

How Spotify Makes Money

Idea In Short

Spotify Technology S.A. runs on a simple bet: give music away for free, then convert enough of that audience into paying subscribers to fund the royalties owed to artists and labels. The bet has paid off. Spotify crossed 761 million monthly active users and 293 million premium subscribers in the first quarter of 2026 and posted an operating margin above 15%, up sharply from a year earlier. Premium subscriptions supply the large majority of revenue, ad-supported listening converts free users and keeps them engaged and royalty payments consume close to 70% of what comes in, a fixed obligation that scales with usage rather than shrinking as the company grows. Rivals like Apple Music and YouTube Music bundle audio into hardware and video subscriptions many users already own, pushing Spotify to widen its catalog into podcasts, audiobooks and video to defend its lead.

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From piracy problem to platform

Daniel Ek and Martin Lorentzon founded Spotify in Stockholm in April 2006, betting that a legal music service simple enough to beat piracy on convenience could win back an audience Napster and similar sites had trained to expect music for free. Spotify launched by invitation in October 2008, first in Sweden, the United Kingdom and a handful of other European markets, then opened to the United States in July 2011, the market that would become its largest source of premium subscribers. The company still frames its purpose in creator terms rather than listener terms.

To unlock the potential of human creativity by giving a million creative artists the opportunity to live off their art and billions of fans the opportunity to enjoy and be inspired by it

That framing signals where Spotify has always seen its real constraint: not listener demand, which arrived quickly, but the licensing relationships it needed to build with an industry it could never simply own.

The freemium wedge

Spotify's free tier is the mechanism that built its audience past 760 million monthly users and it works by trading a degraded experience for zero cost rather than offering nothing at all. Free listeners get the full catalog but face ad interruptions, shuffle-only playback on mobile and no offline downloads, enough friction to make premium worth considering without driving people away entirely. Spotify added roughly 10 million monthly active users and 3 million premium subscribers in the first quarter of 2026 alone, reaching 761 million total users and 293 million paying subscribers.¹ The free tier does double duty as a sales channel, since every free listener is both a prospective advertiser impression and a prospective premium upgrade.

Premium conversion economics

Once a listener decides to pay, Spotify offers several entry points rather than one price: individual, duo, family and student plans, each matched to a different household budget and a different reason to upgrade. Premium subscribers get an ad-free catalog, offline downloads and unlimited on-demand playback across devices, removing the specific frustrations the free tier was designed to create. This tiering pushed premium revenue to €4.15 billion in the first quarter of 2026, up 10% year over year, even after price increases in the U.S. market.² Subscription revenue now supplies the large majority of what Spotify earns, which is why retention has become a more important lever than acquisition.

The royalty burden

Spotify does not own the music it streams, so nearly every dollar of subscription and ad revenue passes back out to record labels, publishers and collecting societies under licensing agreements the company does not fully control. Spotify has said it returns close to 70% of revenue to the music industry, a payout structure that scales automatically with usage and leaves less room to expand margin through price alone.³ The industry moved to a revised royalty model in 2024 that requires a minimum stream threshold before a track earns anything, a change meant to redirect payouts away from noise and toward artists who

draw genuine listening. For Spotify, the royalty line functions less as a cost it manages and more as a pass-through, which is why recent profit gains have come mostly from cutting other expenses rather than renegotiating what it pays creators.

Advertising as the second engine

Ad-supported listening is Spotify's smaller revenue stream, but it plays a role premium cannot: it monetizes the roughly 468 million users who have not converted to a paid plan. Advertisers buy access through Spotify's self-serve ad studio, which lets a brand target listeners by demographics, listening habits and device type, with campaigns startable on a budget as small as a few hundred dollars. Ad-supported revenue is more volatile than subscription revenue; it fell 5% year over year in the first quarter of 2026 even as premium grew, reflecting how sensitive advertising spend is to broader economic conditions.

The free tier is not a loss leader. It is the factory that manufactures both advertising inventory and future subscribers

That volatility is part of why Spotify keeps pushing free listeners toward premium rather than leaning harder into advertising as a growth strategy.

Podcasts, audiobooks and video

Music alone caps how much Spotify can raise prices before subscribers churn to a rival, so the company has spent several years adding formats bundled into the same subscription. Audiobooks became part of Premium in most markets in 2023 and have since grown listening hours by more than a third year over year, giving subscribers a reason to stay even as music pricing rises.⁴ Video podcasts followed similar logic: the number of creators publishing video monthly on Spotify grew more than 50% year over year and the company has begun testing full-length music videos, a direct challenge to YouTube. Each new format raises the cost of switching to a rival that streams music alone, which is the point.

Competitive pressure from bundlers

Spotify's biggest rivals do not need music to make money on their own, which changes the economics of competing with them. Apple Music ships preinstalled on every iPhone and YouTube Music comes bundled with YouTube Premium, Google's fastest-growing consumer subscription, letting both rivals treat music as a retention feature rather than a standalone product they must price to survive.⁵ Spotify's response has leaned on artificial intelligence, including a ChatGPT integration and AI-generated Prompted Playlists, to keep its recommendation engine ahead of catalogs that are otherwise nearly identical across platforms. Scale still favors Spotify: its subscriber base remains more than double Apple Music's roughly 108 million paying users, which keeps its negotiating position stronger with both advertisers and rights holders.

Scaling toward profitability

For most of its public history, Spotify grew revenue while barely breaking even, spending heavily on marketing and content deals to defend its lead in a business with thin structural margins. That changed through 2025, when the company posted an annual operating profit of roughly \$2.5 billion and carried the momentum into 2026 with a first-quarter operating margin above 15%, up sharply from a year earlier.⁶ The turn came less from a change to the freemium model itself than from cost discipline: Spotify trimmed headcount, tightened marketing spend and let its scale advantages in podcasting and advertising compound. Whether that margin trajectory holds depends on how much pricing room remains once video, audiobooks and AI features are counted as part of what a subscription buys.

Key Partners

Record labels, music publishers and collecting societies supply the licensing rights Spotify needs to host any content at all, making Universal Music Group, Warner Music Group and Sony Music Entertainment central to the catalog. Independent artists and podcast creators fill out the long tail of content that keeps the platform differentiated from competitors with narrower libraries. Ad-measurement partners such as Nielsen verify campaign performance for advertisers who buy inventory on the platform. Investors and lenders have also supplied the capital needed to fund years of licensing costs before the business turned reliably profitable.

Key Activities

Negotiating and renewing licensing agreements with rights holders sits at the center of Spotify's operations, since the entire catalog depends on those contracts staying current. Building and maintaining the recommendation algorithm that personalizes playlists and discovery features is a continuous engineering effort rather than a one-time build. Selling and serving advertising to free-tier listeners runs alongside subscription billing as a second operating track. Expanding into audiobooks, video podcasts and creator tools rounds out the activities that keep subscriptions worth renewing.

Key Resources

The licensed music, podcast and audiobook catalog is Spotify's core resource, since none of the business functions without content rights secured in advance. The recommendation algorithm and the listening data that trains it give Spotify a personalization advantage competitors struggle to match. The Spotify brand and its installed base of 761 million monthly users function as a resource in their own right, attracting both creators and advertisers. A global workforce of roughly 7,300 employees builds and operates the software, content and advertising systems that run the platform.

Value Propositions

For listeners, Spotify offers a vast catalog, personalized discovery and a choice between free access and an ad-free premium tier priced for different household budgets. For artists and podcasters, Spotify offers distribution to a global audience, streaming royalties and analytics tools that show who is listening and where. For advertisers, Spotify offers targeted access to listeners who spend hours engaged with audio content daily, through a self-serve studio that works on modest budgets. Each value proposition depends on the other two functioning well, since content draws listeners and listeners draw advertisers.

Customer Relationships

Spotify manages most listener relationships through self-service tools rather than direct support, letting users manage subscriptions, playlists and preferences without human intervention. Personalized playlists such as Discover Weekly and Wrapped, its annual listening recap, keep users engaged and give the relationship a recurring emotional touchpoint. Artists and podcasters get a dedicated relationship through Spotify for Artists, which provides analytics and promotional tools. Advertisers work with account teams and

self-serve dashboards depending on campaign size.

Channels

The Spotify mobile app is the primary channel through which most listening happens, supported by desktop and web players that extend access to every major device. Smart speakers, connected cars and gaming consoles have become secondary channels as Spotify has pushed to be available wherever audio gets consumed. Spotify for Artists and Spotify for Podcasters serve as dedicated channels for creators to upload content and track performance. The Spotify Ad Studio functions as the primary channel through which advertisers plan and launch campaigns.

Customer Segments

Free listeners make up the largest segment by count, using an ad-supported tier that Spotify treats as both a retention pool and a conversion funnel. Premium subscribers, at 293 million as of the first quarter of 2026, generate the majority of revenue through individual, duo, family and student plans. Artists, labels and podcast creators depend on Spotify for distribution and royalty income, making them a segment Spotify must serve well to keep supplying content. Advertisers form a fourth segment, paying to reach the free-tier audience Spotify has built.

Cost Structure

Royalty and licensing payments to rights holders make up the largest cost by far, consuming close to 70% of revenue under agreements with labels, publishers and collecting societies. Research and development spending funds the recommendation algorithm, app infrastructure and new formats like audiobooks and video. Sales, marketing and employee costs, including salaries for a workforce of roughly 7,300, make up most of the remaining structure. Server and content delivery infrastructure adds a smaller but steady operating cost as usage scales globally.

Revenue Streams

Premium subscriptions generate the large majority of revenue, reaching €4.15 billion in the first quarter of 2026 across individual, duo, family and student plans. Ad-supported

revenue, smaller and more volatile, comes from brands paying to reach free-tier listeners through Spotify's ad studio. Both streams depend on the same underlying asset, a large and engaged listener base, monetized through two different mechanisms depending on whether a user pays directly or attention gets sold to an advertiser instead.

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Summary

Spotify's business model works because the free tier and the paid tier reinforce each other rather than compete. Free listening builds the audience advertisers pay to reach and creates the pool premium conversions come from; premium subscriptions then fund the licensing deals that keep the catalog competitive. The model's biggest constraint remains royalties, which still claim roughly seventy cents of every revenue dollar, so profit has grown mainly through scale and price increases rather than margin expansion on any single stream. Bundled rivals test that scale advantage by attaching music to hardware and video subscriptions many users already own. Spotify's answer has been to widen what a subscription includes, layering audiobooks, video podcasts and AI-driven personalization onto the core catalog so that leaving the platform costs a user more than staying.