







Imprint

Published by:

Alliance for Integrity UN Global Compact Network Germany GIZ GmbH Friedrich-Ebert-Allee 32 + 36 53113 Bonn, Germany

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October 2022

On behalf of

Federal Ministry for Economic Cooperation and Development Implemented by



Digital Compliance — Use of IT Solutions to Improve the Compliance Function

Based on Surveys by the German Institute for Compliance (DICO), the UN Global Compact Network Germany (UN GCD), and the Alliance for Integrity. By Dr. Roger Strathausen, Vice Chairman of the Supervisory Board of the Liquid Legal Institute (LLI)

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Executive Summary: SMEs in the Global South have some catching up to do when it comes to digital compliance — and yet they are further along than expected!

The two surveys conducted by the German Institute for Compliance e.V. and the Alliance for Integrity on the current and future planned use of IT solutions for compliance reveal that companies in the Global South, especially SMEs, already have a certain degree of maturity in 'Digital Compliance', but still have weaknesses in the selection, introduction and operation of IT solutions for compliance.

The digital compliance mindset, i.e. the willingness to deal with digital solutions and make them usable for the company, plays a major role here. In particular, SMEs in the Global South with a digitization strategy are more successful in using compliance IT tools than companies without a digitization strategy: they are more likely to actually realize the expected benefits from using the IT tools.

Overall, the differences in digital compliance between the Global North and Global South are smaller than expected. In both surveys, slightly more than half of all companies surveyed have a digitization strategy for compliance and a corresponding budget.

IT solutions currently in use in both the Global North and Global South are mainly in the areas of 'e-learning' and 'whistleblowing'.

There is also a high degree of agreement regarding the business benefits of digital compliance. The most important business benefit cited in the Global North and Global South is 'increased efficiency of the compliance function', which can lead to cost reductions. In addition, however, 'quality improvements', 'reduction of complexity for employees' and 'increase in audit security of critical business processes' are also seen as important benefit factors.

Digital compliance is therefore not exclusively about financial aspects, but also strongly about quality and risk aspects.

These findings on digitization strategy and budget, as well as on the purpose and business benefits of IT tools, indicate that awareness of the importance of digital compliance is already relatively strong in the Global South as well, and that companies in the Global North can expect both a growing willingness and (through the use of IT solutions, among other things) a growing ability to comply with compliance guidelines among their business partners in the Global South. However, this statement can only be applied to a limited extent to companies in the Global South in general, as the companies surveyed were exclusively those interested in sustainability and compliance issues and already involved in a network. In principle, it can be assumed that this awareness is generally not so strongly anchored in the companies.

Introduction: Digitization of the Compliance Function – Today and Tomorrow

In the course of **digitalization**, IT solutions have been increasingly used for several years to strengthen integrity and compliance in companies. The Corona pandemic has accelerated this development. Numerous software companies now offer comprehensive digital **governance**, **risk and compliance** (GRC) solutions in the broadest sense.

For the many companies that are part of global supply chains, these IT solutions can now offer the opportunity to increase efficiency and effectiveness when it comes to managing risks along the supply chain on the one hand and internal as well as external requirements on the other. Due to the dynamic nature of IT technologies and increasing compliance requirements, there is a growing incentive for companies to equip themselves with IT solutions. However, it is largely unclear in which areas software solutions have proven particularly successful among companies and where the development is heading.

Against this background, the **German Institute for Compliance e.V.** (DICO) conducted a survey among its members in 2021.

In a second step, the 16-question survey was expanded in cooperation with the UN Global Compact Network Germany and the Alliance for Integrity to include their cooperation partners in Latin America, Africa and Asia (Global South). Anonymous data from 58 German and 6 other companies from countries in the Global North (a total of 64 companies) from the first survey and 98 companies from 11 Latin American countries and a further 18 companies from the Global South (a total of 116 companies) from various sectors and sizes are now available, providing a non-representative* insight into the use of IT solutions for compliance ('digital compliance') along global supply chains.

Particular emphasis was placed in the study on the current and future planned ('today and tomorrow') use of IT solutions by small and medium-sized enterprises (SMEs)** in emerging and developing countries, especially in the application areas of 'business partner auditing' and 'whistleblower systems'.

This shows that the importance of IT solutions for compliance is increasing both in the Global North and in the Global South, and that companies are well advised to consider the opportunities and business benefits, but also any limitations for digital compliance at an early stage.

^{*} This study does not make any scientific claims but represents a trend-setting mood among the companies associated with the Alliance for Integrity, the UN Global Compact Network Germany and with DICO.

^{**} According to EU Recommendation 2003/361, small and medium-sized enterprises (SMEs) are defined, among other things, as companies with annual sales of up to EUR 50 million.

Digital Compliance: Market, Areas of Application, Challenges and Business Benefits

By compliance', we primarily mean adherence to national and international legal requirements ('legal compliance'). These legal requirements no longer extend only to a company itself, but also to its respective suppliers and partners, who e.g. under supply chain laws' must be reviewed by the company for legal compliance.

In addition, compliance can also mean adherence to regulations and guidelines that companies impose on themselves and that go beyond what is required by law ('corporate compliance').

Corporate compliance puts more emphasis on ESG³-criteria (environmental, social, and corporate governance). There is a global trend for companies to become more aware of their social responsibility and to try to operate more sustainably overall. The increasing focus on ESG has a very concrete business reason in addition to ethical ones: Strong corporate compliance and sustainable business practices promote innovation and help companies become more resilient and future-oriented. They can gain competitive advantages as a result. SMEs also improve their market position by complying with sustainability standards and gain improved access to global supply chains, capital and skilled labor.

Legal and corporate compliance are ensured by companies by analyzing existing and new laws that affect the company, prioritizing them and translating them into internal policies and guidelines that are documented on websites or in manuals. The controls, roles and budgets required to define, adhere to and review the compliance function are ensured organizationally through appropriate management processes and are also regularly audited.

By digital compliance, we mean the use of IT solutions to improve the compliance function in companies.⁴ The term digital compliance has been increasingly used for several years.

Digital compliance solutions are developed by companies themselves in part on the basis of existing office tools (e.g., MS Office Access, Excel, or Word) or purchased from product providers specializing in compliance and adapted to the respective needs.

The development of the software market for compliance solutions, which is also referred to as *Corporate Compliance Solutions* on the Internet, is thus following a dynamic typical of new IT solutions, as has also been observed in recent decades about other central corporate functions such as IT, finance, HR and legal.⁵

Initially, companies try to meet newly emerging external and internal requirements with IT tools they have developed themselves. The growing customer demand is then met by specialized software vendors with so-called point solutions that need to be integrated into companies' existing enterprise resource management (ERP) back-end solutions, e.g. business partner audits and 3rd party management into central finance and risk solutions, or gift & hospitality compliance tools into corporate travel & expense solutions. As customer interest continues to grow, large IT platform providers are finally getting into the business, offering their compliance tools as part of a comprehensive and already fully integrated business suite solution.

¹ See Governance, risk management, and compliance - Wikipedia

² See <u>Supply Chain Act</u> - Wikipedia

³ See Environmental, social, and corporate governance - Wikipedia

⁴ Digital compliance, thus, does not mean compliance with standards relating to the use of IT tools.

⁵ For the area of 'Contract Management', see e.g. the whitepaper by Strathausen/Couch on 'The Evolution of Contracting'.

The **implementation** of self-developed or purchased IT tools is proving difficult for many companies, because there is often a desire to map the specific requirements in each case as optimally as possible. This leads to high costs for in-house developments and a high effort for the adaptation, integration and updating of purchased products. Cloud solutions for compliance are viewed critically by many companies because of security concerns.

In addition, the importance of **organizational**, **procedural**, **personnel and contextual factors** for the use of IT is underestimated. Not every compliance issue is equally suited to automated IT processes. Software does not work in isolation, but is only one component of holistic solutions, which should always start with the definition of concrete **business goals and application areas (use cases)**.

Often, for example, the issue of **digital governance** develops into a major challenge for companies because differences can arise between business units such as sales and purchasing on the one hand and central corporate units such as the legal and compliance department on the other as to who has sovereignty over and is responsible for a particular compliance tool.

It should also be noted that the use of IT solutions not only supports the compliance function, but also in turn poses a **security and compliance risk**. The data generated by the programs, as well as access to and use of this data, must be organized in compliance with the law, which requires internal resources and budgets even after the implementation of a compliance solution, i.e., during the ongoing operation of the solution.

It is to be expected that the use of IT solutions for compliance in companies will continue to increase as a result of increasing legal requirements, because companies need data-driven analyses in order to meet legal requirements. Artificial intelligence (AI) is already widely used in some compliance areas (e.g., fraud prevention in banking and finance) and is likely to become more important in other compliance areas as well.

The above-mentioned marketing term *Corporate Compliance Solutions* attempts to describe a young software market that is driven primarily by globalization and risk management and for which high annual growth is forecast. This market is currently still highly fragmented due to the large differences between national and industry-specific compliance requirements. There are many different products that represent specific solutions (point solutions) and are offered under different names by different manufacturers.

The products can also be listed outside the category 'Governance, Risk & Compliance', GRC, e.g. under the categories ESG as well as 'Corporate Social Responsibility', CSR⁷.

The specialist areas of application of IT solutions for compliance include e-learning on compliance topics, learning management, policy management, business partner check, whistleblower system, donations & sponsoring, gifts, hospitality & entertainment, conflicts of interest, insider list, contacts with competitors, risk assessment and code of conduct alignment.

Business goals to be achieved through digital compliance include better accessibility for all employees, increased auditability for critical business processes, reduced liability for the company and management, increased efficiency of compliance work, increased quality of compliance work, better control options and KPIs for companies, and reduced complexity for employees.

⁶ See <u>Markt für Corporate-Compliance-Lösungen, um in Zukunft massive</u>
<u>Einnahmen zu generieren – GBS News</u> (gbsg.ch) (in German)

⁷ See Corporate social responsibility - Wikipedia

Findings from the Surveys and Recommendations for Action

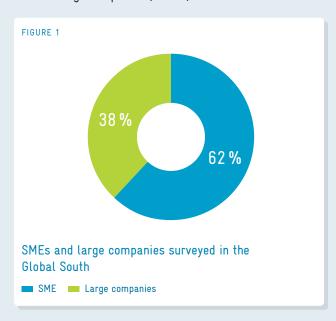
Four key findings for strengthening digital compliance can be derived from the two surveys conducted by DICO and the Alliance for Integrity in cooperation with the UN Global Compact Network Germany.

4.1

SMEs in the Global South in particular lag behind in the introduction of digital compliance

SMEs (companies with sales of up to EUR 50 million) in the Global South have more catching up to do in introducing digital compliance than large companies.

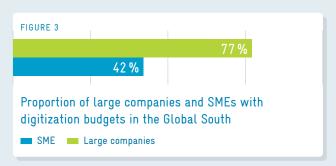
Of the 116 companies surveyed, 72 were SMEs (= 62%) and 44 were large companies (= 38%).



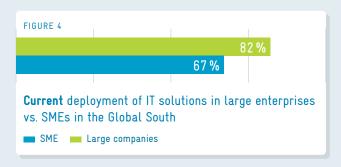
Only 50% of SMEs have a digitization strategy, compared to 75% of large companies.



Only 42% of SMEs have a digitization budget, compared to 77% of large companies.



Only 67% of SMBs currently use compliance IT tools, compared to 82% of large enterprises.



62% of SMBs plan to use compliance IT tools, compared to 64% of large enterprises.



4.2 Strategy and Budget are key success factors for Digital Compliance

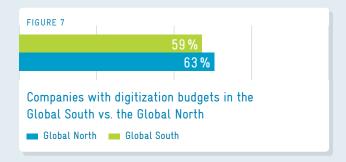
Overall, more than half of the companies surveyed in both the Global North and Global South have a digitization strategy and/or a budget for compliance IT solutions.

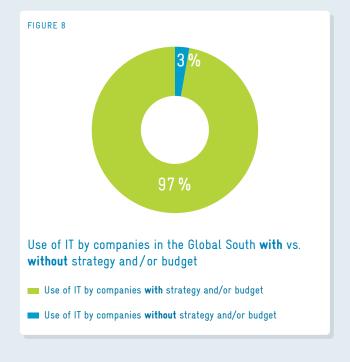


companies, although looking at the identical percentages for strategy and budget for companies in the Global South in isolation might give that impression. Only about three-quarters of Global South companies with strategy also have a corresponding budget; some companies have a budget for digital compliance but do not have a strategy.

However, strategy and budget do not correlate for all

Nearly all Global South companies with a strategy and/or budget also already use IT tools (97%). About one-third of the companies in the Global South that do not have a strategy or budget also already use IT tools.

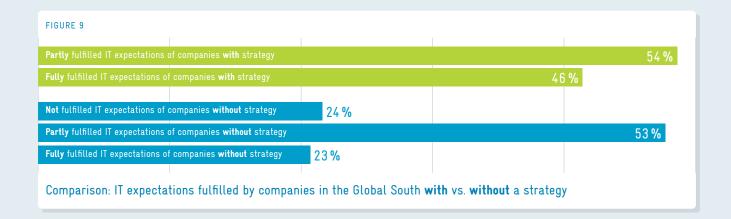




Companies (SMEs and large enterprises) in the Global South with a digitization strategy and (for the most part) a corresponding budget are more successful – in terms of their respective expectations – in using compliance IT tools than companies without a digitization strategy.

For 46% of the companies with a digitization strategy, the expectations for the use of compliance IT tools were met in full, for 54% only in part.

Only 23% of companies that do NOT have a digitization strategy see their expectations for the use of compliance IT tools fully met. 53% have partially met their expectations for the use of compliance IT tools, and 24% have NOT met their expectations for the use of compliance IT tools.



It is noteworthy that of the 69 companies in the Global South with a digitization strategy, 45 companies (= 65%) employ only up to 5 FTEs in compliance, while the remaining companies employ up to 30 FTEs or more (although the size of the compliance department is, of course, itself dependent on the size of the company). This is evidence that the existence of a digitization strategy is not necessarily dependent on the size of the compliance department.

Rather, awareness of the importance of IT solutions for compliance, the *digital compliance mindset* (visible in the development of a digitization strategy), seems to be decisive for whether a company has a digitization strategy and (for the most part) a corresponding budget.

4.3 E-learning and whistleblowing systems are currently the main areas of use for digital compliance

Overall, IT tools are **currently** used more by companies in the Global North (94%) than in the Global South (75%).

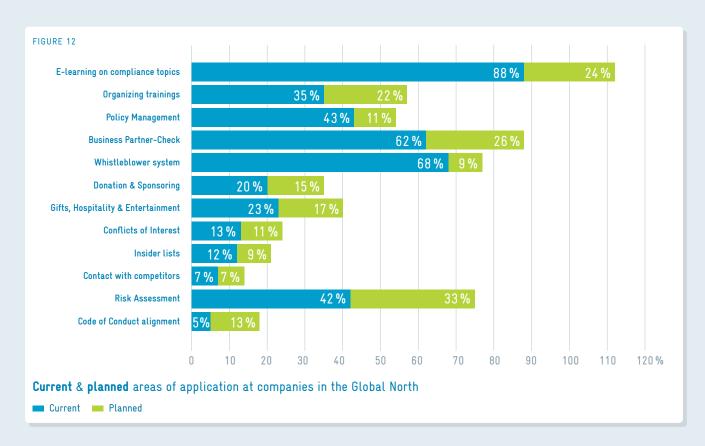
75 %

Current use of IT by companies in the Global South vs. the Global North

Global North
Global South

Regarding the **planned** use of IT tools in the future, the Global North is also clearly ahead of the Global South (83%).





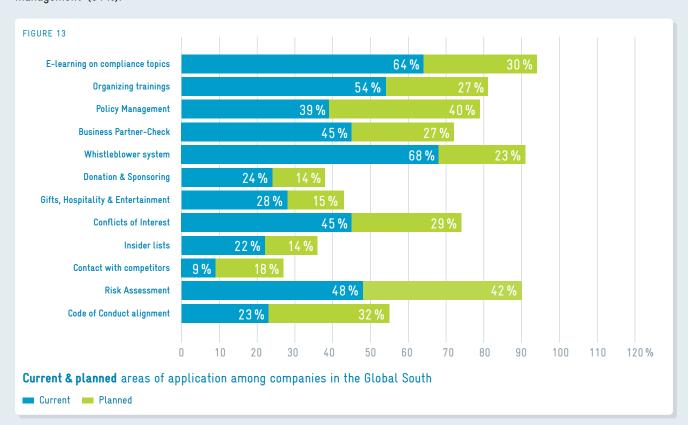
This suggests that while the Global South is already well advanced in *Digital Compliance*, it still needs to make further efforts to catch up with the Global North.

In the Global North, the top three reasons for **current** use are 1. 'E-learning on compliance topics' (88%), 2. 'Whistle-blowing system' (68%), and 3. 'Business partner check' (62%).

The top three reasons for **planned** use of IT tools in the Global North are 1. 'Risk assessment' (33%), 2. 'Business partner check' (26%), and 3. 'E-learning on compliance topics' (24%).

In the Global South, the top three reasons for **current** use of IT tools are 1. 'Whistleblowing system' (68%), 2. 'E-learning on compliance topics' (64%), and 3. 'Learning management' (54%).

The top three reasons for **planned** use of IT tools in the Global South are 1. 'Risk assessment' (42%), 2. 'Policy management' (40%), and 3. 'Code of conduct' (32%).



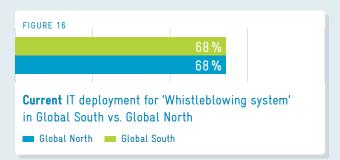
The use of current IT solutions for 'Business partner check' ranks higher in the Global North (62%) than in the Global South (45%).



With regard to the future planned use of IT solutions for 'Business partner check', the Global South with 27% is slightly above the Global North with 26%.



The same percentage of companies (68%) in the Global North as in the Global South are currently using IT solutions as a 'whistleblowing' system.



However, the proportion of companies planning to use IT solutions as a 'Whistleblowing system' in the future is significantly higher in the Global South (23%) than in the Global North (9%).



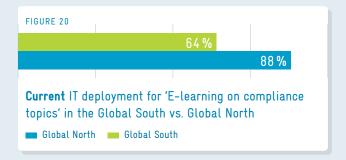
Current use of IT tools for 'Learning management' does not rank as high in the Global North (35%) as in the Global South (54%).



The planned use of IT tools for 'Learning management' is also lower in the Global North (22%) than in the Global South (27%).



Current use of IT tools for 'E-learning on compliance topics' ranks significantly higher in the Global North (88%) than in the Global South (64%).



The planned use of IT tools for 'E-learning on compliance topics', on the other hand, ranks slightly higher in the Global South (30%) than in the Global North (24%).

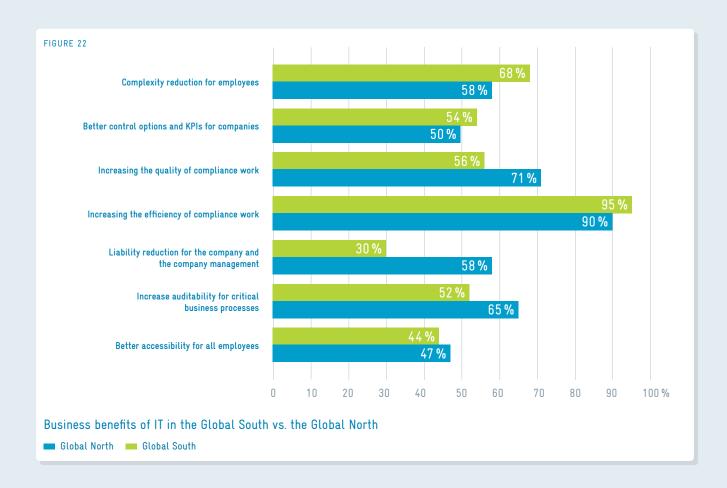


4.4 Efficiency and quality increases as well as complexity reduction represent the most important business benefits of digital compliance

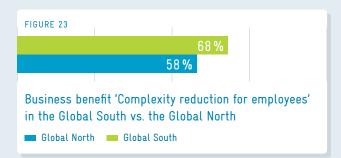
The business benefits of using IT compliance tools are rated similarly overall by companies in the Global North and Global South: both groups see 'Increased efficiency of compliance work' as the most important benefit.

In the **Global South**, the top three business benefits for using IT tools are 1. 'Increasing efficiency of compliance work' (95%), 2. 'Reducing complexity for employees' (68%), and 3. 'Increasing quality of compliance work' (56%).

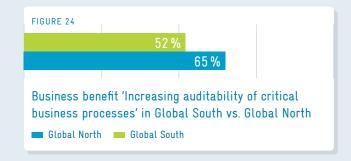
In the **Global North**, the top three business benefits for using IT tools are 1. 'Increasing efficiency of compliance work' (90%), 2. 'Increasing quality of compliance work' (71%), and 3. 'Increasing audit compliance of critical business processes' (65%).



In the Global South, the business benefit 'Complexity reduction for employees' is rated higher (68%) than in the Global North (58%).



In the Global North, the business benefit 'Increased auditability of critical business processes' is rated higher (65%) than in the Global South (52%).



4.5 Recommendation for action: Strengthen the Digital Compliance Mindset!

Based on the findings described above from the two surveys, the most important recommendation for action is that the digital compliance mindset should be promoted at all companies, both SMEs and large enterprises in the Global South and Global North, in order to strengthen the compliance function and enable the targeted use of IT tools.

The digital compliance mindset is an essential factor for companies to develop a digitization strategy and answer the question of what exactly their challenges are and to what extent they can meet them with which tools. The digitization strategy, in turn, is crucial for the successful use of IT solutions in the compliance area.

Suitable measures for strengthening the digital compliance mindset can include conferences, training events and social media activities.

Aspects such as **usability** and **mobile compatibility** of the IT solutions used are also becoming increasingly important for the success of digital compliance. Whether developed in-house or purchased, the tools must ideally be quick to introduce, user-friendly and — depending on the area of application — often easy to operate on a smartphone.

SMEs in the Global South, which as suppliers often have to meet the specifications of their contract customers in the Global North and therefore, as well as for cost reasons, have little leeway when it comes to acquiring IT tools, would do well to consider the opportunities and risks of digital solutions and develop a digitization strategy to meet the increasing demands of their customers. Northern buyers, in turn, should not leave their suppliers alone in this task, but provide them with practical support in introducing IT solutions for compliance. In the expected future investments in digital compliance in the Global North, they should always keep in mind that suppliers in the Global South must also be able to provide the required digitized data in form and scope.

In addition to the direct contacts that companies maintain with their suppliers and business partners, exchange formats with many stakeholders, for example in the context of **Collective Action** on compliance issues, can also be used to build the necessary capacities among SMEs in the Global South. Knowledge exchanges, training and sharing of good practices can contribute to this.

Overall, the two surveys indicate that the future of the compliance function in all companies will be significantly shaped by digital compliance.

Study Design and Participant Structure

This study is based on two written online surveys with 16 questions from 2021.

First, the German Institute for Compliance e.V. (DICO) conducted a survey among its members. 58 from Germany and 6 other companies from countries in the Global North (64 companies in total) participated. The revenues of the participating companies were recorded from 'up to EUR 100 million' to 'over EUR 50 billion', and the number of employees from 'up to 100' to 'over 100,000'.

In a second step, also in 2021, the survey was extended to their cooperation partners in cooperation with the UN Global Compact Network Germany as well as the Alliance for Integrity. 98 companies from 11 Latin American countries and a further 18 companies from Africa and Asia (Global South, 116 companies in total) took part.

Since the Alliance for Integrity is primarily interested in insights about SMEs in emerging and developing countries, the response options for 'Turnover' were expanded compared to the DICO survey to include the two categories 'up to EUR 10 million' and 'up to EUR 50 million', and the response options for 'Number of employees' (MA) were expanded to include the two categories 'up to 10 MA' and 'up to 50 MA'. The remaining structure of the two surveys is identical.

The anonymous data available from the two surveys and evaluated in this study are non-representative and make no scientific claim. The aim is to provide an illustrative picture of the mood regarding digital compliance in order to be able to formulate insights and recommendations. These insights and recommendations were validated from July to September 2022 with ten selected international compliance experts and therefore have a qualitative validity in addition to the empirical value.

The Organizations involved in the Study and the Author

The Alliance for Integrity

The <u>Alliance for Integrity</u> is a peer-to-peer learning and implementation network which, on behalf of the German Federal Ministry for Economic Cooperation and Development (BMZ), supports companies and governments in partner countries in jointly reducing corruption risks. In doing so, it leverages the momentum created by international standards and national legislation in some industrialized countries, which has led to internationally active companies combating corruption in their supply chains. This forms an effective incentive system for companies in emerging and developing countries to take action against corruption in their turn. The Alliance for Integrity is supported by its supporters and partners in 14 partner countries in the Global South and in Germany.

The UN Global Compact Network Germany

Based on the 10 universal principles and the 17 Sustainable Development Goals, the UN Global Compact pursues the vision of an inclusive and sustainable economy. More than 19,000 companies and organizations are already signatories of the UN Global Compact and contribute to the global vision. The UN Global Compact offers all participants comprehensive support services on key sustainability topics as well as a variety of high-profile international events.

The <u>UN Global Compact Network Germany</u> (UN GCD) currently comprises more than 800 participants — of which around 740 are companies ranging from DAX to SMEs, as well as 60 representatives from civil society, academia and the public sector. With the aim of initiating change processes in companies and strategically anchoring sustainability, the UN GCD focuses on the topics of human rights & labor standards, environment & climate, corruption prevention as well as reporting and the SDGs.

With diverse learning & dialog formats, the UN GCD promotes dialog and knowledge exchange. The aim is to make companies aware of the relevance of social and environmental standards for their core business and to support them in implementing them. Furthermore, innovation and business opportunities within the framework of the SDGs are to be highlighted and promoted.

The German Institute for Compliance (DICO)

<u>DICO</u> — <u>Deutsches Institut für Compliance e.V.</u> is a non-profit association based in Berlin. Since its founding in 2012, DICO and its more than 750 members, mostly companies, have pursued the goal of setting and developing standards for compliance practice.

It develops materials that are made available to members for their work. To this end, representatives from companies, associations, consulting and academia discuss concrete compliance topics and experiences from corporate practice in working groups and feed these back to the compliance community in the form of working papers, guidelines and standards.

DICO is thus a qualified contact for all those interested in compliance in business, associations, authorities and legislators, and a sought-after source of inspiration. DICO plays a key role in shaping good corporate governance, actively contributes viewpoints to legislative processes and contributes to the discussion of compliance issues among the interested public.

DICO provides a forum for the national and international networking of compliance experts. At the heart of DICO are the working groups, in which over 200 participants work on a voluntary basis. The professional and personal exchange among members is seen as particularly valuable. DICO membership thus offers direct benefits for compliance work.

The Liquid Legal Institute (LLI)

The <u>Liquid Legal Institute e.V.</u> is a non-profit association under German law based in Munich. It is an open and interdisciplinary platform to promote new thinking in the legal industry. Digitization, new business models and technological innovations are currently transforming all major industries worldwide. However, the legal industry has not yet sufficiently benefited from these trends. To close this gap, the Liquid Legal Institute was founded by seven experts from the practice of law, business, design thinking and computer science.

As a neutral and non-profit platform for discussion, exchange and collaboration, the LLI identifies and promotes new ways of thinking in the legal field together with partners and members. Through projects, they put insights into action, gather knowledge, create method kits, set standards, and more — all of which is available to members who can quickly apply these resources to their daily practice.

Author

This study was written by <u>Dr. Roger Strathausen</u> based on survey data provided by DICO and the Alliance for Integrity and expert interviews he conducted. Dr. Strathausen is one of the founders of LLI, is a full-time self-employed management consultant, and currently serves LLI in an honorary capacity as Vice Chair of the Supervisory Board.

