

Pandora radio: fire
unprofitable
customers?



**ASSIGN
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Their Business Model: Value Proposition: Pandora's Music Genome

Project offers a unique value proposition in that it provides users with their preferred genre of music based on a single input. They have a large collection of songs in their database categorized into 65 million stations. Users are able to pick multiple genres or create 'listening stations' based on musical style, artist, song or composer. This 'hands-free' or minimal-interaction listening service was an innovative idea and offered a distinctive listening experience to the user—a service provided by none other.

Revenue Model

- **Subscription Based:** Pandora's initial strategy was to create a revenue stream by offering 10 free listening hours followed by a monthly fee of \$3. Unfortunately, customers stopped using their service once the 10 hours were depleted. As a result, they decided to waive any subscription fees and stream unlimited music and hours for free. This significantly increased their royalty fees and could not be sustained as a go forward strategy. Eventually, Pandora had no choice but to reintroduce a subscription model and cap free listening hours at 40 per month, and request 'a buck for the tip jar' for the remaining days in the month.
- **Advertisement Based:** One of the key elements to Pandora's advertising strategy is that they have the ability to leverage their user database with demographic and geographic information that would

allow advertisers to stream custom advertisements to their audience.

Pandora was able to provide precision targeting to its advertisers because they tracked customer profile information and listening preferences. Advertisers are able to not only target their advertisements, but also track their effectiveness real time.

- **Affiliate Fees:** Pandora's affiliate fees are generated through customer purchases on online partner stores. Unfortunately, this is minimal and does not contribute much to Pandora's revenue stream as consumers are less likely to purchase a song they like. **Customer Acquisition and Retention** Due to the popularity of the service, Pandora's customer base is growing at a significant rate. They have 16 million registered users, and are adding to that user base at a rapid rate. Customers are acquired via word of mouth and are a loyal to the service primarily because of free listening.

In addition to free streaming, Pandora does an excellent job to enhance their customer experience by attending Town Halls and responding to all emails etc. It was because of this passionate customer base, Pandora was able to leverage their effort to lobby against high royalty fees that were being incurred. The net result is tremendous growth with no direct marketing costs. No doubt it was the enthusiasm of their customers that resulted in the viral spread of their popularity but it was these ' power users' that were also the most expensive for the company.

Any effort to reduce cost of licensing would have to be done without negatively impacting the ' power users' who formed the backbone of the viral marketing effort. **Competitive Strategy** Pandora faces competition from

both traditional radio and other online services, such as iTunes, Spotify, MOG, and Rhapsody. Pandora founder Tim Westergren recently stated that he does not see iTunes (AAPL) or Spotify as competitors to Pandora, for they are both subscription services (for the record, iTunes is not a subscription service, but that is how Westergren worded it). In fact, many Pandora users hear a song on the service and go to iTunes to buy it.

There is no reason that Pandora and these other services cannot live side by side. While Pandora may face competition from other providers, they have the advantage of owning a large and continually growing fan base that because of the customer experience they provide. Their music collection continues to multiply, while new songs and upcoming artists are added each day, giving users a continuously evolving musical experience. Consumers typically rely on traditional radio or word-of-mouth to discover new music. Traditional radio is filled with commercials, and disrupts the listening experience.

Unlike pick-to-play services like iTunes and Rhapsody mentioned above, Pandora fills a niche because it offers new listening choices coupled with fewer commercials per hour. This listening package combined with its library of codified music is Pandora's strength and creates a barrier for entry into this market. Despite the competitive landscape Pandora enjoys, they need to generate a revenue stream that goes beyond the listeners. In a world where 'free' reigns, a customer is not going to be eager to pay for a service when an alternate, but less desirable option, is available.