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Spotify check: Rethinking digital music services and compensation for artists

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Last month, Spotify, the popular on-demand music streaming service, launched its new Spotify Artists website, which clarifies how the company pays royalties to artists, publishers and record labels.

According to information released by Spotify, it has paid more than $1 billion in royalties since its inception in 2009, of which more than $500 million was paid in 2013. But the most pertinent information released by Spotify concerns how its compensation structure works.

Spotify likely is releasing this information after coming under fire this summer from musicians and commentators who argued that Spotify is hurting the record industry by paying musicians only a fraction of a cent each time their music is streamed. It is for this reason, Spotify hopes, that the information released last month will dispel criticism directed at the company.

According to Spotify, it does not pay artists on a "per stream" basis. Rather, Spotify pays approximately 70 percent of its monthly revenue to holders of the rights to the music it streams. To do this, Spotify takes each artist's monthly streams and divides it by the total number of streams on Spotify that month. That number is then multiplied by Spotify's monthly revenue and artists (or their labels/publishers) receive 70 percent of that figure.

This split between Spotify and rights holders is based on the popularity of each artist's music on the service. Payments made on behalf of each artist include royalties for use of both sound recordings and compositions. Thus, rights holders receiving royalties include organizations collecting public performance royalties (ASCAP, BMI and SESAC), statutory license fees for non-interactive streaming (SoundExchange) and mechanical licensing (Harry Fox).

Spotify cautions that while "it is possible to reverse engineer an effective 'per stream' average by dividing one's royalties by the number of plays that generated them ... this is not how we measure our payouts internally nor is it a reliable yardstick for Spotify's value to artists."

Several variables affect an artist's particular royalty payment, including the country in which an artist's music is streamed, the premium pricing and currency value in these countries and Spotify's total monthly income. Nevertheless, Spotify reports that the average "per stream" payout to rights holders is currently between six one-thousandths and 84 one-thousandths per stream.

Based on Spotify's payment model, as the company grows, so will each artist's "per stream" royalty payment, since revenues generated by Spotify are derived from monthly subscriptions and advertising revenue and not the number of streams played by consumers.

Thus, the more subscribers Spotify attracts, the more monthly revenue it generates, which will increase the revenues provided to rights holders and put more money into the hands of artists each month. Spotify believes this is all but inevitable, given that it currently has only 24 million users worldwide, which is small compared to YouTube (1 billion users) and iTunes (575 million users).

While many argue that digital streaming services like Spotify cheat artists of reasonable compensation, we should be cognizant of the fact that the music industry is continuing to evolve with technology. Thus, streaming services like Spotify are not going away any time soon.

We must not forget that before digital streaming services, there was iTunes and the 99-cent digital download. Allowing consumers to purchase a single song for 99 cents was the music industry's response to music piracy services like Napster, which allowed consumers to download their favorite music for free.

> ***"We must therefore shift the way we think about music consumption to fully understand how an artist's royalty payment through Spotify and other services compares to compensation received if the same music was purchased through a platform like iTunes."***

As digital download services became the norm, physical music sales plummeted. Many commentators blame Napster for this, but in reality, credit should be given to technology, which made it possible to download music in the first place (much like technology first allowed consumers to record music off the radio and create mixtapes). The industry eventually caught up with the pirates and reconfigured how music was purchased.

The most recent technological shift to influence the way music (and, for that matter, film and television) is distributed and consumed is increased performance in wireless Internet services such as Wi-Fi and 4G. Consumers can more efficiently stream music and television through their cellular phones, Apple TVs and even video game consoles, which in turn has resulted in an explosion of streaming services in the marketplace.

Netflix's mailing service has been eclipsed by its streaming service and the company now produces its own Emmy-nominated TV shows. Spotify, Pandora and YouTube have become essential apps on all our devices. Even cable television behemoth Comcast now offers an Internet Plus package, which strips away many traditional cable services and packages high-speed Internet with basic cable and HBO Go so consumers can watch a majority of their TV shows through the Internet.

These examples exemplify how technology has made it easier for us to stream entertainment, thereby making it unnecessary to "own" a song, TV show or movie in order to enjoy it. This does not mean that digital streaming services exploit content creators by paying unfairly low royalty rates.

We must therefore shift the way we think about music consumption to fully understand how an artist's royalty payment through Spotify and other services compares to compensation received if the same music was purchased through a platform like iTunes. If a consumer purchases a song on iTunes, Apple charges approximately 30 cents to the content owner. Thus, an independent artist will receive the remaining 70 cents.

In this scenario, the transaction is complete and the consumer may listen to this song as many times as desired without making any additional payments to the artist. If this same consumer instead chose to listen to the artist's song on Spotify, then every listen of the song will earn the artist between six one-thousandths and 84 one-thousandths.

If this consumer listened to the song just 10 times, the artist will receive between six and eight cents. Over time, the consumer may listen to this song more than 100 times, which would earn the artist between 60 and 84 cents.

Bottom line: Once a consumer purchases a song, the transaction is over. But if they are streaming the same song, the transaction begins again with every listen. Is this a good thing or a bad thing?

Only time will tell.

Either way, we must understand that technology has altered the way entertainment is consumed and that all-you-can-enjoy subscription services appeal to millions of consumers. We therefore encourage all artists and rights holders to embrace this fact and use their understanding of how these services are structured to gain the most financially.