



Future of Advice podcast

Why profitability steering in banking needs a rethink

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Host: Welcome to the Future of Advice Podcast by Deloitte Luxembourg. Today we are going to tackle a subject that sits right at the intersection of strategy, psychology, and—well—hard data. I want you to picture a scenario that I think many of our listeners have actually lived through.

Guest: I'm sure they have.

Host: Imagine a bank that looks from the outside like an absolute fortress of success. The annual report is glossy. The shareholders are smiling. Dividends are flowing. And the bottom line is a healthy, vibrant green.

Guest: Exactly. But if you were to walk past that glossy lobby and into a closed-door strategy meeting and you asked a really simple fundamental question—something like "which specific client is actually draining our resources right now?" or "is that new mobile app feature actually making us money or is it just burning through server fees?"—you might just be met with dead silence. It is a silence that keeps a lot of COOs and CFOs awake at night. It's the central paradox of the modern banking industry. You can be profitable in the aggregate. I mean, the big picture looks fine. The ship is floating. But you can be functionally blind in the details.

Host: And that's a terrifying place to be for a strategist.

Guest: It is. You're essentially steering a massive ship while wearing a blindfold, just trusting that because the ocean was calm yesterday, it'll be calm today.

Host: That is such a vivid image. It's like flying a plane and knowing you're generally heading north, but having no idea which engine is burning the most fuel. So today, we're unpacking a really dense but crucial piece of research on profitability steering. We're looking at why banks are struggling and, maybe more importantly, the solution it proposes: building a digital twin. But let's start with the problem statement. Banks are numbers businesses; they literally sell math. Why is this so hard for them? Surely they know where the money is.

Guest: You would think so, wouldn't you? The landscape has shifted underneath them. It's not just about counting cash anymore. They are dealing with massive macroeconomic uncertainty, regulatory pressure that never sleeps, and—this is the big one—organizational complexity that has just skyrocketed. So the old ways of looking at things don't work anymore.

Host: Not at all. In the past, high-level financial aggregates were enough. You looked at the big totals, saw they were positive, and moved on. But today, relying on those creates a massive knowledge gap.

Guest: Knowledge gap sounds a bit academic. What does that gap look like in practice on a Tuesday morning for a bank executive?

Host: It looks like a lot of unanswered questions. As you hinted at, banks often struggle to answer which specific products or channels are the least profitable. Not which ones bring in the least revenue—that's easy. But which ones are actually unprofitable once you factor in the effort to support them.

Guest: Okay. The hidden costs.

Host: Exactly. What is the true cost? Not the estimated cost, the *true* cost of serving a specific client segment. And here's a big one that hurts: Does growth in Assets Under Management (AUM) actually justify the rise in staff costs?

Guest: That last one has to sting. You grow the assets, everyone claps at the town hall because AUM is up...

Host: Right? But nobody tracks if you had to hire 20 people to manage that growth, essentially wiping out the margin.

Guest: Precisely. You're running faster just to stay in the same place. And that brings us to the mission of this deep dive. We're distinguishing between reporting and steering.

Host: Okay?

Guest: Reporting is looking in the rearview mirror telling me what happened last quarter. Profitability steering is driving the car, making decisions in real time. And to do that, we have to talk about something called a digital twin.

Host: I love that term. It sounds very sci-fi and I want to get into the nuts and bolts of it because I usually hear digital twin in the context of like jet engines or factories. But before we get there, I want to linger on the current state. If banks aren't using these advanced models, how are they deciding who gets what budget? How are they doing cost allocation today?

Guest: Well, for many, it is what we call the spreadsheet nightmare.

Host: I think everyone listening has lived through a spreadsheet nightmare at some point. It's almost a corporate rite of passage.

Guest: It really is. It's the standard operating procedure for legacy institutions. You have these fragmented approaches. You have manual data extracts happening at the last minute from three or four different systems. The HR system, the IT log, the general ledger. It's a mess.

Host: It's a total mess. You have one team using data from Monday and another team using data from Tuesday.

Guest: So, you walk into a meeting and spend the first 20 minutes—or maybe the whole hour—just arguing about whose Excel sheet is correct.

Host: Exactly. The war of the versions.

Guest: There's total confusion over which version of the truth is being used. And the consequence isn't just a headache for the finance team. It obscures true performance. It dilutes accountability because if I don't trust your numbers, I'm not going to accept responsibility for them.

Host: Of course not. If you tell me my department overspent and I know your spreadsheet is full of manual copy-paste errors, I'm just going to ignore you.

Guest: And ultimately, it makes it impossible to adapt strategies quickly. You can't turn the ship if you don't even know where the rudder is. Or if the rudder is connected to a spreadsheet that crashes every time you open it because it's too big.

Host: The research makes a really interesting distinction here. It says allocating revenue is usually pretty straightforward. I sold a mortgage. The bank made X amount. That's clear. The problem is the cost. Why is cost so much harder to pin down?

Guest: Because revenue has a clear address. Cost is homeless. I mean, think about shared services: IT, HR, marketing, legal, ESG compliance. These are massive overheads that sit in the center of the bank. How do you allocate the cost of the legal department to a specific checking account product? Or the cost of a cloud server farm to a specific client?

Host: Exactly. And what usually happens in my experience is they just take the total cost and sort of peanut butter spread it across everyone.

Guest: You have 10% of the headcount, so you pay 10% of the legal bill. I've seen that.

Host: Which is the worst thing you can do. That is the definition of a false signal because maybe your department never uses the legal team. The trading desk next door is getting sued every other week. If you spread the cost evenly, the profitable, low-risk units are just subsidizing the risky, expensive ones, and you have no idea which is which. You are effectively penalizing efficiency and subsidizing waste.

Guest: You've got it.

Host: Okay, so that's the spreadsheet nightmare. It's manual, inaccurate, and creates bad incentives. Let's talk about the way out. The research proposes building a digital twin. Now, explain this to me like I'm five. How does a digital twin apply to a bank?

Guest: Okay, a digital twin of a bank is a structured agnostic organizational model that tracks revenues and costs consistently across all relevant business dimensions. Think of it like a virtual replica of your value chain.

Host: So you're not just tracking money coming in and out.

Guest: No, you are tracking the activities that cause the money to move.

Host: Agnostic is an interesting word choice there. Banks are usually very hierarchical. What does agnostic mean in this context?

Guest: It means the data model doesn't care about the current political hierarchy or the org chart. It is business agnostic. It governs the allocation rules centrally. So if the CEO decides to redraw the org chart tomorrow, which happens all the time...

Host: All the time.

Guest: ...and move the wealth management team under the retail arm, you don't have to rebuild your entire financial model from scratch. The underlying data, the twin, stays stable. It separates the view of the data from the source of the data.

Host: That seems crucial for flexibility. If you have to call in consultants for 6 months every time a department changes names, you're never going to be agile. But let's dig into the granularity. What are we actually tracking in this twin?

Guest: This is where the magic happens. Most banks just track departments. The digital twin tracks five specific dimensions at the same time to triangulate value. First, clients and client segments. You need to know profitability person by person or at least group by group. Second, products and services. Is the mortgage making money or the credit card? Third, channels. Is this money coming from the app, the branch, or a broker? Fourth, business units. And fifth, and this is often the most controversial one, relationship managers.

Host: Whoa, that last one, relationship managers, feels incredibly personal. You're actually tracking the profitability of the specific people managing the client relationships.

Guest: You have to. In private or corporate banking, the relationship manager is the primary cost driver and revenue generator. They are the business. If you can't see the P&L of a specific manager, you can't incentivize them correctly.

Host: I see. So you might have a manager bringing in millions in revenue...

Guest: But if they require a support staff of five people and travel first class everywhere, they might actually be less profitable than the quiet manager who brings in half as much but costs almost nothing to support.

Host: This sounds like a massive amount of data. We're talking millions of transactions, thousands of employees.

Guest: It is huge. That's why you need a system, not a spreadsheet. You define the indirect costs once—say the IT budget—and then you have automated, documented allocation rules that redistribute that cost to those five dimensions based on usage drivers.

Host: Usage drivers. So that would be something like number of help desk tickets or terabytes of storage used.

Guest: Exactly. Instead of guessing or that peanut butter spreading, you have a rule that says this trading app consumes 20% of our server capacity. So 20% of the server bill goes to the trading desk. It's automated, it's fair, and it runs every day.

Host: This brings up the human element. Data is just numbers until people start arguing about it. I can imagine that if you start allocating costs based on real usage, some people are going to be very unhappy when they see their bill. How does this change the culture?

Guest: It shifts the conversation from disputes to trade-offs. This is a profound change. In the old world, a business unit head gets a bill for IT. They shout, "This is too high. I didn't spend this. Finance is screwing me." It's an emotional political fight.

Host: The classic budget battle: "I'm not paying for this," or "this isn't fair."

Guest: Right? But with a transparent traceable model, the conversation changes. The bill comes and it shows exactly why the cost is there. You requested these three new software licenses. Your team lodged 50 help desk tickets...

Host: And you are using this much cloud storage.

Guest: Precisely. Now the manager can't dispute the validity of the bill. The data is the data. So they have to make a trade-off.

Host: So instead of fighting finance, they have to look in the mirror.

Guest: Exactly. They have to ask, okay, do I really need those licenses or would I rather spend that money on marketing? It forces them to act like a business owner. It creates a culture of accountability where people understand that resources aren't free just because they come from another department.

Host: I see. It reframes the conversation from "what does this function cost" to "what value does it create."

Guest: Yes. And when employees understand how their actions influence costs and how those costs link to their performance, they take ownership. We've seen this happen. When you show a team clearly that every time they call the help desk for a password reset, it costs the department \$50, suddenly everyone gets really good at remembering their passwords.

Host: It's funny how that works. Money focuses the mind. The research also talks about better pricing being a big one.

Guest: Huge. If I know the true cost to serve a client, including the legal checks, the onboarding time, the software they use, I can price their fee accurately. Often banks underprice complex clients because they don't realize how much back office time those clients consume.

Host: They see the revenue, but they miss the operational drag.

Guest: And product design, too. If you see that a specific feature on your app is driving huge IT costs but generating zero revenue...

Host: Yeah, you cut it.

Guest: Or you redesign it. You stop flying blind.

Host: So, it's not just about saving money, it's about stopping the infighting.

Guest: It's about trust. Stakeholders trust reports when they can trace the logic. If the logic is a black box in a spreadsheet owned by one person in the basement, nobody trusts it. If it's a clear automated rule in a digital twin, people accept it and move on to solving real business problems.

Host: That brings us to the strategic side of things. I feel like often cost allocation is seen as a chore. It's a compliance exercise. The regulator says, "We need to report this, so let's just fill in the boxes and get back to work."

Guest: That is the old way, and it is such a dangerous trap. The new goal is strategic alignment. The cost allocation model shouldn't just mirror the accounting chart of accounts. It should mirror how value is created.

Host: Can you give me an example of the difference? Because to me, a cost is a cost. Rent is rent.

Guest: Well, think about it this way. An accounting chart might just list salaries, rent, and software. That tells a strategy leader nothing. It's just a list of ingredients. A value creation model allocates those buckets into things like acquisition costs, retention costs, service delivery, and innovation.

Host: That is a huge difference. If I see salaries going up, I panic. If I see innovation going up, I might be happy because it means we're building the future.

Guest: Exactly. And now you can embed this data into core business processes. Pricing, budgeting, performance tracking. If your model is aligned with your strategy, it acts as a guidance system. It tells you if you're actually doing what you said you were going to do.

Host: And the reverse must be true. If your model is bad, you're guiding the ship straight into the rocks.

Guest: The research explicitly warns about wrong signals. If your model is flawed, you might be penalizing a product that's actually highly strategic. Let's say you have a new digital wallet product. It's losing money right now because it's in growth mode.

Host: Okay.

Guest: If you use that peanut butter approach and dump a huge chunk of legacy IT costs onto that new product, it will look like a disaster. You might kill it.

Host: When in reality, it just needed to be protected from those overheads to grow.

Guest: Right? Or the opposite. You might be propping up a legacy product that looks profitable only because it's not paying its fair share of the risk costs. You drive unintended behaviors. If you allocate IT costs based solely on headcount, a manager might fire people and replace them with expensive consultants just to game the metric.

Host: Yeah, I can see that happening. Look, I reduced headcount. Meanwhile, the consulting bill exploded in a different column that nobody is tracking.

Guest: Exactly. You need a model that captures the reality of the business, not just one that is easy to calculate.

Host: So, this obviously changes the role of the finance department. They aren't just the scorekeepers anymore.

Guest: No, the days of the bean counter are over. Financial controlling has to elevate from a reporting function to a strategic advisory role. They aren't just hinging the numbers. They are helping the business improve the cost-to-income ratio. They become partners.

Host: And this ties into the idea of agility, right? We hear about agile all the time in software, but agile finance is a newer concept.

Guest: It's critical. Static annual models, they just die in volatile environments. If you set a budget in January 2024, by March the world has changed. Interest rates moved. A competitor launched a new app. If you're stuck to that January plan, you are dead.

Host: So, a robust framework allows for rolling forecasts.

Guest: Exactly. And for scenario analysis. You are updating your view of the future constantly based on the new granular data coming in. You can run scenarios. What if interest rates drop? What if this client segment leaves? Because the model is granular, you see the ripple effects immediately.

Host: You don't have to wait 3 weeks for a generic answer.

Guest: You can see if rates drop, this specific product line becomes unprofitable. So, we need to pivot. It helps identify those hidden inefficiencies.

Host: Hidden inefficiencies. That sounds like code for waste we didn't know we had.

Guest: It often is. Or it's profitable segments we didn't realize were profitable and we should be doubling down on. The digital twin acts like a flashlight in a dark warehouse. It shows you what is actually on the shelves.

Host: That is a perfect analogy. And I think the key takeaway here is that cost allocation is no longer just a finance exercise. It is a leadership lever for performance management.

Guest: That's it in a nutshell.

Host: So to summarize what we've covered, we're moving from a world of manual spreadsheets and high-level reporting to a digital twin that tracks granular data across clients, products, and channels. And this isn't just about better accounting. It shifts the culture from fighting over budgets to trading off for value.

Guest: And it turns finance into a strategic adviser that can actually help steer the ship using rolling forecasts and real-time data. It's a move from defense to offense.

Host: It's about confidence, isn't it?

Guest: It is. If you are a leader, you want to know that when you pull a lever, it's actually connected to something. You want to know that your decision is based on reality, not a best guess from 3 months ago.

Host: I'd recommend our listeners look at their own organizations right now. Ask yourself, are we managing performance or are we just reporting results? The goal is a leaner, smarter approach, where every cost serves a purpose and where every decision is grounded in insight. That's the competitive advantage. The bank that knows its costs best is the bank that can price most aggressively and invest most intelligently.

Guest: I want to leave you with a final thought to mull over. It's a bit of a challenge to take back to your teams. If you had to justify the exact value created by your specific unit's share of the IT budget today, right now with data, could you do it or would you be guessing? If you'd be guessing, it might be time to look into a digital twin.

Host: A provocative question, but a necessary one. Until our next episode, thank you for listening.