

Economic Consequences of Hostile Takeovers in the South Korean Entertainment Industry: A Case Study of Kakao's Acquisition of SM Entertainment

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Abstract. This paper investigates the hostile takeover of SM Entertainment by Kakao, a landmark case in South Korea's entertainment industry. It explores how weak internal governance, founder override, and capital-driven strategies contributed to the takeover. The study examines the motivations behind the acquisition and illustrates the impacts of the takeover at the corporate level, market level, and institutional and legal levels. Data from company reports and media sources reveal that SM's internal governance deficiencies and Lee Soo-man's shadow control made it vulnerable to acquisition. While the merger enabled Kakao to expand its digital content ecosystem and strengthen its foothold in the entertainment market, both companies experienced short-term financial setbacks and reputation risks, exacerbated by legal investigations into alleged stock manipulation. This case underscores the need for stronger corporate governance frameworks and regulatory deterrence in creative industries. It contributes to the broader discourse on the economic, organizational, and institutional consequences of hostile takeovers in highly capitalized cultural sectors.

Keywords: Hostile Takeover, Corporate Governance, Mergers and Acquisitions, K-pop Industry

1. Introduction

In recent years, the K-pop industry has experienced rapid capital expansion. The Korean entertainment industry is experiencing rapid growth and is gradually establishing itself as a significant player in the global cultural market. Entertainment companies are increasingly becoming targets of strategic investments and acquisitions. This trend of capitalization has intensified ownership battles, particularly among firms with high brand value and global influence. SM Entertainment, one of the "Big Three" entertainment companies in the K-pop industry, became a focal point of such tensions due to long-term governance weaknesses. Despite stepping down from executive roles, founder Lee Soo-man maintained control through a private outsourcing firm, triggering conflicts with SM's board and shareholders. These structural problems eventually led to a fierce takeover battle between HYBE and Kakao in 2023. Kakao's acquisition of SM marked a landmark case in Korea's entertainment sector, highlighting the significance of risks of founder

override and the strategic value in Mergers and Acquisitions decisions. This case provides critical insight into the intersection of corporate governance, market consolidation, and the evolving dynamics of the K-pop industry under capital-driven forces.

In corporate development, there are increasing cases where major shareholders exert control through shadow mechanisms. Such behavior influences and manipulates the company via indirect mechanisms, thereby giving rise to a series of problems, such as the vulnerability of corporate governance [1]. Meanwhile, companies with weak corporate governance usually send negative signals to the market, thus making them targets of hostile takeovers [2]. To prevent hostile takeovers, companies need more sound corporate governance, more independent boards of directors, and supervision. Meanwhile, identifying and preventing hostile takeover motives is also crucial. Legal sanctions will also be imposed against improper behaviors such as malicious manipulation of stock prices [3]. Although previous literature has extensively discussed the status of founders and the independence of the board of directors, few studies have explored how hostile takeovers in the entertainment industry affect brand recognition and artistic autonomy.

Against the above background, this article describes the representative case of Kakao's acquisition of SM Entertainment, and explores how internal governance deficiencies of enterprises, founder control, and joint action on the motives for hostile takeovers in the entertainment industry. Through the analysis of acquisition motivations, legal disputes, and consequences of mergers and acquisitions, this paper aims to comprehensively understand the operational mechanism of cultural industry integration driven by capital. Specifically, this article will analyze how SM's weak governance structure has triggered a struggle for control, study the profound impact of this acquisition at the regulatory level and in the market structure, and put forward targeted governance improvement suggestions to prevent the recurrence of similar conflicts.

2. Case overview: Kakao's acquisition of SM entertainment

2.1. Case background

Lee Soo-man was originally a popular singer in South Korea during the 1970s; later, he graduated with a degree in computer engineering from California State University. After returning to South Korea, he established SM Studio in 1989, which later evolved into SM Entertainment. He introduced a systematic idol training and production model inspired by American pop culture, setting the foundation for the future K-pop industry. Initially, Lee was appointed as CEO. Even though he gradually stepped back from daily management, he still retained significant influence through his large shareholding and control over the music production. In the early 2000s, he began outsourcing production responsibilities to his privately owned company, Like Planning, which signed exclusive contracts with SM Entertainment. Although he no longer held an executive position, this arrangement allowed him to maintain strategic control over SM's creative direction and operations. His formal role within the company diminished, but he remained a central figure through indirect decision-making mechanisms, sustaining a lasting influence on SM's structure and business practices for over two decades [4].

Kakao is a South Korean technology and internet company founded in 2010, headquartered in Jeju. It began with its flagship mobile messenger, KakaoTalk. And it holds over 90% market share in South Korea. Over time, Kakao expanded into various industries, including financial technology (Kakao Pay, Kakao Bank), entertainment (Kakao Entertainment), and gaming (Kakao Games), forming a comprehensive digital ecosystem. Through strategic acquisitions and investments, Kakao has become a major player in Korea's digital content and media industries [5].

HYBE Corporation, formerly known as Big Hit Entertainment, is a South Korean entertainment company founded by Bang Si-hyuk in 2005. HYBE is renowned for nurturing the international artist group BTS and earning the initial funds. Subsequently, through strategic expansions and acquisitions such as the acquisition of Source Music, Pledis Entertainment, and Ithaca Holdings, it has developed into a global multi-brand company. Its business covers music production, artist management, fan platforms (Weverse), and IP merchandising. In 2021, the company changed its name to HYBE and is headquartered in Seoul. HYBE aims to lead the global entertainment market through a synergy of technology, content, and artist-driven business models.

2.2. The acquisition battle

The competitive takeover battle process began with SM's management and their rising tensions with its founder, Lee Soo-man. Management announced a strategic partnership with Kakao in February 2023, granting Kakao a 9.05% stake through newly issued shares and convertible bonds. This move was strongly opposed by Lee, who thought the issuance was illegal and sought an injunction to block the deal. In response, Lee sold his 14.8% stake to HYBE, making HYBE the largest shareholder and offering to acquire an additional 25.2% of shares to gain control of SM. However, SM's management resisted HYBE's acquisition; they favored Kakao's more decentralized and supportive governance model.

In March 2023, the Seoul Central District Court temporarily halted the issuance of new shares to Kakao. Instead, Kakao launched a public tender offer with a higher per-share price (150,000 KRW) compared to HYBE's (120,000 KRW), eventually acquiring 35% of SM's shares. HYBE withdrew from the takeover on March 12 to avoid facing strong market resistance and increasing costs. By the end of March, Kakao had secured a controlling 39.87% stake in SM Entertainment and restructured its board of directors, marking the end of Lee Soo-man's direct influence and the beginning of SM's integration into Kakao's broader content ecosystem.

2.3. Drivers behind Kakao's hostile takeover

The strategic value of SM is one of the factors that led to its being subject to a hostile takeover. The acquiring party will attach great importance to the strategic assets and restructuring potential of the enterprise [6]. Before the acquisition of SM, Kakao already owned a smaller K-pop organization, Starship Entertainment. SM, founded by Lee Soo-man in 1995, is a pioneer of K-pop. Over the accumulation and sedimentation of time, SM has developed its own complete system for nurturing and developing artists. And in terms of market capitalization, SM is the second largest entertainment group in South Korea, with a market capitalization of 2.8 billion US dollars, second only to HYBE, which is valued at 5.5 billion US dollars [7]. So this is the main reason that the acquisition of SM is an important goal for Kakao to enter the entertainment industry.

Weak internal governance and concentrated founder control were two key drivers that made SM Entertainment a prime target for a hostile takeover. Enterprises' internal governance is the strongest shield against hostile takeovers. The weakness of internal governance not only weakens governance efficiency but also sends passive signals in the capital market [8]. It is identified by the external market as a target of "ground defense", attracting ambitious investors and making it a target of hostile takeovers. When there is a lack of effective internal supervision, the last line of defense will also be breached. Governance deficiencies are the core starting point of hostile takeovers. The more concentrated the power is, the lower the quality of the company's governance system and the board structure will be [9]. SM Entertainment is a typical example. In its early days, its internal

governance was highly dependent on its founder, Lee Soo-man. Later, after Lee Soo-man introduced surface control and implemented “shadow control” through Like Planning, it intensified shareholders’ dissatisfaction, triggered a split between the board of directors and him, and eventually led HYBE and Kakao to successively launch acquisition battles. Ultimately, SM’s weak internal governance and founder-dominated structure made it vulnerable to acquisition by ambitious market players like Kakao and HYBE.

3. Economic consequences of the acquisition

3.1. Corporate level impacts

This article discusses the comprehensive impact on the company level after the acquisition from aspects such as strategic layout adjustment, financial performance changes, and profitability changes. Firstly, Post-Acquisition Development Strategies. After completing the acquisition of SM, Kakao and SM established a joint venture in North America, integrating the global network resources of both sides. SM also launched many overseas activities later on, further expanding its global market. SM also launched the “SM 3.0” strategy after this, establishing diversified production centers and label systems to enhance its competitiveness in the entertainment industry.

Secondly, Financial Performance Comparison: SM vs. Kakao. Following Kakao’s acquisition of SM, the integration challenges and strategic reorganization have greatly affected the financial performance of the two companies. SM achieved strong sales in 2023, including record-breaking album and concert revenues, but its net profit declined in 2024 due to rising production and expansion expenses. Due to significant investment in SM and internal governance turmoil, Kakao has suffered consecutive net losses. The integration process led to changes in leadership, the expansion of overseas activities, and the development of new platforms, all of which generated significant costs and delayed returns. Coupled with the downward of the digital advertising market, this acquisition did not bring additional objective profits to the two companies in the short term. But it also reflects the ambition for long-term growth.

In order to analyze the situation before and after the merger and acquisition, this paper compares the ROA and ROE performances of Kakao and SM in the first and second quarters of 2023. Based on the analysis of Kakao and SM’s financial report data, it can be concluded that SM’s ROA rose from 1.49% to 1.84%, and its ROE rose from 2.53% to 3.11%, indicating improved profitability post-acquisition. In contrast, Kakao’s ROA dropped from 0.24% before the acquisition to 0.21%, and its ROE also decreased from 0.44% to 0.38%, indicating that Kakao’s short-term profits were affected by the acquisition. As can be seen in Table 1, SM’s debt-to-asset ratio rose from 39.4% in 2022 to 40.9% in 2023, while Kakao’s increased from 41.4% to 44.4%. This indicates that both companies have taken on higher leverage risks during the merger and acquisition process.

Table 1. Part of Kakao and SM's financial statements

Kakao Financials		
Item (bn KR)	2022	2023
Total Asset	22978	25582
Total Liability	9520	11356
Total Equity	13457	14426
Debt to Asset	41.43%	44.39%
SM Financials		
Item (bn KR)	2022	2023
Total Asset	1462	1541
Total Liability	577	632
Total Equity	886	909
Debt to Asset	39.43%	40.99%

3.2. Market level impacts

After Kakao acquired SM, it gained certain market advantages and also expanded its share in the entertainment market. A new competitive landscape and global development trend have emerged in the K-pop market. Firstly, the acquisition impacted these corporations' financial positions. On March 7, 2023, Kakao officially proposed to publicly acquire SM's shares at a price of 150,000 won per share, causing SM's stock price to rise by more than 15% on the same day. Investors had positive expectations for the prospects of the merger and acquisition, and the stock price once reached as high as 149,000 won [7]. However, at the end of December 2023, South Korean prosecutors announced that the founder of Kakao was suspected of maliciously manipulating stock prices and was arrested after an investigation was launched. After this news was disclosed, the share prices of both Kakao and SM dropped sharply. This indicates that the vulnerability of enterprise risk management can greatly undermine investors' information. This series of events indicates that hostile takeovers not only have an impact on the corporate brand governance structure but also trigger quantifiable reactions in the capital market.

Secondly, the acquisition impacted their reputation. As a pioneer of K-pop culture, SM's production level and aesthetic sense remain first-class, and its artists also have a stable fan base and are still recognized. However, after losing independent governance, SM was gradually regarded as a subsidiary of Kakao, and its image as an innovation pioneer was shaken, which was met with dissatisfaction from some shareholders and fans. After acquiring SM, Kakao became one of the corporate representatives of content integration platforms, further expanding its business blueprint and significantly increasing its usage in South Korea. However, due to its hostile acquisition of SM and the arrest of its founder for suspected stock price manipulation during the acquisition process, Kakao has also faced criticism, including "excessive concentration of power" and "aggressive capital behavior".

3.3. Institutional and legal implications

Firstly, the arrest of Kakao's founder. In July 2024, South Korean prosecutors arrested Kim Beom-soo, the founder of Kakao, on suspicion of manipulating stock prices and violating capital market

regulations. The prosecution accused Kim and Kakao's internal executives of engaging in improper market interference during the acquisition process. They deliberately drove up SM's stock price by purchasing a large number of stocks and exerting public opinion pressure, thereby suppressing HYBE's bidding intentions.

Secondly, strengthening of regulatory oversight in South Korea. To prevent conflicts of interest and ensure information transparency, the Financial Services Commission revised the enforcement order of the Financial Investment Services and Capital Markets Act. They required listed companies to disclose the board's written statement during mergers and acquisitions, including the purpose, expected impact, and rationale of the acquisition price. The rationality of the merger and acquisition price and proportion [3].

4. Implications and recommendations

4.1. Improving corporate governance

Firstly, board independence and shareholder supervision. Independent directors play a crucial role in enhancing the effectiveness and integrity of the corporate governance framework [10]. Objective supervision helps balance the interests of shareholders, management, and other stakeholders. In this way, the decision-making process can remain transparent. During the process of Kakao's acquisition of SM, the original board of SM failed to properly coordinate the conflicts between the management and the major shareholder (Lee Soo-man), resulting in opaque disclosure of the acquisition information in the early stage and causing conflicts of interest. This sent a negative signal to Kakao and led to the occurrence of the hostile takeover.

Secondly, limiting the founder's excessive control. The founder's solitary shareholding will show different control tendencies at different stages of the company's development, forming a "shadow governance" structure. The increase in the shareholding of highly concentrated founders will lead to information asymmetry, thereby infringing upon the interests of minority shareholders [11]. For many years, SM has been led by Lee Soo-man to produce contracts and collect copyright fees through the outsourcing company Like Planning, which has triggered dissatisfaction among minority shareholders and a corporate governance crisis.

4.2. Enhancing regulatory deterrence

Firstly, clearer recognition of a hostile takeover. In corporate governance practices, it is crucial to identify and prevent hostile takeovers as early as possible. The first step is to identify the characteristics of hostile takeovers. For example, the acquisition intention is without obtaining the support of the original major shareholders or management. In this regard, it is suggested that the relevant regulatory authorities set up a more precise disclosure mechanism. Secondly, the company should set up and establish a hostile takeover early warning system, combining big data to monitor the structural changes of equity in real time and identify abnormal stock price fluctuations.

Secondly, a crackdown on stock price manipulation. In an environment with strict laws and regulations, corporate governance tends to be more sound [12]. To combat and prevent the occurrence of stock price manipulation, regulatory authorities should enhance real-time monitoring of the stock price trading market, require transparent information disclosure in stock trading, and impose severe penalties on those who manipulate stock prices. In addition, coordination between financial authorities and stock exchanges should also be strengthened to prevent and investigate insider trading and collusion. Listed companies must also disclose major events in a timely manner

to reduce information asymmetry. Finally, it is necessary to do a certain amount of popular science for individual investors, further maintain market integrity, and ensure a fair and healthy investment environment.

5. Conclusion

This paper takes the case of Kakao's hostile takeover of SM Entertainment as a representative example to explore how weak internal governance, founder dominance, and capital-driven motivations jointly contribute to hostile acquisitions in the cultural industry. Through the analysis of corporate behavior, financial data, and legal developments, it is found that SM's founder-centered structure and lack of board independence significantly weakened the company's defense against external takeovers. The acquisition, while offering strategic expansion for Kakao, also led to short-term financial losses and triggered public controversy and legal risks. This case highlights the need for stronger governance systems and early-warning mechanisms to prevent similar conflicts. Looking ahead, the dynamic between creative autonomy and capital control will remain a central issue in entertainment mergers, calling for more effective regulatory coordination and stakeholder balance in capitalized cultural sectors.

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