Reviewing the streaming market as we head into 2017

We all know that the story of recorded music over the last fifteen years has been the shift from CD to download to streams, so from physical to digital, and from a sales model to a subscription model.

With recent financial reports from most music companies and trade bodies dominated by the continued boom in streaming income, it's easy to think that we are now in the final chapter of that story, where the streaming business comes of age and takes the record industry back into long-term growth.

Though it may well be that we are, in fact, only half way through the digital music story.

SPOTIFY AND APPLE MUSIC

From a European perspective, it feels like there are basically two primary paid-for digital music services as we move into 2017, and that is Spotify and Apple Music.

Deezer is still a player in some countries, especially France; Tidal continues to enjoy plenty of hype; and the long-standing Napster is still ticking away in the background; but, across Europe, Spotify and the Apple streaming service are by far the best performers, in terms of both users and revenue.

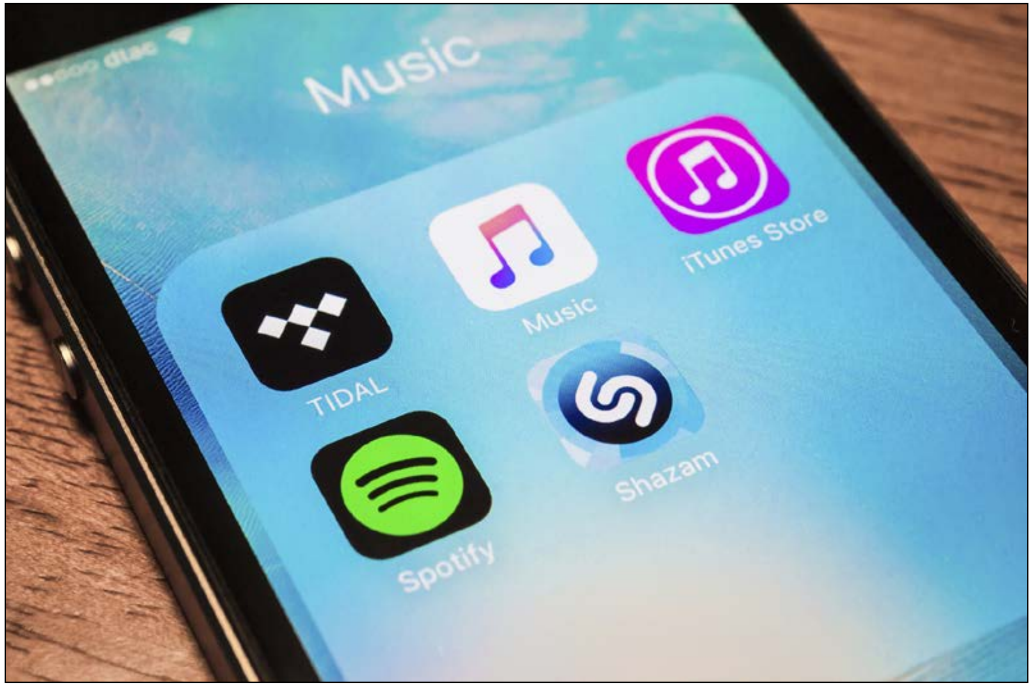
Which isn't to say downloads are dead yet. Download income has been in decline for a few years now – a trend that motivated Apple's own shift from downloads to streams of course – and while in 2015, overall, downloads and streams were bringing in similar levels of revenue, 2016 was the year where the latter started out-performing the former.

Though, as with CD sales, that decline may as yet slow down, meaning both Apple and Amazon – and some genre-specific platforms like Beatport – will likely continue to sell downloads for a while yet. Though Apple may as yet tire of the model before the market actually does.

But all the growth – and the boost that has meant global revenues for the recorded music market are now properly growing again after a decade and half of decline – is coming from streaming, by which we mean paid-for streaming. Most of that boost is coming from Spotify and Apple Music, the last official premium subscriber figures for which were 40 and 17 million respectively, though both have been adding significant numbers of new customers each month.

The fact that both Spotify and Apple Music have continued to see pretty rapid subscriber growth in 2016 – and that the launch of the latter last year didn't result in any dent on the former's growth – has resulted in a renewed optimism in the record industry.

The hope is that both services will continue to grow at the current rate for the foreseeable future, keeping ahead of continued declines in CD and download sales, so that – when physical product and MP3s become basically niche products on a global basis – the recorded music market will be still able to sustain recent and imminent growth.



Though, despite the recent and ongoing expansion of the streaming market – and Spotify and Apple Music in particular – there is still room for pessimists in the music industry. The main reason for pessimism is that pretty much all of the streaming services are currently loss-making, and that is simply unsustainable. Smaller players are going to find it increasingly difficult to raise finance to subsidise those losses now that Spotify and Apple have secured such significant market share. Meanwhile both of those services will need to go into profit at some point in the relatively near future.

Although an aggressive growth strategy is partly behind the losses made by an industry-leader like Spotify – and that growth strategy coupled with preparations for the inevitable initial public offering has seen headcount rise considerably – a key reason why even Spotify is still haemorrhaging cash, despite its impressive sign-up rate, is its deals with the music industry.

Although the core deal done between music rights owners and streaming services is a revenue share arrangement that allows a Spotify to keep up to 30% of its income, most deals also include minimum guaranteed payments for the rights owners, which is why streaming firm's are handing over way more than 70% of their revenue to the labels, publishers and collecting societies.

Which in turn means that the impressively increasing 'subscription streaming' line in most record companies' accounts are in part subsidised by the loss-leading streaming services.

The hope is that each service will eventually reach a scale where revenue share payments out-perform the minimum guarantees, so eventually the platforms will have 30% of their revenue to play with each month. As it currently stands, it seems likely only Spotify and Apple can reach that scale, though they too could well need to cut the guarantees from their deals before that happens. Which means you could see a period where Spotify and Apple Music's user numbers continue to speed up at current levels, but the accompanying revenues at the labels and publishers do not rise so rapidly.

PANDORA AND IHEART

In the US, while Spotify and Apple Music have had some successes, no conversation about digital music can ignore Pandora and iHeart which, while not currently direct competitors of the platforms that dominate in Europe, are huge in terms of user numbers. Between them, Pandora and iHeart Radio have more users in the US than Spotify and Apple Music have worldwide. That's how big they are.

To date both Pandora and iHeart Radio have provided a personalised radio service, where users get a personalised stream of music based on their listening tastes, and what tracks they have liked and skipped in the past, but a subscriber can't go in and demand to listen to any one track or album at any one time.

The reason this kind of streaming service is so big in the US, but has never really taken off on a large scale in Europe, is down to licensing.

A basic personalised radio service is covered by a compulsory licence on the recordings side in America, meaning platforms can operate under a SoundExchange licence at industry-wide rates, rather than having to negotiate bespoke deals with the record companies.

Pandora was very early to market, simply because it didn't need to get buy-in from the labels, while iHeart caught up fast because it was an invention of the American radio giant formerly called Clear Channel, and the media firm plugged its online service relentlessly on air. Though, despite their massive scale in terms of users, neither services are profitable. iHeart has only had an ad-funded free option until now, while the vast majority of Pandora's users have always opted for its free version rather than paying $5 a month to get rid of the ads.

With both services needing to increase their revenues, both are now going full-on into subscription streaming. And they are doing it in a pretty similar way, offering an ad-free enhanced personalised radio service for $5 a month and a straight Spotify competitor with fully on-demand functionality for $10 a month. Pandora already offered the former, but has revamped and rebranded it, and is now shouting about its paid-for options much more proactively.

Fully on-demand streaming is not covered by the SoundExchange licence, so both Pandora and iHeart have had to do direct deals with all the labels in order to offer to the soon-to-launch full-functionality option.

Those deals are always costly for the service providers, though on the up side it means neither company is now reliant on a compulsory licence that is only available in the US, meaning global expansion is now an option (both were actually already in Australia and New Zealand, but no further). Pandora in particular is likely to seek that global expansion in the near future.

There is another element of both Pandora and iHeart that is interesting.

KEY STREAMING SERVICES (especially in European and Anglo-American markets)

In the case of Pandora, what's interesting is its move into ticketing. Whereas other streaming services have mainly seen the plugging and upselling of other music products, like tickets and t-shirts, as an added value service to offer to artists, especially when said artists are moaning about streaming royalties, for Pandora ticket selling is now part of its business, opening up a third revenue stream beyond ad sales and subscriptions.

Ticketing is a tricky market to break into – even when, as Pandora did, you acquire an existing player like Ticketfly – though it means that Pandora is the first streaming firm to basically admit that long-term sustainability means finding other ways to make money out of your audience, data and direct-to-consumer channels.

What's interesting about iHeart is the integration of the streaming service with the firm's AM/FM radio stations, which the company was keen to stress made its expanded streaming platform – despite it being something of a replica of Pandora's expanded offer – totally unique.

The radio industry is yet to really feel the heat of the streaming services as competitors, except in the youth market, though traditional AM/FM stations will increasingly find themselves colliding with the Spotifys of this world in the coming years.

While in the UK you will find Global Radio dabbling on the sidelines in creating streaming apps alongside its Capital brands, iHeart is really the only radio company in the world to seek to future-proof itself by fully embracing streaming in a big way. It will be interesting to see how its bid to make streams profitable works out.

AMAZON

Perhaps the most interesting developments in streaming in 2016 have come from Amazon, which started the year bundling a couple of million streaming tracks in with its Amazon Prime membership scheme, but is now going head-to-head with Spotify and Apple in the streaming music space.

And Amazon, like Apple, has the benefit of a massive existing audience of music consumers. Though it is one element of Amazon Music Unlimited that will be most interesting to watch in 2017.

Much has been said in recent years about the ten dollar/euro/pound price point that has become standard in the premium streaming space. The general consensus is that for mainstream consumers £120 a year is simply too expensive for a service that only offers recorded music, and even if Spotify and Apple can find enough subscribers willing to spend that sum in order to become viable businesses in themselves, the music industry at large needs to hook in a much bigger audience. Which means you need mid-price options.

Various discount schemes and bundling arrangements with mobile firms mean that plenty of subscribers to $10 a month services are actually already getting a better deal than that, but is there a consumer-facing $4 a month service that could pull in a whole new audience to paid-for streaming?

And if so, what does that service look like, given that you don't want to lose existing $10 a month subscribers, but the mid-price option is going have to be better than any free streaming set-up that is out there?

Pandora and iHeart are playing in this space too, of course, with their enhanced personalised radio option for $5, though Pandora hasn't had huge success with that in the past.

Amazon's $4 a month service is locked to its proprietary Echo wireless speaker device, so what users lose with the cheaper price point is portability. The hope is that there is a consumer base who will pay to stream music on-demand at home, but who are quite happy with traditional radio in the car and MP3s on their phone.

Previous attempts to offer cheaper subscriptions locked to non-portable devices – including by Spotify – failed, but this one could just work, especially given the popularity of the Echo device. And through it, Amazon could become the third key player in subscription streams.

YOUTUBE AND SOUNDCLOUD

But what about free fully on-demand streaming? It's no secret that in terms of user numbers, the free services totally out-perform premium, but it terms of revenue, it's the paid-for services that are fuelling the aforementioned boom.

It's impossible to talk about free streams without talking about YouTube and, of course, the main story there this year has been the music industry's efforts to rewrite copyright law to stop the Google site from operating an opt-out streaming service, while getting big name (mainly heritage) music stars to lay into the video platform and the royalties it pays the music community. For its part, YouTube has put more effort into countering its musical critics this year.

The real problem with YouTube, from a music industry perspective, is that it won't pay

OTHER SERVICES (including key services in some Asian markets) the aforementioned minimum guarantees. Therefore from a revenue perspective, the continued boom in people streaming music on YouTube is irrelevant, what matters is the site's ad sales, which have been pretty flat of late. If the music industry gets copyright law re-written, YouTube could possibly be forced into paying minimum guarantees, which would force it to sell more ads, or limit the amount of music users both upload and play.

Though none of that is assured, even if the music industry's lobbyists do score some copyright law successes in Europe.

And anyway, the real issue goes beyond YouTube: what does the music industry do about the sizeable slice of consumers (very possibly the majority of consumers) who will never pay to stream music?

Does it try to cut them off, and risk driving them back to piracy? Does it try to limit the functionality of free streams, not so much that it drives the majority of users to illegal sites, but enough that it makes paid-for streaming more attractive? Does it try to sell more ads, or persuade advertisers to learn how to make five second commercials to reduce the number of ad skips? Does it try to persuade the likes of Google that they should take a hit because of the value of the data free streams provide?

Or, once the industry at large has signed up enough premium subscribers, does it just accept that a majority of consumers will get free music via services that pay nominal royalties, while a minority of premium consumers pay far more than their fair share into the music industry?

Of course it's not only YouTube trying to get the industry to embrace ad-funded. Having finally secured its licences, SoundCloud now has to make a go of its ad-sales business (unless you believe paid-for SoundCloud Go has any chance of succeeding – and few do). Guvera has made much of the potential its ad-funded business in certain Asian markets, though in 2016 all the talk there was about its failed IPO and much predicted demise. Meanwhile Spotify continues to have to defend its freemium-sells-premium approach.

The music industry is likely to continue giving the free-streamers a hard time in 2017, though at some point there'll have to be a serious debate about what free streaming will look like in five years time.

KKBOX, QQ MUSIC, LINE MUSIC ET AL

And finally, let's recognise that this overview has been pretty Europe and North American-centric. In some Asian and other emerging markets other services have actually gained the most traction, like Taiwan's KKBox, China's QQ Music and Japan's Line Music.

All of these platforms provide interesting case studies for alternative approaches to streaming, though it's true at least some benefit from the better deals that can be struck with rights owners when streams are being delivered in emerging markets where Western music companies rarely saw any income in the CD or download eras. But these are all services to watch, and CMU Trends will return to them next year.

CONCLUSION

So, as we head into 2017 the streaming music market still faces most of the challenges we discussed a year ago. Though with streaming fast becoming the record industry's single biggest revenue stream, the stakes are ever higher for record companies and recording artists if these challenges are not met in the coming years. Mid-price and workable free streaming will be key as the market really does come of age ■