one of our analysts on the marketing and advertising briefing. Based out of New York, it's Daniel Konstantinovic.

Daniel Konstantinovic:

Hey Marcus. Thanks for having me.

Marcus Johnson:

Hey, fella. Of course. Today's fact. What is the hottest pepper in the world? If you don't know, you can phone a friend. That friend, being Victoria, who edits the show, who's also listening.

Daniel Konstantinovic:

Oh gosh. Oh my gosh. I actually don't know. It's not the Ghost Pepper. I feel like every year actually, instead of answering the question, I'm going to do a tight five on how every year they come up with a new hot pepper that's the hottest pepper, hotter than the previous hottest pepper, and then they turn it into a chip, and there's a single chip that's made of the hottest pepper, and people eat it on the internet and suffer.

Marcus Johnson:

So that's a no. Daniel doesn't know.

Daniel Konstantinovic:

I don't know. I'm trying to change the topic. Distract from the fact that I have no idea.

Marcus Johnson:

Victoria, do you know what it is?

Victoria:

I actually don't know what it is.

Marcus Johnson:

It is the Carolina Reaper.

Victoria:

Ah.

Daniel Konstantinovic:

Yeah, that's right. I did know that.

Marcus Johnson:

Of course.

Victoria:

I knew that too.

Marcus Johnson:

Of course. So currently the hottest pepper in the world, according to Guinness World Records measuring over 1.6 million Scoville heat units. It's the scale that was created early 1900s, I think. So SHUs, Scoville heat unit. The Reaper is 1.6 million. Jalapeno peppers average about 5,000 SHUs. So a Carolina Reaper would be 300 times hotter than a jalapeno pepper. Nope.

Victoria:

It could burn a hole in your esophagus.

Daniel Konstantinovic:

Yeah, no thank you.

Marcus Johnson:

Yeah. One time when I was a kid, my older brother told me a jalapeno was a green grape. My parents thought it was hysterical.

Daniel Konstantinovic:

Yeah, it looks just like one.

Marcus Johnson:

Terrible parenting.

Victoria:

How are you guys confusing a jalapeno with a green grape?

Marcus Johnson:

No, he told me it was so that I would eat it without knowing.

Victoria:

Ah.

Marcus Johnson:

He's a terrible person. Anyway, today's real topic, why Spotify is struggling to monetize all these new users.

In today's episode, first in The Lead we'll cover Spotify. Then for in Other News we'll discuss how good folks are at recalling audio ads and where Netflix with ads is at. But we start with The Lead and we're talking about Spotify. So Daniel, let's talk about how many people are using Spotify these days. Spotify now has 551 million MAUS, monthly active users, 551 million, after they added a record 36 million Q1 to Q2. So in three months they added 36 million new users. That's three times as many as they added from Q1 to Q2 last year. So it's pretty damn impressive. Daniel, Spotify was expecting to add 15 million, half as many as they did, so they over-delivered significantly. According to their guidance, they said 15 million, they hit 36. What happened, Daniel? How were they able to add so many new MAUS in Q2?

Daniel Konstantinovic:

Well, I think Spotify is a really powerful service just in the culture. I think that there's a really big draw to Spotify. Similar to Netflix, they were early on the audio streaming scene, so they

continue to benefit from that. But I think they just have such good personalization recommendations. It's so linked to broader social media too that I think there's always going to be a pretty strong appetite for it.

They also have a really good onboarding process. They have a student subscription that's a lot cheaper than a standard plan that gets people, young users, into the service early and gets them to stay typically. So I think the fact that they continue to have pretty strong user growth is just a testament to how well those things are working and how well they've seized on their popularity to become a really powerful brand in culture.

Another big thing is that a lot of their growth this quarter came from markets outside of the US.

Marcus Johnson:

Yeah.

Daniel Konstantinovic:

They have really strong numbers in the US but they've been making a big push to get subscribers in other markets. Big ones that have been thrown around as targets for them are places like Argentina and China. They've specifically been trying to get a lot of these new users and newer markets into podcasting to make it as big of a new source or popular media format as it has become in the US and UK. So this shows that they're having some success breaking into those newer markets.

Marcus Johnson:

Yeah. Yeah, those two things stood out to me as well. The company pointing to strong growth among Gen Z listeners, as you mentioned, younger people, and then secondly, the share of users coming from rest of world going from 15% to over 30 in the last four years, at the expense of North America and Europe, Latin America performing particularly well as of late as you said.

Where are new users coming from in terms of unsupported versus ad free? Comparing Q2 additions last year to this year, so Q2 2022 versus Q2 2023, Spotify added 4 million ad supported last year, last Q2, and 26 million ad supported, seven times as many, this Q2, so significant growth there. In ad supported premium, they added 6 million last Q2 and 10 this Q2, so it went up, but buy less. Premium subscribers continue to account for a smaller and

smaller share of its total ad supported, accounting for more and more. Premium subscribers used to account for 46% of the total back in Q2 2020. Today it's just below 40%. So that's going down.

Let's move to the money they made, Danny. So revenue growth was 11%. That's half of the growth it saw in Q2 last year. So the money side was less great. The company made \$3.5 billion in the quarter though. Why was Spotify's Q2 revenue growth the lowest it's ever seen?

Daniel Konstantinovic:

I think it's a number of things. I think the main issue is that Spotify doesn't really have the most diverse revenue streams. It gets pretty much all of it from subscriptions or from advertising. And they've really struggled to find new revenue streams. They have all of these new services like a AI DJ, they're getting into audiobooks, but they haven't really figured out how to get more money out of those things. Things like audiobooks still have to be bought individually. There's not a fold in subscription service or pay a little extra month and get access to the audiobook library or anything like that yet. They're still figuring out a lot of kinks there.

And now with interest rates being a lot higher and users trying to cut back a little bit on subscription expenses, I think it makes sense that things have slowed down a little bit. And I know we'll also talk about the price increase. I think that's also part of why they have to raise prices, is because they're struggling to find new places to get money from so they need to show that the existing things can continue to provide increasing returns.

Marcus Johnson:

Can this new tier that they're expecting, people are expecting them to launch this new higher quality audio tier, I don't know, pay \$20 a month and you get this superior level of audio quality from your Spotify subscription? Can that move the needle?

Daniel Konstantinovic:

I'm not sure, to be honest. I think there are definitely people who will pay for it. It definitely has an audience of audiophiles. But if you think about the types of things that most Spotify users are probably listening from, like computers or AirPods or just wired headphones, the audio quality is not always the best.

Marcus Johnson:



Yeah.

Daniel Konstantinovic:

So would you really as a user notice the big jump in audio quality if you don't have hardware that can take advantage of it?

Marcus Johnson:

Good point.

Daniel Konstantinovic:

I'm not sure. It'll definitely be a tiny bump and it's a feature that's been requested for a long time. But I think another thing that's going to make it difficult is that Spotify's competitors offer the high quality audio for much less.

Marcus Johnson:

Right.

Daniel Konstantinovic:

Or sometimes as a basic bonus to the subscription.

Marcus Johnson:

Yeah.

Daniel Konstantinovic:

So is it really going to be that enticing as a Spotify user to bump your monthly fee up from \$10 to \$20 to get something that all the other audio services are offering-

Marcus Johnson:

Right, it's not by a few dollars. Is it?

Daniel Konstantinovic:

-just for entry?

Marcus Johnson:

Yeah. So revenue growth, as I mentioned, 11% year on year in Q2. Pretty balanced between the two different revenue streams that you mentioned. Revenue from ads was up 12, revenue from subscriptions was up 11. Both figures much smaller than last Q2. They've got to do something because the company's average revenue per user is going in the wrong direction, down 6% year on year as they added a lot of people but were struggling to monetize those people.

Let's talk about that price increase, which you quickly alluded to just there. After 12 years, the price of Spotify Premium is increasing in the US. The subscription will now cost \$11 a month. The cost of its Duo plan will go from 13 to 15, family goes from 16 to 17, and the student one from five to six. Danny, what impact will Spotify's price increase have, if anything?

Daniel Konstantinovic:

I think it'll definitely have an impact on new subscriptions in the next couple of quarters. I think that they'll probably slow down a little bit. Spotify itself has said that it expects that they're going to slow down because of the price increase.

I don't think it's going to trigger anything like a mass exodus. I think you can look at other examples in subscription entertainment services to see that people are not really inspired to cut subscriptions when there's a price increase. Like Netflix, for example, just cracked down on password sharing. A lot of people lost access to Netflix. And then they had one of their biggest quarters of signups ever. So I think there's pretty strong evidence to show that even when there's price increases or tough economic times, users are only willing to cut down an entertainment so much. And I think Spotify waiting what, 10 years, was it, to increase?

Marcus Johnson:

Plus, yeah.

Daniel Konstantinovic:

Yeah, over 10 years to increase prices in the US, is just going to make it even less likely that there will be a really mass exodus. Plus the price increase is coming while every other subscription entertainment service is also hiking prices.

Marcus Johnson:

That's the thing.

Daniel Konstantinovic:

Yeah.

Marcus Johnson:

If one company is doing it's easy to get annoyed at them and say, "Oh, well, I'll go somewhere else." But everyone else is doing the same thing. John Porter at The Verge noting Spotify's increase isn't unexpected considering every other major music streaming service has announced a price increase in recent months. Going through them, Apple was first, last October. Amazon in January. TIDAL and YouTube Music Premium announced hikes in July and they all increased their services by a buck for its standard individual monthly subscription. So it seems like, yeah, this just kind of following suit with everybody else. Let's talk about their podcast business for a second. Danny, a few mentions in it during their earnings. What's the latest on Spotify's podcast efforts?

Daniel Konstantinovic:

Latest on Spotify's podcasting business. They have been cutting costs a lot. There were a lot of layoffs in podcasting recently. In this last quarter, I think it was about 200 people.

Marcus Johnson:

Yep.

Daniel Konstantinovic:

Which is a very small portion of Spotify's total workforce.

Marcus Johnson:

2% of their workforce, yeah.

Daniel Konstantinovic:

Yeah, yeah. It's crazy what a huge company they are. But yeah, so there have been cuts there. I think that's all related to things like the price increases and revenue troubles. They're not the only company looking to cut costs. But I think where Spotify is struggling a little bit in podcasting is getting more meaningful revenues out of it I think has proved to be a challenge for them. Podcasts are just available to anyone who is a subscriber and I think if they wanted to put it behind some kind of paid access, they would really run into trouble there. I think

podcast advertising still has some tech issues to work out, like the fact that you can skip through ads that are baked into the recording. There isn't really a tech in place to say detect that there's an ad read happening, so you can't skip that.

So I think Spotify has called it a \$20 billion opportunity, and I think the road to getting that much out of it is a little longer than expected. There's been a real slowdown in the main markets that we've talked about in the US and the UK. They are expanding into other markets, and they're having a lot of success there, but it's a different thing to go into a new market and say, "Here is a huge personal music library." And another thing to try and develop a media format into something that audiences are willing to pay for and listen to ads through. Podcasting is just not as popular in some of these new markets and so Spotify's challenge is to get these new users to engage with a pretty different format.

Marcus Johnson:

Yeah, first glance it's a little concerning, because you see that they're cutting 200 jobs from podcasting, but as we mentioned, it's just 2% of the total. They've consolidated some of their premier, Gimlet and Podcast Studios, and cut some of its original shows as well. But when you scratch below the surface, you see that they're just doing this to right the ship, so to speak. Because CEO Daniel Ek recently saying the company has made the right bet on podcasts four years ago before there was much data available on the market, saying that as it cuts costs, they're coming at this with the process of right-sizing some deals, doubling down on some of the things that worked really nicely, and then stepping out of some deals and relationships that haven't worked out. We'll keep an eye on it. That's all we've got time for for The Lead. Time for The Halftime Report.

So, Danny, instead of asking you what was most worth repeating from the first half, I'm going to ask you to tell me what you expect from Spotify in Q3 and beyond.

Daniel Konstantinovic:

Well, I think there's going to be a little bit of a slowdown in new user growth because of the price hikes, but I think in Q3 I would really like to see in the next couple of quarters some progress on things like an audiobook service, some new podcast advertising, features, or technology. Spotify has done a lot to try and increase the volume of podcasts on there, but things like discoverability are also pretty low. So I think they just have to do a bunch of

scattered minor things to bring it to a level that it needs to be at to perform the way that they say that it's going to perform.

Marcus Johnson:

Yeah. Q3, on the user side they say they're expecting to add 21 million new users in Q3. That's lower than 36 that they had this quarter in Q2. 21 million would be pretty much the same that they added in Q3 last year. They're not expecting to add many premium folks. On the money side expecting slower revenue growth than last Q3, adding that it expects that price increases will have a minimal impact on total revenue in the current quarter. That's all we've got time for the first half. Time for the second. Today In Other News, how are folks at recalling audio ads? And we check in on Netflix with ads.

Story one. How are folks at recalling audio ads? Well, in a recent article that you wrote, Danny, you point out that audio ads produce higher brand recall and sentiment among consumers than ads on other media formats including video, according to a study from Dentsu and Lumen. You explained that the study showed folks were able to recall brands from audio ads across formats 41% of the time. That's a few points higher than other types of ads, and the people were a little more likely to choose a brand they heard an audio ad for. The study included data from folks like Amazon Ads, iHeartMedia, SiriusXM, and Spotify covering radio, digital and podcasting. But, Danny, the most important sentence in your article about recalling audio ads is what and why?

Daniel Konstantinovic:

I think it would be consumers were able to recall brands from audio ads across formats 41% of the time compared with 37 for other forms of advertising. I think that might sound like a small gap between audio and other formats, but I think paired with some other stats in the study, it seems a lot stronger. I think the fact that recall and brand sentiment are so much higher with audio ads pairs really well with the fact that audio CPMs across podcasting and radio and so on are so much lower. It's so much cheaper than the other prevailing media formats, that you might see some budgets being directed further towards audio, which could benefit a company like Spotify, especially right now when marketers are really concerned about spending and budgets and cutting costs.

Marcus Johnson:

Yeah. The chart jumped out to me. So you had a chart looking at the share of time people spend with digital audio versus the share of ad dollars that are spent on digital audio, and radio too, so both for radio. So digital audio, 11% of people's time, total media time is with digital audio 11%. But in terms of ad dollars it's just 2%. And radio as well. 11% of people's time spent with radio, same as digital audio, but just 3% of the share of ad dollars for radio.

Story two. Danny in another article, you write that Netflix lowers CPMs and rethinks its Microsoft deal after months of slow ad growth. Netflix is bringing prices down for and supported tier and looking at tech partners outside of Microsoft to help accelerate its ad revenue growth. You point out that according to The Journal, Netflix is exploring options to bring in an ad partner that would sell alongside Microsoft. But, Danny, the most important sentence in your article about Netflix lowering prices and rethinking its Microsoft deal is what and why?

Daniel Konstantinovic:

I think it's that the streamer is reportedly looking to build its own advertising technology or bring existing services in-house once its contract with Microsoft expires in 2024. It is looking for a possible new ad partner according to the Wall Street Journal, to sell alongside Microsoft. I think what you get from the story and from recent Netflix earnings is a lot of frustration that despite all this pressure to start an ad supported tier, that it hasn't produced results very quickly. Which makes sense, but clearly Netflix is not satisfied with the pace that it's been going. They've said that they don't think ad revenues are going to be very material for the rest of the year, and the fact that they are looking for another partner shows some tension there with the relationship with Microsoft.

I'll also say that I think Disney Plus, Netflix, even in retail media, all of these companies that are launching ad tech, digital advertising services, with a third party partner, eventually all of these companies are going to look to bring it in-house because you stand to have a larger share of the revenues if you're the one controlling it. So eventually Netflix will say, "Thanks, Microsoft. You've taught us well. We've learned all we can from you, but bye-bye. It's our turn now."

Marcus Johnson:

Yeah. "Time for us to do it on our own." Yeah, I really liked your line about Netflix boasting 5 million subscribers for its ad supported tier in May, which is decent considering it's only been around for six months up until that point. But that number, that 5 million number, is still too low

for advertisers to commit significant spending to the platform. We expect Netflix to make \$1.3 billion from ads by 2025, in the year 2025. That's kind of Instacart, Spotify, Twitter, kind of ad dollars, but this year, not expecting to make very much from advertising at all. That's all we've got time for for this episode. Thank you so much, Danny, for hanging out today.

Daniel Konstantinovic:

Yeah, thanks for having me. It's always fun.

Marcus Johnson:

Of course. Yes, sir. Thank you to Victoria who edits the show, James who copy edits it, and Stuart who runs the team. Thanks to everyone for listening in. We'll hopefully see you guys tomorrow for the Behind the Numbers Daily, that's an eMarketer podcast made possible by Awin.