

BOEING, BRAZILIAN FEDERAL GOVERNMENT, AND EMBRAER: GOLDEN SHARE VETO AND THE ANATOMY OF A JOINT VENTURE

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This case studied how the Brazilian jet manufacturer Embraer (*Empresa Brasileira de Aeronáutica*) negotiated a joint venture with the North American jet aircraft manufacturer Boeing Corporation, after a failed acquisition attempt. The globe's second largest industry tried to acquire Embraer to face the competition from the main competitor, Airbus SE, which acquired the C-jets operation from the Canadian Bombardier. This was a two-round negotiation. First, Boeing announced prematurely Embraer's hostile takeover for \$ 3.7 billion USD. Brazilian Federal Government used the golden share veto power and prohibited the sales operation. In the second round, Boeing reframed the proposal and a \$ 3.8 billion joint venture was accomplished, 80 percent Boeing and 20 percent Embraer to manufacture commercial aircraft. We addressed in this single case, the Government's golden share veto power, as well as its implications to the negotiation itself, as well as the consequences to both sides. Finally, we discussed the strategies on both sides and presented managerial recommendations for practitioners, as well as future research recommendations.

Keywords: Golden share, Aircraft manufacturer, Embraer.

Introduction

The present case investigated the two-round negotiations between two aircraft manufacturing companies: the North American Boeing SE, and the Brazilian Embraer (*Empresa Brasileira de Aeronáutica*), resulting in a \$ 3.8 billion commercial agreement, in July 2018.

The negotiation took place in two rounds: first, Boeing failed in an acquisition attempt. In the second round, a joint venture was achieved between the two parties, under the blessings of the Brazilian Federal Government (BFG). However, in the first round, BFG imposed a golden share veto on the transaction, previously announced by Boeing as a *fait accompli*. President Michel Temer interfered and the Wall Street Journal anticipated, on December 21, 2017, Embraer's difficult takeover (WSJ, 2017, p.1). President Temer argued national security affairs to prevent the operation.

The implications to the Brazilian society in general, and the civil aircraft market represent a great deal, since Embraer is the world's fourth largest aircraft manufacturer (See Figure 1). This negotiation also affected directly on both companies: (a) the supply chains, (b) shareholders, (c) stakeholders, (c) outsourced companies, (d) domestic, and (d) foreign markets. Also included: (e) suppliers, (f) sellers, (g)

customers, and (h) the Brazilian Federal Government itself (benefitted directly with the transaction, regarding tax collection, and job creation).

Therefore, the importance of the present descriptive case to the Brazilian economy is paramount, given the importance of Embraer in the international commercial jet manufacturer market. It was also important to Boeing, who strengthened its market position to face the main competitor: The French aircraft manufacturing company Airbus SE, as depicted in Figure 1, as follows:

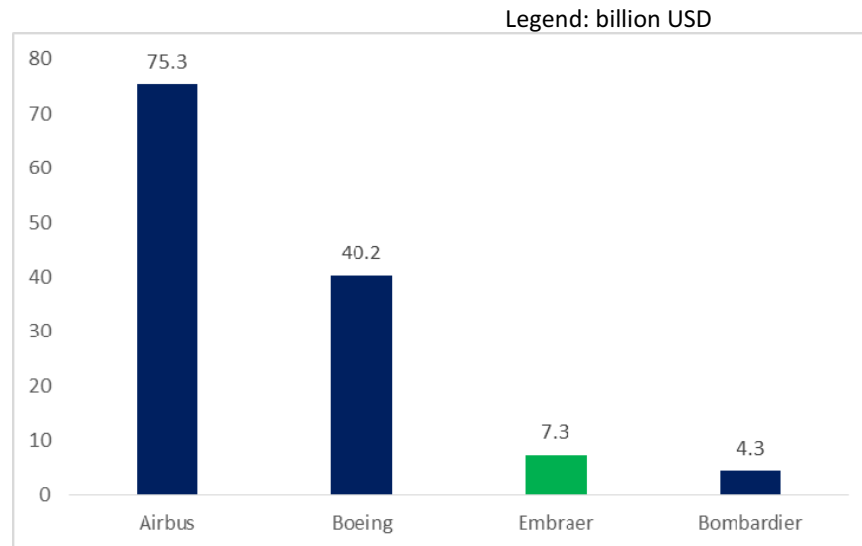


Figure 1. Aircraft manufacturer ranking.

Source: Dias, Teles, and Duzert (2018). Reprinted under permission.

Background: Boeing versus Airbus

Boeing and Airbus struggled about the supremacy for the aviation industry, over the past decades. Boeing, currently is the world's second largest aviation aircraft producer, just behind Airbus, the largest industry (see Figure 1). The fierce competition had another round of interventions in the first semester 2017. The United States Government threatened to impose penalties up to 300 percent taxes on C-series jets of the Canadian manufacturer Bombardier, because they considered that the company benefited from incentives that affected the competition with Boeing (G1, 2018).

In retaliation, Airbus SE counter-attacked on October 2017. The aircraft manufacturer acquired 50.1 percent of the Bombardier C-series jets, namely the Aircraft Limited Partnership (CSALP). It produces commercial jets up to 100-150 seats (G1, 2018). Therefore, Airbus SE kept 50.1 percent of the total shares, Bombardier 33 percent, and Québec Investissement, 16.9 percent of the remaining ones (Airbus, 2018).

Since Airbus was suffering retaliation from their main competitor, tried to restore balance through the aforementioned strategic acquisition, which provided a brand new, unexplored commercial aviation market, because the smallest aircraft produced by Airbus and Boeing has 130 seats. "Therefore, Boeing is not only betting against Airbus. It also tries to expand its participation into an unexplored 100 to 150 seats commercial jets market" (Dias, Teles & Duzert, 2018, p.59). Therefore, Boeing, to counterbalance the opponent's move, decided to acquire the Brazilian Embraer, third largest world aircraft industry (see Figure 1).

Bombardier C-series has the following features: (a) twin-engine, (b) narrow-body, (c) medium-range jet aircraft, designed to transport between (d) 108-133 passengers, plus (e) five to ten crew members, designed by Bombardier Aerospace (Bombardier, 2018). The CS-100 (C-series jet, Embraer E-195-E2 main competitor) is depicted in Figure 2, as follows:



Figure 2. Bombardier CS-100 versus Embraer E-195-E2.
Source: G1, 2018; Embraer, 2018. Reprinted under permission.

This case, therefore, investigated the aforementioned failed acquisition process, the importance of the golden share veto, and the successful joint venture performed between Boeing and Embraer on July 2018, as the primary unit of analysis.

This study also contributes to the discussion about state-owned companies privatizations. The Brazilian Federal Government (BFG), brought the negotiation between Boeing and Embraer into a new arena, not an acquisition, prohibited by the BFG, but a joint venture instead.

According to Dias, Teles & Duzert (2018), “this is the first time in Embraer’s history that a multibillionaire company tries to acquire it, because the golden share veto” (p.56).

The discussion is relevant to Brazil, since the newly elected government of Jair Messias Bolsonaro, a four-year presidential term, on general elections held in October 2018, mentioned the hypothesis of continuing the Brazilian privatization program (Dias & Teles, 2018).

Therefore, Embraer’s case could be a cornerstone for other privatizations, such as Eletrobras, the world’s fourth largest electrical service provider (Dias, Teles & Duzert, 2018). Through this single case study, the acquisition process is investigated, and final lessons and recommendations are further presented and discussed.

Background: Embraer

Empresa Brasileira de Aeronáutica (Embraer) was founded on August 19, 1969, in the middle of the Brazilian military government (1964-1985), during the general Costa e Silva administration. Embraer was then a 51 percent, state-owned, company (Brasil, 1968).

“Embraer was founded during the period of maximum repression and state control in the entire Brazilian history. Golden shares, hence, were instruments of national security affairs, to avoid foreign capital to take over Brazilian state-owned or mixed companies (those with 51 percent of BFG ordinary shares).

Embraer was conceiving to foster both civilian and military aviation industry in Brazil (Embraer, 2016). Embraer also responds to the Ministry Aeronautics. Attached to them are: (a) *Centro Tecnológico da Aeronáutica* (Aeronautics Technological Centre - CTA), and (b) *Instituto Tecnológico da Aeronáutica* (Aeronautics Technological Institute - ITA).

The first turbo-propelled civil passenger aircraft, the *Embraer Bandeirante 110* was the project fostered by Embraer's first president, later Minister of Aeronautics, Ozires Silva, one of the Embraer's pioneers (Embraer 2018).

Embraer is headquartered at São Paulo state (southeastern Brazil), at São José dos Campos. Its activities encompass four sectors: (a) commercial and (b) executive aviation; (c) defense & security. Finally, (d) systems (Embraer, 2016). Embraer generates approximately 18.000 direct jobs, up to 8.000 aircraft delivered in near half-century of existence (Embraer, 2018; Dias, Teles & Duzert, 2018).

Methodology

This study is a qualitative, interpretive, inductive, single, descriptive case study, involving extensive archival research, which unit of analysis (Yin, 2009) is the negotiation involving Embraer and Boeing, which ended in a joint venture. Secondary data were gathered through archival research and literature review. This study is limited to the takeover operation occurred in 2017 and the final joint venture occurred in July 2018, when Boeing finally succeeded after a failed acquisition attempt. The primary data were collected through N=2 qualitative, in-depth interviews, with 100% of response rate. Quotes were allowed.

Brazilian Federal Government and Golden share veto

The golden share is a particular type of share, allowing veto powers on state-owned companies, by the government. In Embraer case, the golden shares are described at the Social constitution act (*Estatuto Social à Ação de Classe Especial*, in Portuguese). Article 9th, describes the golden share veto power, as follows:

- I. Change in the name of the Company or its corporate purpose;
- II. Change and / or application of the Company's logo;
- III. Creation and / or modification of military programs, involving or not the Federative Republic of Brazil;
- IV. Third-party training in technology for military programs;
- V. Interruption of the supply of maintenance and replacement parts for military aircraft;
- VI. Transfer of control of the Company (Embraer, 2018, p.1, our translation).

The BFG participation is also mentioned, on article 9th, paragraph 1:

PARAGRAPH 1 - The prior approval of the Federal Government, as holder of the special class common share, shall be subject to the public offering for the acquisition of shares referred to in art. 54 of these Bylaws (Embraer, 2018, p.1, our translation).

The golden shares appeared for the first time in 1990, through Law 8.031/90 (Privatization Law), from April 12, 1990, which Article 8 states that:

Whenever there are reasons to justify it, the Union shall directly or indirectly hold shares of a special class of the capital stock of privatized companies, which will confer veto power on certain matters, which shall be characterized in the corporate by-laws, according to what is established in art. 6, item XIII and §§ 1 and 2 of this law. (Brasil, 1990, art 8).

However, Law 8.031/90 was then substituted by Law 9.491/97, from September 9, 1997, increasing and extending BFG veto powers, then devising a regular definition on golden shares (Law 9.491/97 included also financial institutions to be privatized), as shown in Article 8, m as follows:

Article 8 - Whenever there are justifiable reasons, the Union shall directly or indirectly take action of a special class of the capital stock of the company or financial institution that is the object of the privatization, conferring special powers on certain matters, which shall be characterized in its bylaws (Brasil, 1997, art 8).

Finally, the Law 10.303, from October 31, 2001, encompassed virtually all forms of economic societies, increasing, even more, the golden share veto powers, then including *Sociedades Anônimas* (Anonymous Societies – Brazilian version for the North American corporations), referred on article 17, paragraph 7:

In the companies that are subject to privatization, special class preferential shares may be created, exclusively owned by the privatizing entity, to which the bylaws may confer the powers they specify, including veto power to the deliberations of the general meeting on matters to be specified (Brasil 2001, article 17, paragraph 7)

Law 10.303/2001 formally introduced golden share veto in all kinds of companies in Brazil, not restricted to private to limited, incorporated, and public enterprises.

According to Dias, Teles & Duzert (2018), Laws 8.031/90, 9.491/97, and 10.303/01, in practice enhanced and improved the government control mechanisms, on such companies, as depicted in Table 1, as follows:

Table 1. Brazilian golden share legal substantiation.
Source: Brasil (1990, 1997, 2001), Dias, Teles & Duzert, 2018.

Law	Article	Description
8.031/90	8	Golden share to state owned companies
9.491/97	8	Included Financial Institutions
10.303/01	17, paragraph 7	Included <i>Sociedades Anônimas</i> (Corporations)

First Negotiation Round: Boeing Failed in Embraer Acquisition

The North American Boeing aircraft manufacturing company was founded in 1916 by William Boeing. It is currently (Boeing, 2018), a transnational enterprise, which manufactures: (a) aircrafts of more than 130 seats; (b) rockets, and (c) satellites, among others, estimated in approximately \$ 176 billion value.

The Airbus executive Tom Enders declared that the C-series operation acquisition represented “a victory for all” (G1, 2018, p.1). In retaliation, Boeing planned the Embraer acquisition, frustrated by the acting Brazilian president, Michel Temer (O Globo, 2017).

After President Temer’s declaration, on October 2017, who stated that “on my government, Embraer will never be sold” (O Globo, 2017, p.1), the consequence was an outstanding increase on the Embraer’s stock price value at the NYSE stock market (New York Stock Exchange), as reported by the Wall Street Journal (2017).

On December 21, 2017, the Wall Street Journal also confirmed Boeing's difficulties on the takeover negotiations, affirming that "Embraer is a crown jewel of Brazilian industry, and it is far from guaranteed the government would sign off." (The Wall Street Journal, 2017, p.1).

Finally, President Temer, through the Ministry of Aeronautics, announced the end of the acquisition negotiations. BFG officially withdrew the bargaining table (Dias, Teles & Duzert, 2018). Nevertheless, as a goodwill gesture, BFG welcomed another sort of associations, such as joint ventures (O Globo, 2017). President Temer stated that Embraer could not be sold, because it is a "national security issue, and therefore, could not have its share control in hands of strangers" (O Globo, 2017, p.1).

Second Negotiation Round: Successful Joint Venture

Despite Boeing's failure, not everything was lost. Boeing already had a joint venture on military aircraft manufacturing, on the light-attack A-29, the *Super Tucano* maneuver aircraft, along with the Embraer KC-390 military cargo aircraft.

On February 25, 2018, Boeing decided to create a new joint venture, this time on civil aviation. According to Raul Jungmann, Ministry of Defense: "Boeing understood the Brazilian refuse in the case of Embraer's stock control" (Extra, 2018).

Finally, on July 5, 2018, a Joint Venture involving Embraer and Boeing was signed through a Memorandum of Understanding (MOU), designed to embrace a strategic partnership. Boeing would pay \$ 3.8 billion, to hold 80 percent of the mentioned joint venture, while Embraer keeps 20 percent of the participation on the newly created company, NewCo, which will have Boeing's control, to be managed in Brazil, but reporting directly to Seattle Headquarters, under control of Dennis Muilenburg in the United States (Boeing, 2018). The negotiation is expected to be concluded at the end of 2019.

Last, on December 5, 2018, the Labor Party *Partido dos Trabalhadores – PT*, filed a popular suit against the transaction, arguing violation of national interests. The suit was judged improcedent by Alberto Souza Ribeiro, judge from TRF-3, which suspended the veto to the whole operation (G1, 2018), reassuring the joint venture transaction.

Discussion

The case under analysis revisited Dias, Teles & Duzert (2018). It seems that the final solution was achieved, satisfying the acting government of Michel Temer. However, on January 1st, 2019, the Government of the newly elected president, Jair Messias Bolsonaro may interfere with the agreement, although not manifested contrary opinions on the subject (Dias & Teles, 2018).

Embraer loses control of its own employees. Conversely, receives an injection of capital to pay its debts. It may represent layoffs in the near future, a clear loss to the Brazilian Federal Government. On the other hand, Boeing is benefitted with Embraer's technology and expertise on commercial jets. Boeing has been successful is strengthening its position on the global C-series jets market.

Without the golden share veto, the entire Brazilian military aviation would be controlled by Boeing's executives, a risk to the National Security. It is a fact that golden share leverages BFG power and prevent absolute powers from strangers.

The current definition on Embraer and Boeing joint venture put more pressure on Airbus to create alternatives to counter attack Boeing's move on the chess aviation table.

The fierce competition between Boeing and Airbus is far from an end.

Lessons Learned

1. *Do not succumb and give up after the first failed attempt.* It is essential to create value and to devise an alternative to ongoing negotiations, and not to give up at the first failed attempt. Otherwise, Boeing would not have succeeded in the joint venture.

2. *Do not promise without 100 percent assurance.* The major Boeing mistake was to announce victory before time on Embraer's acquisition. Once the negotiation failed, reputation is scratched, trust in future business decreases (Dias, 2016, 2017).
3. *Keep the focus on results and avoid escalation.* The situation could turn into escalation if Boeing took the subject to the North American Government, as in the Bombardier's case. Here, Boeing devised a creative environment for problem-solving, avoiding escalation (Dias, 2012).
4. *Negotiate with all parties.* Evidence suggests that Boeing did not negotiate with BFG properly, and paid the price, since BFG had the veto power, at the end of the day, used it (Dias, Teles & Duzert, 2018; Dias, 2013).
5. *Be creative, open-minded to new solutions.* As preconized by Dias, Teles & Duzert, 2018, "It is important to endure in a negotiation, even if the first outcome is negative. It is important to keep focus and to persist on a better solution for all parties, or at least, a solution that all parties can live with" (p.61). The recommendation proved to be accurate in this case.
6. *Be prepared to complexity and value creation.* The case of Boeing vs. Embraer suggests a much more complicated scenario that Boeing was passing through. As Dias, Teles & Duzert participated, "In such cases, alliances are better than takeovers" (p.61).

Future Research and Limitations

Finally, this research was limited to the negotiation between Embraer and Boeing, regarding the Brazilian Federal Government golden share veto.

Other countries are excluded from the present research, which abide by the Brazilian Federal Laws.

The present study aimed at consolidating current data, from past research, into a new perspective about the issues analyzed here: (a) Boeing's failed acquisition attempt on Embraer; (b) the BFG golden share veto; (c) The successful joint venture between Boeing and Embraer; (d) Brazilian Federal Privatization and Golden Share Laws, which are usually studied in separate; (e) current facts and figures on the global aircraft manufacturing industry. In this sense, the present work consolidated previous complementary research, providing a concise and broad vision on the subject under investigation.

Finally, it is encouraged for future research, the performance of both companies working together as one; the impacts on the Brazilian economy, as well as the current lawful aspects on the golden share veto, and its consequences, and case visitation.

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