Brazil's airlines change formation

VARIG (Viacao Aereo Riograndese) earned US $22 million last year and even in the first quarter of this year managed to show a $2·5 million profit. Earlier this year, after six months of negotiations, the Ruben Berta Foundation, which controls 65 per cent of the Varig stock, bought out a Brazilian competitor, the financially weak Cruzeiro.

How does Varig manage to make money and have enough confidence to buy a losing operation? Success is partly attributable to the profit-sharing motive. Varig was founded as a private company in 1927, but in 1966 its president, Ruben Berta, left the airline in trust to its employees. Each of the 15,000 staff now has a share in the Ruben Berta Foundation. This employee ownership is often given credit for the quality of service on Varig flights. Profit sharing motivates air and ground staff to give a little extra touch of hospitality and service.

The personal touch seems to work. In the first eight months of this year Varig carried 1·9 million passengers; in the whole of 1974 the number was 2·6 million. More significant is the high market share on highly competitive international routes. Varig shares Brazil-US (New York, Los Angeles and Miami) routes with four airlines, and has 42 per cent of the flights, but so far this year has carried 50·7 per cent of the passengers. On the European routes the competition is even keener, with a field of 11 airlines. Varig operates 32 per cent of the flights and carries 39 per cent of the passengers. Even on the route to South Africa, which Varig shares with South African Airways, the Brazilian airline has 56·5 per cent of the passenger traffic.

Some of the credit for Varig's success goes to the Brazilian Government. Brazilians are hard bargainers and as the country's international flag carrier Varig enjoys the full support of the Government in Brasilia. Varig has 90 per cent of the international flights operated by Brazilian airlines and one-third of the domestic flights. Services within Brazil include some of the most lucrative, like the Rio-Sao Paulo air shuttle.

In fact Varig's dominating position was a major obstacle to merger negotiations. The company was accused of trying to set up a monopoly; a Varig-Cruzeiro combination would have all Brazil's international services and more than half the domestic routes.

Cruzeiro has profitable international routes to South American neighbours and a quarter of the domestic sectors. It has 14 727s and a staff of almost 5,000. It began to lose money after the fuel price rises of early 1974 and in that year the Brazilian Government made it known that it wanted one of the three other Brazilian airlines—Varig, VASP or Transbrasil—to buy or merge with Cruzeiro. All three airlines were interested.

The first to talk was Transbrasil. This comparatively small airline (formerly Sadia) has only been breaking even in the last two years, but it is owned by the powerful Sadia industrial group and its president, Omar Fontana, thought he could raise the capital needed for a merger. Talks broke down after the National Development Bank refused to guarantee 42 per cent of the sum required.

The next scheme proposed was a double merger, with Varig absorbing Transbrasil (which also had financial troubles) and VASP taking over Cruzeiro. No deal resulted because Fontana felt his financial problems were only temporary and decided not to sell. The Varig-Transbrasil deal would have been compensation for the takeover of Cruzeiro by the State-owned VASP.

Even though VASP has no profitable international routes and is burdened by some of the worst "social obligation" interior routes, the company last year reported profits of US $5 million. VASP directors felt they could easily obtain credit to buy Cruzeiro.

The plan did not pass unopposed. VASP is owned by the state of Sao Paulo and was charged with "statism"; at that time private interests were campaigning against the growing role of State ownership in Brazil. Finally, money turned out to be the decisive factor. VASP's highest offer of $7 million was outbid by Varig's $9·4 million.

The Varig-Cruzeiro combination is now by far the largest airline in Latin America and has a fleet of 63 aircraft, including four DC-10-30s. Company officials, however, will not quote the new international traffic and fleet rankings resulting from the merging companies, calling it a stock purchase rather than a merger.

Announcing the takeover, Varig president Erik de Carvalho said that of the total $9·4 million purchase cost, 70 per cent will be paid in nine instalments and the remaining 30 per cent in Varig stock. At the same time Varig took over the Cruzeiro debt, estimated at $15 million.

"It was in the social and political interest," said Carvalho, "to keep Cruzeiro as a private company and a separate juridical entity." Some commentators note that the decision to keep the two airlines separate is also aimed at cutting down the criticisms of monopoly. The airlines retain their separate identities and there are no plans for a complete merger.

Carvalho points out that there is already a tradition of co-operation between the two airlines on standardisation of fleet maintenance spares. These measures are being extended; ticketing, routes and timetables are being integrated. For administrative reasons, airline spokesmen add, it is better to keep the companies separate, eliminating massive lay-offs and mountains of paperwork.

VARIG/CRUZEIRO—COMBINED FLEET

	Varig	Cruzeiro
DC-10	4	—
707	16	—
727	9	8
737	10	6
Electra	10	—