Western Bank - A case of leading strategic change in a commercial bank

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Abstract

In 2001, Western Bank was a small and traditional bank burdened with non-performing loans, weak managerial staff, and the legacy of the culture of government-owned banks due to the extended management of the bank by the Ministry of Finance. The major challenge of the new team was to find out how to convert this bank into one with international performance standards. At that time, in terms of profitability and funds under management (total deposits plus total loans), Western Bank ranked 29th and 28th, respectively, out of 32 privately owned commercial banks. Upon joining the bank, Mr. Alam and his team brought about radical changes to restructure the Western Bank and improved the bank's ranking to 12th from 28th position. He introduced centralized control and evaluation of portfolios and cut down drastically the bank's non-performing loans and operating costs. However, his journey was not smooth, and he was challenged and obstructed by the existing seasoned employees of the bank throughout different stages. Mr. Alam and his team prudently steered the bank to reach its' improved position by overcoming these challenges and barriers.

Keywords: Restructuring, management, performance, efficiency, centralized.

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BACKGROUND

Banking Industry in Bangladesh

Following independence, which was earned in 1971, Bangladesh's banking sector got off to a strong start with six nationalized commercial banks, three state-owned specialty banks, and nine foreign banks. With the entry of private banks in the 1980s, the banking industry experienced substantial expansion. Now, there are mainly two types of banks in Bangladesh:
Scheduled Banks:

The banks that are still included in the list of banks in accordance with the 1972 Bangladesh Bank Order. Bangladesh Bank, which has the authority under the Bank Company Act of 1991 and the Bangladesh Bank Order of 1972, fully controls and supervises all 61 scheduled banks in Bangladesh. The categories of scheduled banks are as follows:

- State-owned commercial banks (SCBs) are wholly or primarily owned by the Bangladeshi government.
- Specialized banks (SBs) founded with specific goals in mind, like the development of the agricultural or industrial sectors, are currently operational. The Bangladeshi government also owns all or a majority of these banks.
- There are 43 private commercial banks (PCBs), most controlled by private people or companies. PCBs can be divided into two categories:
- Foreign commercial banks which operate in Bangladesh as branches of the banks which are incorporated outside Bangladesh (Bangladesh Bank, n.d.).

Non-scheduled Banks

Banks that are not scheduled banks but that were founded with a specific goal in mind and that function under any act. These banks cannot carry out all the duties of scheduled banks (Bangladesh Bank, n.d.).

Bangladesh's economy has benefited greatly from the contribution of commercial banks; however, the reckless self-dealing by bank insiders has been a major factor in a significant number of recent bank collapses, making it extremely perilous for the performance and survival of the institutions (Mahmood and Islam, 2015). Since the 1990s, the relevant authorities have made significant efforts in the areas of legal, institutional, and policy reforms to create an efficient environment in the banking industry (Ahamed, 2012). However, the banking sector in Bangladesh still struggles as the total amount of Non-Performing Loans (NPLs) as of September 2022 exceeded Tk 1,340,000 million BDT. These bad loans were caused by lending based on political connections (where corrupt bank directors and chosen politicians band together and disobey all rules related to loan disbursement), a general lack of enforcement of banking regulations, and the absence of adequate internal monitoring systems, which can help identify and reduce common sources of credit risk (Haque, 2022).

Mr. Alam (Head of the Corporate Banking Unit)

After completing his MBA in Marketing from the most prestigious school in Bangladesh, Mr. Alam joined a foreign commercial bank (ABC Bank) that was incorporated in Australia. ABC Bank has been operating in Bangladesh since 1918. Mr. Alam served ABC Bank from

1990 to 2001. But in 1999, ABC was bought out by XYZ Bank (another foreign commercial bank that was incorporated in the United Kingdom). All of the former ABC branches had their name changed to reflect the new owners, XYZ Bank. During most of his tenure with ABC Bank, Mr. Alam served in the Corporate Banking department, which typically handles the most complex transactions of a bank. Mr. Alam was in charge of many crucial accounts with the bank. For example, in 1991, he was the account manager of local operations of Philips International in Bangladesh and worked in close consultation with the Marketing group based in London. As the local account manager of the London-based group, Mr. Alam was linked with Philips International's global relationship with XYZ Bank. An account manager was primarily responsible for key bank customers (usually large international and national corporate groups) to ensure due diligence for credit line approval and that the bank gets a reasonable return from the account.

Mr. Alam was involved in many other transactions like the above, which enabled him with the ability to understand complex balance sheets, equity financing, loan syndication, management of business, etc.

WESTERN BANK'S ENVIRONMENT

Western Bank basically has its roots in the Bank of Credit and Commerce International (BCCI Bank), which was closed by the Bank of England in 1991. Immediately after the shutdown of BCCI bank, the government of Bangladesh took over BCCI bank's local operations and turned it into a local commercial bank, named Western Bank, primarily to safeguard the interests of the bank's depositors. The transaction was termed the BCCI structuring program, which was supervised by the Ministry of Finance of the Government of Bangladesh. Under this program, Bangladesh Bank, the central bank of Bangladesh, returned saved amounts to the small depositors. For the large depositors, the central bank turned their deposits into equity shares. The government of Bangladesh also injected funds and acquired equity shares in the bank. The Ministry of Finance, the major equity shareholder, ran the bank's board during this time. The bank operated with this structure from 1991 to 2001.

At the end of 1999, the government of Bangladesh divested its shareholdings to the depositor shareholders, and the new owners took up the bank. Some of these new owners were customers of XYZ and ABC Bank. The board wanted to convert this bank into one that meets international standards. The new owners of the Western Bank hired Mr. Islam as the managing director, and he was asked to form a new team to revitalize the bank. Many private commercial banks lacked proper oversight and were burdened with a significant number of non-performing loans, stemming from pressure by the board of directors to issue loans based on personal affiliation, etc. In this context, Mr. Alam and some other executives from foreign-owned banks were recruited by Mr. Islam in May 2001.

In 2001, Western Bank was a very small and traditional bank burdened with non-performing loans, poor management, and a legacy of loans issued due to political connections. At that time, in terms of loan-to-deposit (LDR) and profitability, the bank ranked 28th and 29th out of 32 privately owned commercial banks. Mr. Alam's new responsibility was to head the bank's corporate banking unit—the corporate banking units of a bank deal with the bank's largest portfolio holders. Mr. Alam's main task was to create the corporate banking unit. Many traditional banks in Bangladesh at that time, privately and government-owned, did not have a separate corporate banking unit headed by a relationship manager responsible for centrally coordinating and overseeing the corporate relationship of a bank.

Before Mr. Islam established a corporate banking unit in Western Bank, the individual bank branches handled the management and disbursement of loans, the clearing of all security documents, and deciding on the interest rates as indicated in Figure 1 (Appendix). This structure allowed the branch managers to defy proper procedures in order to meet business targets. Many managers approved subprime loans to meet their targets. The branch managers also played the role of relationship manager for all customers. In order to meet these targets, many branch managers were motivated to make decisions in their best interests, which were not aligned with the bank's profitability and growth. Although there is a credit risk management team at Western Bank, the team does not have the authority to independently evaluate the loan proposal except for making a two-page summary of the proposals before being sent to the board. In foreign and multinational banks in Bangladesh, these functions are well separated. In these banks, the corporate loan proposals originate from the bank branches but are thoroughly reviewed and scrutinized by centralized units in the head office before being sent to the board for approval. The centralized credit administration team does not have any business targets. In this structure, individual branches are responsible for booking businesses with potential customers in their jurisdiction. Both the credit administration team and the corporate banking unit carry out due diligence for these business proposals. However, the credit administration team has a higher status in judging the business proposal. This is so because the corporate banking unit also has business targets, but the credit administration team does not. The corporate banking unit is the relationship manager for the clients, who are usually large corporate organizations. The corporate banking unit monitors the performance of the loans, meets the client's needs from branches throughout the country, and decides if more equity is needed from the client. These activities require specialized training and skills. Mr. Alam's responsibility in the Western Bank was to create a credit administration team, a corporate banking unit, and an SME unit (Small and Medium Enterprises Unit).

Mr. Alam took the initiative to create these units along with creating a centralized operations unit. He also analyzed the performance of the bank and concluded that the bank had high monthly expenses due to being hugely overstaffed. The bank had 22 branches and a staff size of 860. The previous owners, the government of Bangladesh, were not concerned about profitability. Once the new owners took over, they wanted to make the bank more profitable, so the management made the decision to recruit Mr. Islam.

Mr. Islam, Mr. Alam, and others led the bank as a team. To deal with the overstaffing problem, they used a Very Early Retirement Scheme program (VERS) that offered employees an 18-month salary as an incentive for filing for early retirement. This initiative resulted in reducing the staff size to 423, which was almost a 50 percent reduction in the staffing budget. Although the amount disbursed by the bank for early retirements was considerable, the bank managed to recover this expenditure within the next two years as the cost-to-income ratio came down significantly and the business grew. Usually, in Bangladesh, employee groups complain to their respective government officials when companies embark on a staff reduction program. The bank was lucky to implement this program during a 2–3-month period while a non-political interim government (Caretaker government) was in power.

The bank achieved a 30 percent growth in loan disbursement over the first year. This growth was impressive in terms of percentage but insignificant in terms of volume as the starting business portfolio was small. The bank decided to focus most of its efforts on business with

corporations as the SME, Retail, and Car loan portfolios were expected to experience slower growth. For example, one retail portfolio can be worth 10 million Bangladesh Taka (BDT), while a corporate portfolio can be worth 10 billion BDT. It was also advantageous for Mr. Alam and his team to focus on the corporate sector because of their prior experience working at large foreign banks and their connections with local and multinational corporations. However, the bank needs a diversified customer base to maintain sustainability, but it has found it more efficient to work with large corporations, which could be accomplished using a small team.
In 2001, the bank had a portfolio of 18 billion BDT, 55% from business with corporations and the remaining 45% was mostly from SMEs. By the end of 2007, when Mr. Alam's team left the Western Bank, the bank ascended in the ranking in LDR from 28th to 12th within Bangladesh. The portfolio growth resulted in the share price rising from 291 BDT in 2001 to 1,070.8 BDT in 2007 as indicated in Table 1 (Appendix). The business portfolio grew from 18 billion BDT to more than 80 billion BDT during the same period. The business with corporations' share of the bank's entire portfolio grew from 55 to 80 percent.

The journey was by no means smooth. Initially, Mr. Alam's team faced strong resistance from the branch managers. In the previous business model, the corporate loan proposals were handled by the branch managers, and now they are exclusively handled by the corporate banking unit, thereby taking away a lot of power from the branch managers as indicated in Figure 2 (Appendix). The branch managers were not only upset about the loss of control, but they were now stripped of additional income they earned from issuing compromised loans. The bank also centralized the SME business portfolio, making branch managers feel more marginal. No branch managers could now change interest rates at will as it has to pass through a formal procedure. As a result, governance improved radically.

However, the frustrations of the branch managers affected the bank's performance to some extent. Initially, there was a go-slow attempt by the branch managers. They attempted to slow down business growth, which undermined the performance of Mr. Alam's team. The slowing down of business growth affected the bank's performance until the conversion was completed, which took about 1 to 1.5 years. Banks work towards continuous business growth not only with new customers but also with expanding business with their existing customers. Many branch managers discouraged customers from extending their credit limits by portraying that the bank was in trouble. The new changes also took away branch managers' ability to unethically modify loan terms for personal gain.
Some of the unethical practices of the branch managers involved the following:

- The bank disbursed a working capital loan to customers for a specific purpose per the terms of the loan agreements. The customers often used these funds for unapproved purchases and expenses. Despite these unauthorized transactions, the branch managers continued to approve the renewal of the line of credit to those customers.

The corporate banking unit was able to generate business five times the 22 branches did in the previous year. The team's strategy for dealing with the defiant branch managers had two components. First, they convinced staff members that changes would benefit everyone in the bank via an extensive training program. The second component was threatening to terminate any branch manager attempting to slow down the bank's operations. So, the disenchanted branch managers had a chance to either realign themselves or leave.

The team wanted to increase the efficiency of operations by improving the existing IT platform that was developed by local providers and supported by local enterprises. Given the situation at that time, the locally developed IT platform was good enough for a small private bank, but when the bank grew significantly, it was no longer scalable to handle the volume of complex transactions. These included retail and credit card loans, meeting the growing customer demands reports, portfolio analysis, complex queries, information retrieval, etc. Compared to this are the internationally developed IT platforms that utilize lessons from more than 500 years of banking and are efficient in ensuring checks and balances in enabling and monitoring complex transactions, processing, and queries. The internationally developed systems were capable of complex reporting, upgraded continuously, and equipped with high-security protocols. However, the internationally developed IT platforms were extremely expensive and affordable only if the bank attained a certain business size. Western Bank reached that business size in 2003 when it acquired an internationally developed IT platform. In 2003, the minimum loan portfolio business size required by a bank to afford an internationally developed IT platform was around 32000 million BDT, and the size necessary grew to 120000 million BDT. in 2021

But there was another challenge for the new team. The local board of directors of the bank was impatient. They did not want to wait for many years to see results. However, the grand plan of the team required a sufficient length of time to bring in the desired results. The team's goal was not only to grow the business but to transform the processes and infrastructures of the bank's operations while managing the board, the media, the staff of the bank, the regulators, and the shareholders. All these were to be accomplished through many complex processes. It was also difficult because profits fluctuated, and some influential customers complained due to the transformation. These influential customers were unhappy that they were no longer experiencing preferential treatment as earlier. These customers would often make complaints to the board of directors. The team made numerous presentations to the customers about the transformation to mitigate their dissatisfaction. The team had to hire new employees to implement their transformation program. Often, these employees, who had outstanding qualifications, were paid higher salaries. That created salary discrepancies and became a Human Resources (HR) issue. The board was sensitive to this issue, and the team had to convince the board of the necessity of such requirements. The team had introduced other initiatives also. They introduced a performance evaluation management system that established KPIs at the beginning of each year in order for HR to justify the salary discrepancies. The HR department also provided counseling, sales and management training, central bank regulations, etc. However, it was still difficult for the team to convert the staff with more than 10 or 20 years of experience working in a different environment. In the old environment, the decisions were centric to the managing director, and it was difficult for them to shift to the new paradigm of the new team. Eventually, half of the senior-mid-level managers left the bank.

Mr. Alam had a very visible role in the bank as the head of the corporate banking unit because, in the first three months of his joining, he brought in ten new corporate customers. The performances of some members of the transformation team were not visible to the board. In Bangladesh, the board members are impatient for results and can be easily influenced by non-specific general complaints from staff and customers.

While the board appreciated Mr. Alam's performance, the heads of HR and retail banking were asked to leave the bank. The head of HR faced non-specific general complaints from the older staff, while the head of retail banking struggled to achieve the expected results. It had been previously noted that the retail banking business, though profitable in the long run, takes a considerable amount of time to establish itself. In retail banking, the foundation is laid first, and it takes a while before the business begins to yield results. This decision was made despite the fact that both individuals were performing their duties competently.

The board opted not to investigate the vague allegations made by the senior staff members. Interestingly, it has been a customary practice for board members to prioritize the opinions of their close associates over performance metrics or camel ratings. However, these incidents occurred within the first 1 to 1.5 years of the transformation's initiation. By the end of the third year under the new team's leadership, the majority of the older staff had departed from the bank. Business growth for the bank was significant, and the board had developed confidence in the team members. The new Head of HR encountered fewer issues with the older staff, and the new Head of Retail Banking was able to leverage the groundwork laid down by the previous head. However, the team encountered its most significant challenge in 2004 when the board decided to assess the team's performance and brought in a high-ranking official from a foreign bank for this evaluation. Initially, the team welcomed this new official, who happened to be someone familiar to the team members. However, the team's enthusiasm waned as they discovered that the evaluation primarily revolved around societal and peer pressure, rather than the expected focus on profitability and numerical achievements. In Bangladesh, the board prioritized staff compliance with their directives over raw numerical results. This shift in emphasis gradually led to the team's decision to depart from Western Bank in 2007 and join another privately-owned commercial bank. In 2013, Mr. Alam assumed the role of Managing Director at this new bank.

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CASE QUESTIONS

1. The case highlights the process of rightsizing (reducing the number of employees). What are the other options available for the firm that want to right size?
2. Discuss pros and cons of early retirement incentives to reduce the workforce. Do you agree early retirement packages as the right method?
3. What is employment-at-will doctrine? Explain whether terminating the head of HR and head of retail operations would be legal under employment-at-will doctrine?
4. Refer to the Path-goal theory of leadership. Which leadership style was practiced by Mr. Alam, who led the turnaround of Western bank?
5. Discuss the difference between vision and mission. Develop a vision and mission statement for the Western Bank.
6. Explain the difference between centralized and decentralized company structure? Which structure did the Western Bank follow?
7. Does the case reflect a good example of ethical leadership? What changes can be made?
8. Does the case reflect a good example of corporate governance given the interference of board members in the decisions of management. Why or why not?
9. Which model of change management is highlighted in the case?

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APPENDIX

TABLE 1. FINANCIAL PERFORMANCE OF WESTERN BANK (in million BDT)

Account	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Authorized Capital	1000	1000	1000	1000	1000	1000	1000	1000	3300	3300	3300
Paid up capital	600	600	600	600	720	720	828	828	828	828	1035
Reserve	1699	1774	1856	2260	2322	2448	2560	2733	3132	3146	3539
Deposits & other accounts	9568	8879	11231	12375	13277	13661	11952	15649	19396	25734	30092
Loans & advances	5258	5774	7902	8141	9946	10891	11288	14973	17758	26008	30962
Operating income	985	1199	1611	1916	2022	1986	1985	2241	2957	4272	5325
Operating expenses	629	796	1030	1242	1319	1255	1226	1349	1901	2913	3454
Operating profit	356	403	581	674	703	731	759	892	1056	1358	1870
Net profit before tax	343	373	409	475	553	631	638	851	967	1134	1286
Total Assets	10186	10973	14394	16880	18284	18445	18716	23048	27400	35971	42579
Market value per share		104.5	103.25	186.0	291.0	303.0	382.0	780	1222.8	792.5	1070.8
Dividend per share	10	10	20	30	30	35	20	43	40	45	34
Number of branches	21	21	21	21	22	22	22	22	22	25	28

Source: Annual reports of Western Bank

One US dollar was the equivalent of $110 Bangladeshi Takas in early December 2023.

FIGURE 1. WESTERN BANK'S ORGANIZATIONAL CHART PRIOR TO RESTRUCTURING

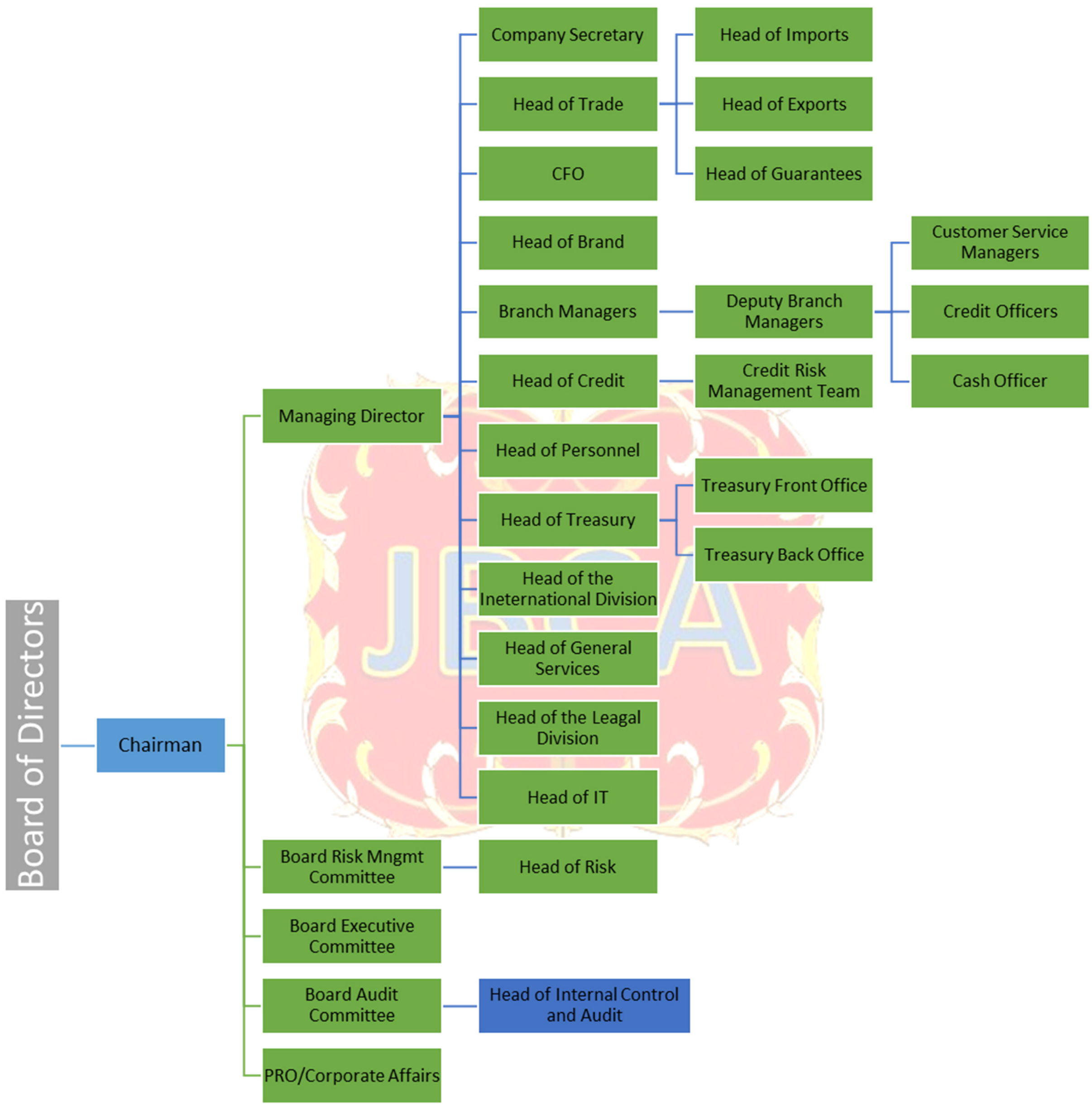

FIGURE 2. WESTERN BANK'S ORGANIZATIONAL CHART AFTER THE RESTRUCTURING