GLOBAL ESG, COMPLIANCE, AND RISK REPORT 2024

New Ways to Combat Rising Complexity and Costs

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New Ways to Combat Rising Complexity and Costs

To increase resilience in today's evolving risk environment, companies must address a multitude of new external and internal requirements. Many companies are tackling these individually rather than holistically, however, which increases organizational complexity and raises the costs of managing it. How can companies combat complexity and boost efficiency by simplifying processes while still ensuring that they maintain a robust risk and compliance framework?

Summary

This report explores the answers to the question above, highlighting practical measures that companies can take to achieve these goals. In doing so, it draws upon insights from BCG's 2024 global survey of senior risk and compliance executives across industries. We also leverage our experience in implementing efficiency programs and simplifying risk, compliance, and ESG management systems. These initiatives have decreased the number of mandatory documents, related processes, and resources by up to 50% on a global level, with even greater reductions locally.

The survey produced four main findings:

- Companies are struggling to keep pace with shifting risk priorities, particularly with regard to nonfinancial risks related to ESG, geopolitics, cybersecurity, AI, and other topics. The potential for adverse media coverage and regional variations in risk perception intensify these challenges for global organizations.
- The constantly shifting landscape of risk priorities has led to a growing array of external and internal requirements, complicating risk and compliance frameworks to a point where they have become unmanageable and excessively costly. As management and internal auditors demand more stringent measures, internal requirements have emerged as significant drivers of complexity.
- Many companies have addressed new risks with a succession of isolated responses, leading to a proliferation of policies, processes, and workflow tools. To combat the resulting complexity and rising costs, companies have focused on high-level initiatives, such as training, rather than on more effective solutions that require greater commitment, such as implementing new processes.
- Companies significantly underutilize generative AI (GenAI) as a way to reduce complexity and costs. Because most companies are not fully aware of GenAI's capabilities, they limit its use to simpler tasks, such as risk assessment. Relatively few companies use it for more substantial tasks, such as identifying gaps in the risk setup or drafting policies.

Exhibit 1 - How Simplification Reduces Burdens and Promotes Efficiency

Source: BCG project experience.
Note: FTE = full-time equivalent employee.

To address the unsustainable level of complexity and associated costs, leading companies focus on managing major risks, reducing bureaucracy and duplication, and empowering risk owners. Striking the right balance between complexity and resilience enhances both effectiveness and efficiency. Our recommended approach comprises four sets of actions:

- **Adjust governance and risk management approaches.** Conduct a thorough risk assessment to prioritize risks in order of severity. Allocate more resources to higher-priority risks while simplifying management of lower-priority ones, potentially reducing internal regulatory requirements and costs.

- **Simplify risk management.** Streamline organizational structures and clarify roles to optimize risk management, policies, and documents. Align risk management with audit activities to prevent overlap and ensure a strong defense model against nonfinancial risks.

- **Enhance risk and compliance frameworks.** Develop and implement real-time monitoring and response systems, using advanced analytics and AI to manage evolving risks. Ensure that the company updates these systems to align with evolving regulatory requirements.

- **Leverage GenAI for risk mitigation and effective risk and compliance management.** Invest in GenAI technologies to reduce complexity, enhance efficiency, and reduce costs in risk management. In parallel, prioritize implementing a responsible AI framework to address the associated risks.

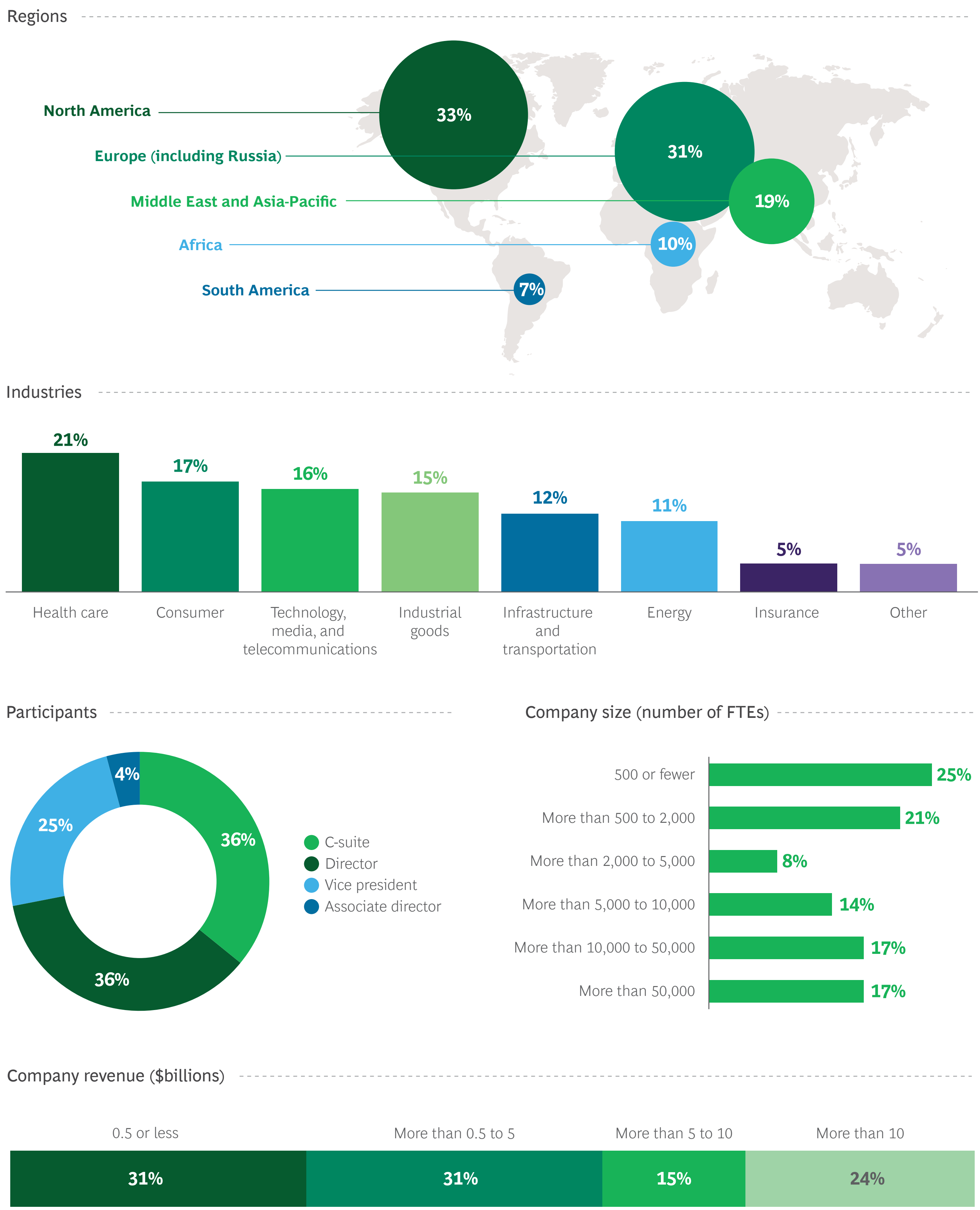
Our project experience confirms the significant positive impact of this approach. We have observed a 20% to 25% reduction in risk and compliance topics that teams need to cover, freeing them to focus more deeply on prioritized topics. We have also seen a 20% to 50% reduction in the volume of documents and regulations within the document hierarchy and a corresponding streamlining of related processes and assurance activities. (See Exhibit 1.)

Our Study: Balancing Complexity and Resilience

Recent crises, including geopolitical tensions, climate change, and the pandemic, have significantly altered the risk landscape for businesses. Concurrently, external pressures—such as trade policies, sanctions, environmental regulations, and supply chain challenges—have intensified. In response, companies have strengthened their internal risk and compliance requirements, recognizing the value of mature risk management frameworks.

To quickly address these new requirements, many companies have adopted a piecemeal and incremental approach that focuses on specific enhancements. However, the lack of a holistic implementation strategy has burdened organizations with complexity in the form of uncoordinated requirements, overlapping responsibilities, and unclear accountability. Many employees have found the ever-increasing number of paper documents, process descriptions, guidelines, and handbooks to be overwhelming. Recognizing the need to improve the efficiency and effectiveness of their risk and compliance setup, many companies are reassessing how to balance complexity and resilience.

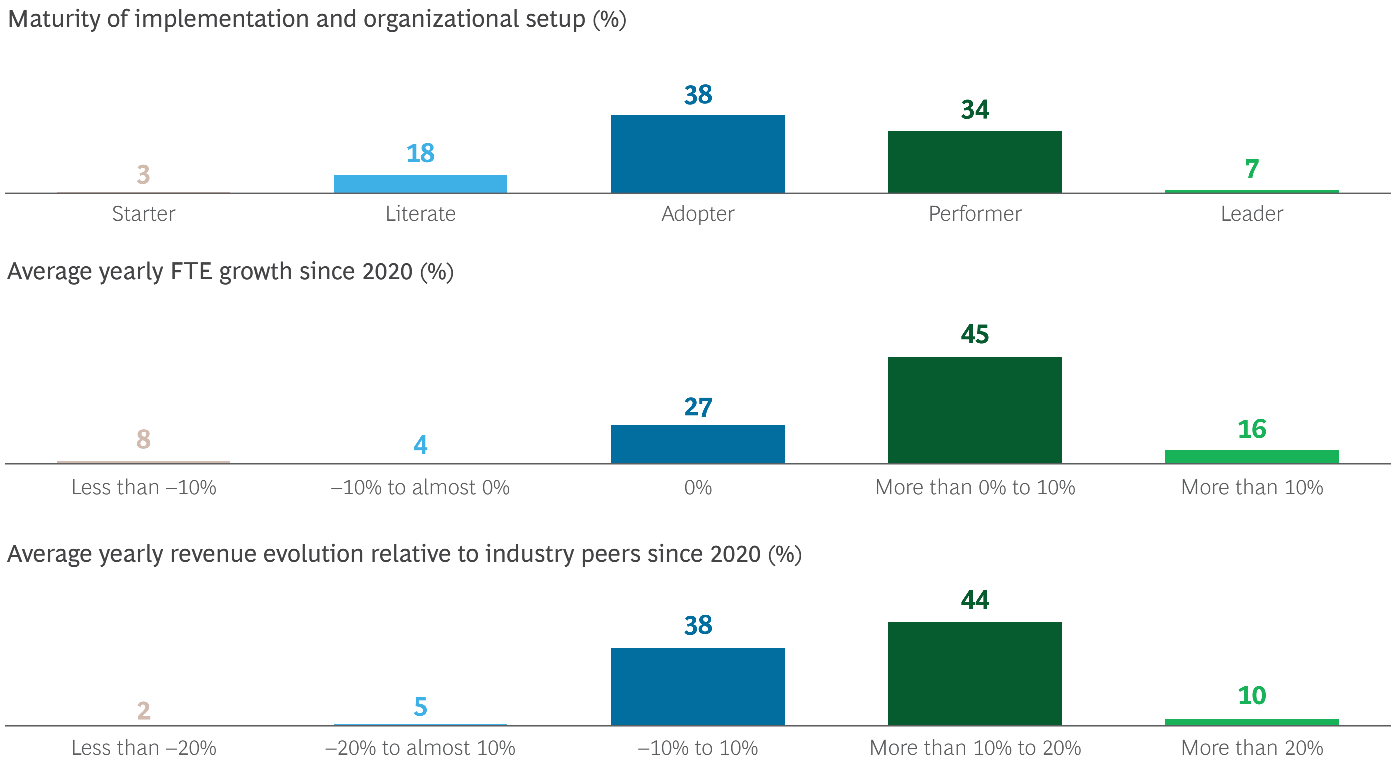
Exhibit 2 - Our Findings Are Based on Feedback from 200 Companies



Source: BCG's 2024 Global ESG, Compliance, and Risk Survey.

Note: Because of rounding, not all percentage totals add up to 100%. FTE = full-time equivalent employee.

Exhibit 3 - Surveyed Companies Are Diverse in Risk Maturity and FTE Growth



Sources: BCG's 2024 Global ESG, Compliance, and Risk Survey; BCG analysis.

Note: Because of rounding, not all percentage totals add up to 100%. FTE = full-time equivalent employee.

Our survey investigates the current state of companies' efforts to achieve resilience through mature risk and compliance management without introducing burdensome complexity and higher costs. The survey garnered responses from 200 senior executives, the vast majority of them in businesses outside the financial sector. (See Exhibit 2.) The companies in our survey also reflected a wide distribution of maturity levels for implementation and organizational setup, from starter to leader, allowing us to draw broad conclusions. (See Exhibit 3.)

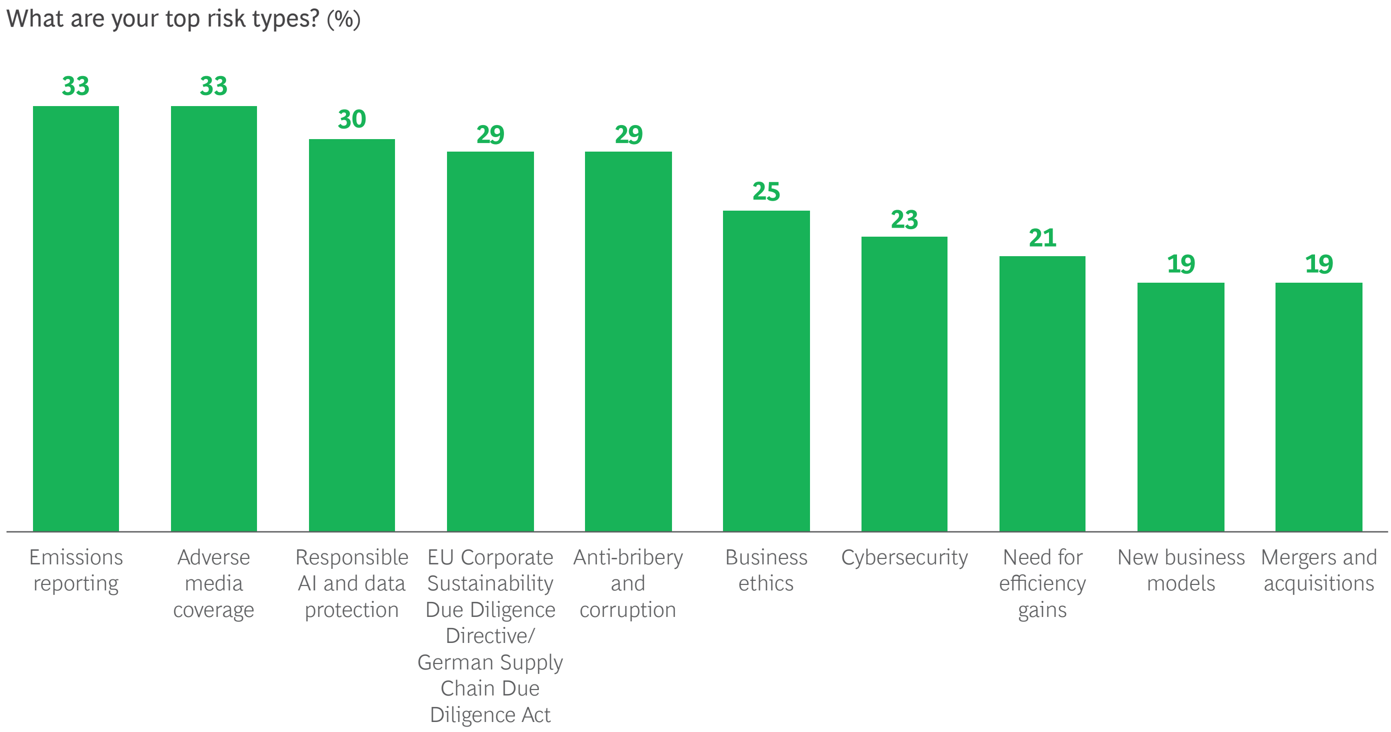
Companies' Ranking of Risks Has Changed

In last year's survey, respondents emphasized their concerns about legal and operational risks, such as cybersecurity. This year, we see several major shifts:

- **Respondents are seeing ESG-related risks as more prominent.** Emissions reporting surged from sixth place to first place in the survey's ranking of top risks. (See Exhibit 4.) Compliance with the EU Corporate Sustainability Due Diligence Directive and the German Supply Chain Due Diligence Act also gained importance. Other EU regulations—including the Corporate Sustainability Reporting Directive—are adding to ESG compliance burdens. Companies subject to US laws must manage compliance with regulations such as the Security and Exchange Commission's Enhancement and Standardization of Climate-Related Disclosures for Investors rule, as well as California's stringent disclosure requirements. Nonfinancial companies' heightened attention to sustainability and reporting obligations mirrors trends that we saw earlier in financial institutions. However, many organizations are struggling to cope with the expanding regulatory burdens.

- **Adverse media coverage is a new key risk.** The second-place ranking of adverse media coverage reflects the growing importance and fragility of reputational risk in recent years. The rapid spread of news via social media adds another layer of complexity to what has for some time been a significant area of concern. Nevertheless, many companies have not implemented a holistic framework to manage, monitor, and react to reputational risks, leaving themselves vulnerable in the fast-moving social media landscape.

Exhibit 4 - ESG-Related Risks and Adverse Media Coverage Are Top of Mind



Sources: BCG's 2024 Global ESG, Compliance, and Risk Survey; BCG analysis.

Note: Respondents were asked to select their top five risk types.

- **Companies now view responsible AI and data protection as one of the top three risks they face.** As AI regulation gains global attention, it has become an important focus for risk and compliance officers. For example, as the European Union's AI Act comes into force, finding efficient and effective ways to implement its requirements is a top priority. (See "The EU AI Act Highlights Greater Regulatory Scrutiny.") Complying with AI regulations entails dealing with significant complexity, not only in the area of technical adjustments but also with regard to governance changes across organizations. Moreover, as AI continues to evolve, companies must stay agile, continuously adapting their compliance frameworks to meet new legal and ethical standards.

- **Respondents rank IT and cybersecurity risks lower in the risk hierarchy than they did in the recent past.** This surprising change, which contrasts with the intensification of cyber threats globally, may simply be a sign of risk fatigue. Years of continuous emphasis may have fostered a perception that these risks are now under control or less urgent than emerging threats such as geopolitical tensions, climate change, or global health crises.

Regional differences in risk priorities add a further degree of variability to the mix. (See Exhibit 5.) For example, respondents in the Middle East and Africa give higher priority to anti-bribery and corruption, potentially owing to sociopolitical circumstances in those regions. Meanwhile, in South America and Central America, the need for efficiency gains rates as a prominent risk, an assessment likely tied to companies' efforts to catch up from weaker economic positions. Local environmental regulations are at the center of risk perception in Europe, but the effects of these regulations have repercussions in other regions as well. Interestingly, respondents in South America and Central America do not yet perceive adverse media coverage as a major risk, though this may change in the future.

The EU AI Act Highlights Greater Regulatory Scrutiny

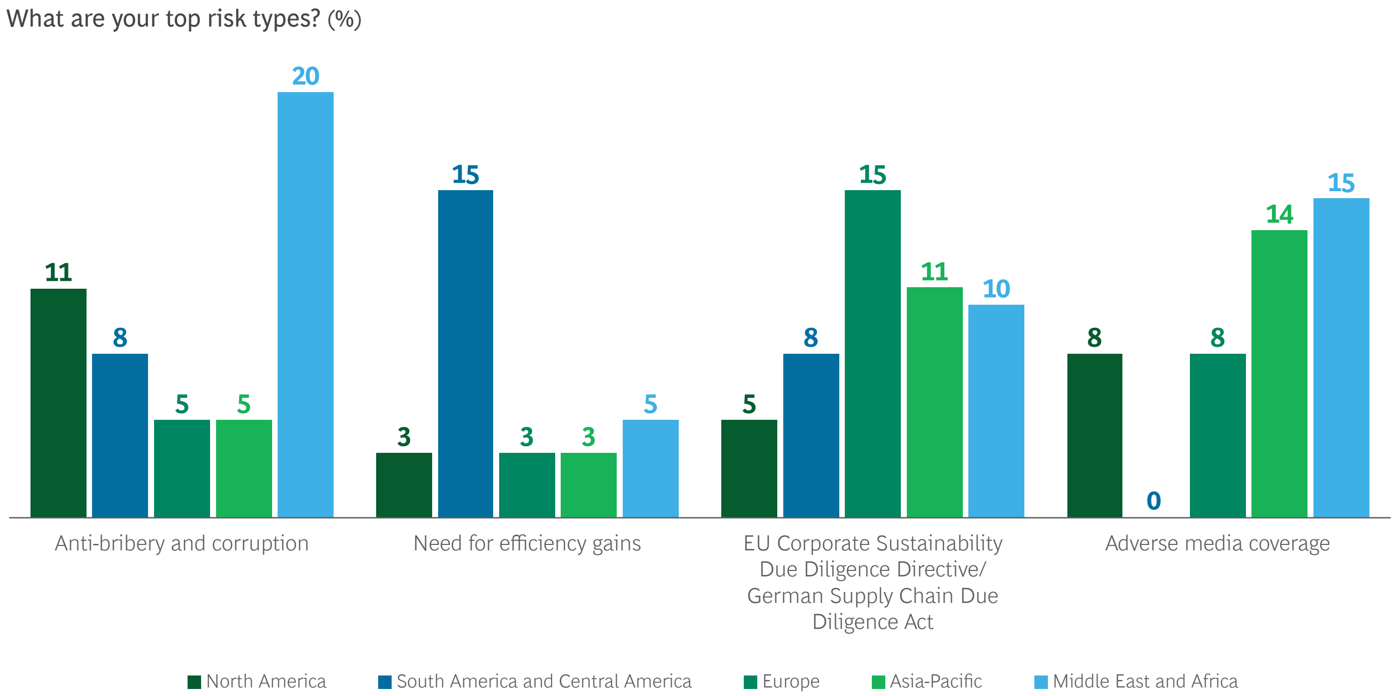
The EU AI Act includes four key aspects:

- A four-tiered risk classification for AI systems: unacceptable, high, limited, and minimal
- A comprehensive set of requirements for high-risk AI systems, including third-party audit and registration
- Additional transparency requirements for all AI systems that interact with people
- An obligation for companies to ensure compliance, based on role (for example, provider or distributor)

The act imposes fines of up to 7% of annual global revenue for noncompliance. Companies have 6 to 36 months to ramp up their compliance, depending on the risk classification of their particular use cases. For example, unacceptable use cases, such as certain emotion recognition applications, cannot be implemented in the EU as of February 1, 2025—six months after the law went into effect.

In addition, the act significantly alters the overall process of use-case development by requiring an integrated risk assessment at every step—from initial ideation (for example, determining the scope of the risk assessment) through going live (for example, conducting the EU conformity assessment) and running the system (for example, reporting incidents). To ensure compliance, companies must holistically consider several dimensions, such as AI definition and risk tiering. In addition, companies must redefine risk mitigation strategies across the entire value chain.

Exhibit 5 - Regions Differ Strongly in Their Perception of Risks



Sources: BCG's 2024 Global ESG, Compliance, and Risk Survey; BCG analysis.

Note: Respondents were asked to select their top five risk types.

Internal and External Requirements Are Now Almost Equal as Drivers of Complexity

For the first time in our annual survey, this year's results indicate that internal and external requirements are almost equally responsible for driving risk and compliance complexity in nonfinancial institutions (see Exhibit 6):

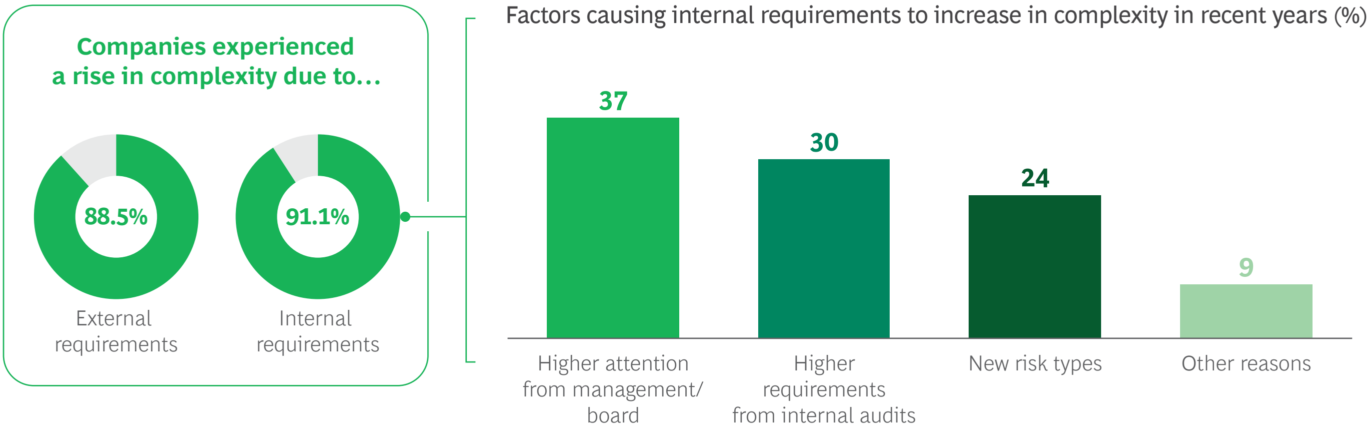
- External requirements, such as additional regulatory demands (cited by 69% of respondents) and pressures from auditors (19%), continue to be important drivers of complexity.
- Even so, internal requirements have effectively caught up with external factors in importance. This shift reflects increased attention from management and the board, heightened requirements from internal audits, and the emergence of new risk types (such as those relating to AI and ESG).

The change in emphasis reflects management's growing awareness of the importance of having robust risk and compliance frameworks in place, spurred by recent crises, such as COVID-19 and the Russia-Ukraine war, as well as an era of generally high geopolitical and economic volatility. In addition, companies face more intense regulatory scrutiny of high-profile topics, such as compliance with US trade regulations. These circumstances have prompted more exacting demands from internal audits to ensure adherence to defined processes and standards, with a focus on gaps relative to market standards. Further, companies have adopted a more proactive approach to new risk types, requiring that the company integrate consideration of these risks into the framework for assessment and monitoring.

Together, these factors increase complexity and associated costs for companies, adding to the pressure on them as they try to cope with the evolving risk environment. Complications may take the form of overlapping assurance activities, unclear governance, and uncoordinated execution.

More complex risks require comprehensive solutions and full attention of the management board.

Exhibit 6 - Internal and External Requirements Fuel Complexity Almost Equally



Sources: BCG's 2024 Global ESG, Compliance, and Risk Survey; BCG analysis.

Companies Lack an Effective Strategy to Manage Complexity and Reduce Costs

Over the past few years, companies' risk and compliance challenges have intensified as they have sought, in many cases, to manage new laws, regulations, and risks with distinct management systems layered on top of existing risk management frameworks. As a result, companies find themselves burdened with additional complexity that is costly and difficult to manage.

Respondents told us that they view their current strategy and approach as inadequate for addressing new, volatile risks. Only 2% of respondents deem the measures their company has adopted to manage complexity to be fully effective, and another 30% consider them to be moderately effective. (See Exhibit 7.) Even among more mature companies, no more than 5% of respondents indicated that their organization had implemented fully effective measures.

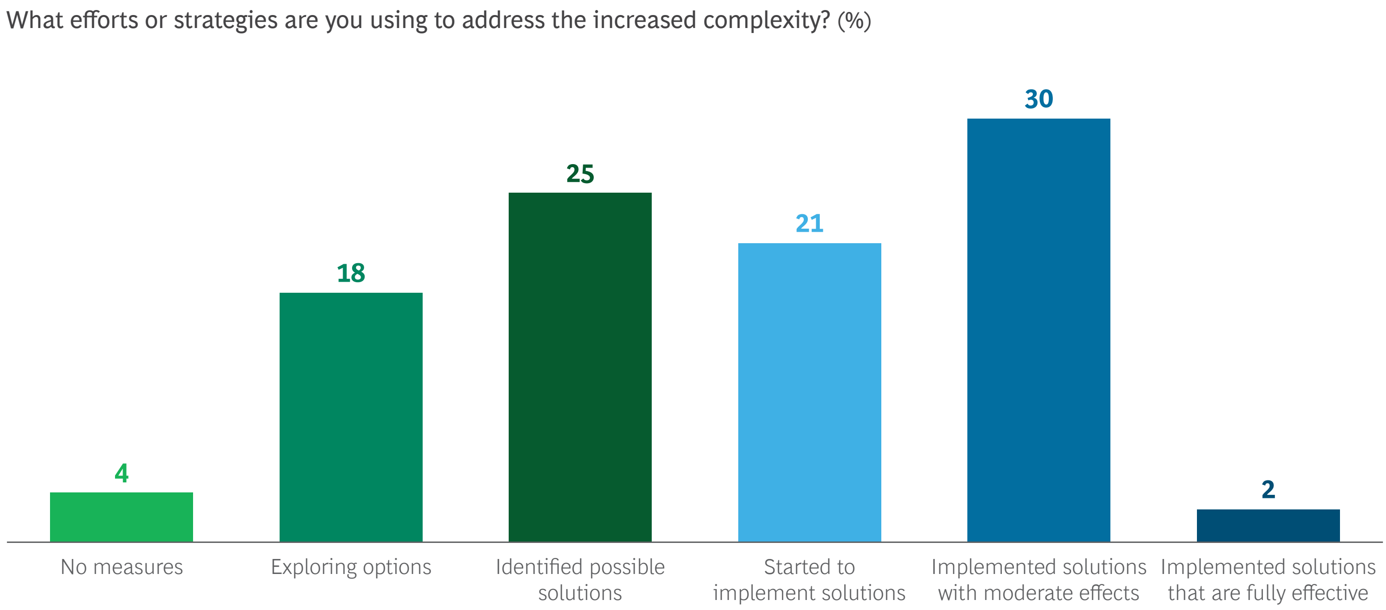
The root cause of the problem is that, unlike operational and technical risks, more complex risks require comprehensive solutions and the full attention of the management board. In addition, many companies lack a holistic overview of their risk landscape, which is essential for prioritizing and managing risks appropriately.

The measures that companies have implemented so far provide insight into why companies struggle to combat complexity. (See Exhibit 8.) Commonly, companies focus first on high-level measures that, although relatively easy to implement quickly, do not adequately address today's more stringent requirements and greater uncertainty, and fail to reduce costs. For example, although a stronger tone from the top and additional training—the two most widely cited implemented measures—are necessary, in many cases they do not directly reduce complexity or costs.

Companies are responding to the situation by planning more effective measures that focus on holistic changes within the organization—such as the top-ranked initiative, "reprioritizing focus areas," and the third-ranked, "closer collaboration between centralized and decentralized functions." These measures require pursuing alignment across different stakeholders and departments, as well as defining a new governance model or working mode. (See "Companies in Process Industries Can Simplify Risk Management with Holistic Measures.") Since these changes fundamentally alter an organization, a strong commitment from all levels is essential.

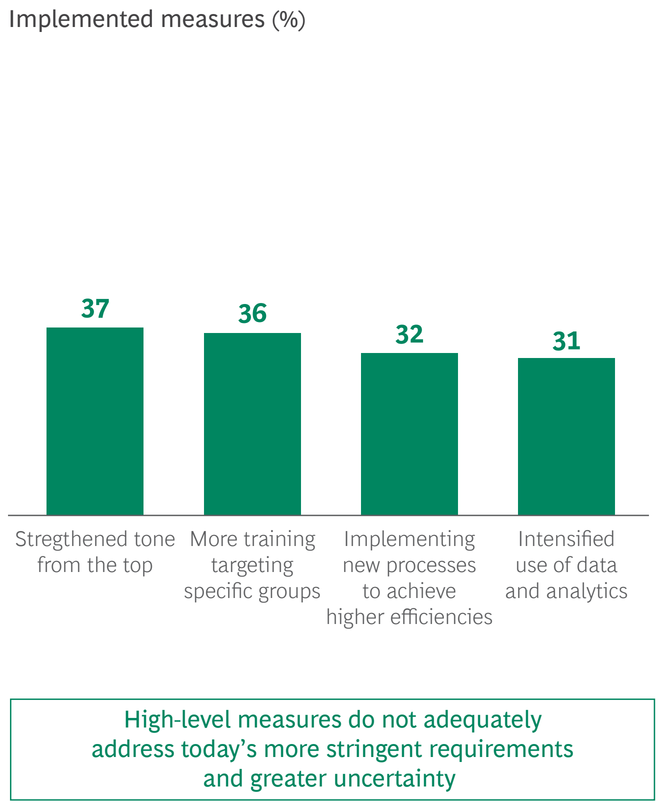
The second-ranked planned initiative, "investment in specialized talent"—such as hiring employees with specialized skills—is effective but difficult to implement. The shortage of highly skilled workers makes it hard to find people with the appropriate capabilities. Moreover, once they are hired, specialists can add significant value only if they are working with streamlined organizational structures and setups.

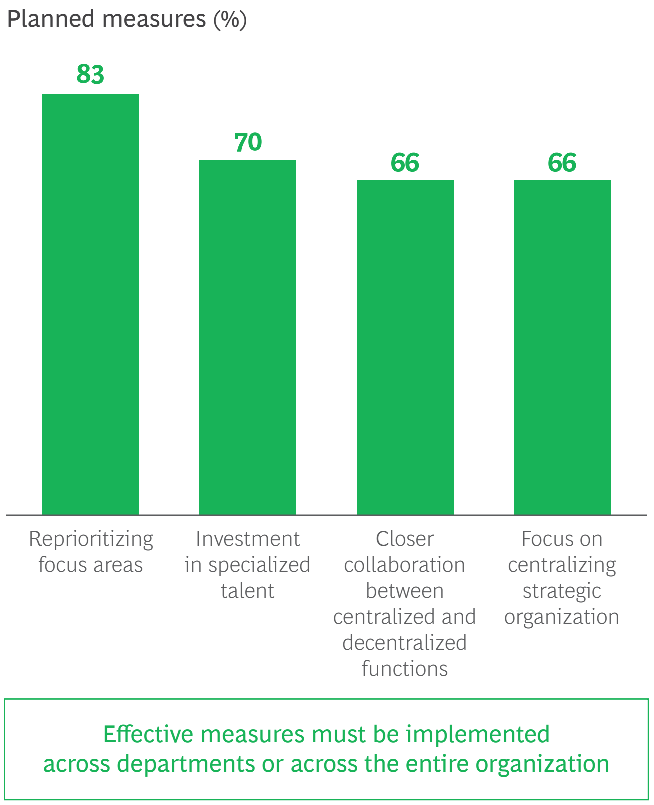
Exhibit 7 - Companies Haven't Found an Effective Strategy for Combating Complexity



Sources: BCG's 2024 Global ESG, Compliance, and Risk Survey; BCG analysis.

Exhibit 8 - Implemented Measures Fail to Adequately Reduce Complexity, but Companies Are Planning More Effective Ones





Sources: BCG's 2024 Global ESG, Compliance, and Risk Survey; BCG analysis.

Companies in Process Industries Can Simplify Risk Management with Holistic Measures

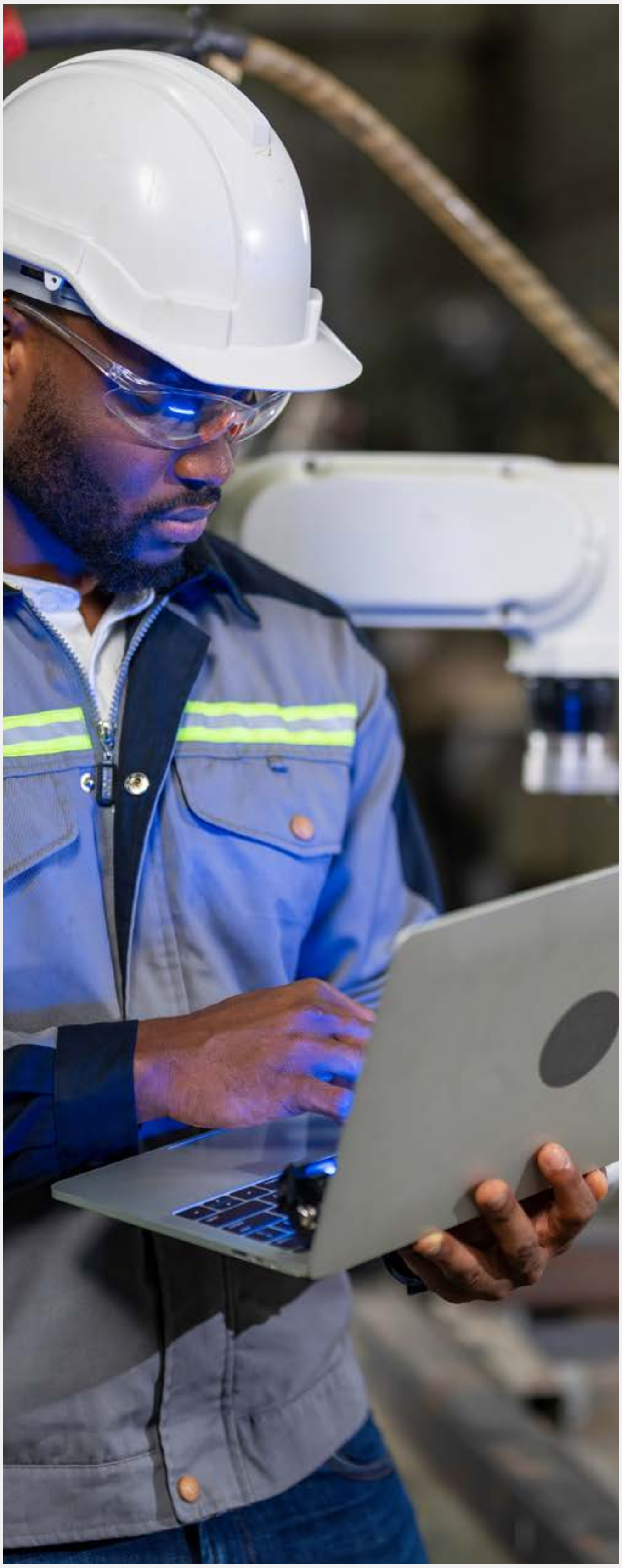
Many companies in process industries struggle with fragmented risk assurance activities. Unclear governance structures lead to duplicative efforts by operations, risk, and compliance functions. In the absence of a unified approach, assurance efforts lack consistent alignment and coordination, and teams may not share a common understanding of their organization's risk taxonomy.

To tackle these challenges, one company implemented a holistic risk assurance transformation. This process involved establishing a central team to coordinate assurance activities across all business functions, guided by an improved document hierarchy to ensure alignment of the first, second, and third lines of defense. The central team now leads the planning process, prioritizing risk assessments and consolidating assurance efforts.

The transformation has yielded a number of significant benefits:

- 33% fewer mandatory documents, streamlining compliance efforts
- 30% fewer mandatory requirements, simplifying risk management processes
- 40% fewer nonessential, nonmandatory elements, freeing teams to focus on critical risks
- 20% less time spent on non-value-adding activities

Other process industry companies have adopted similar measures to centralize governance, standardize processes, and align assurance activities with their risk appetite, thereby enhancing effectiveness and minimizing redundancies. They have also implemented a comprehensive methodology playbook to ensure greater consistency in risk and compliance functions. As a result, the organizations are better equipped to respond to emerging risks even as they operate with greater clarity and focus.



Survey results indicate that GenAI remains massively underutilized as a tool for tackling complexity and effectively managing risk.

Companies Are Underutilizing GenAI

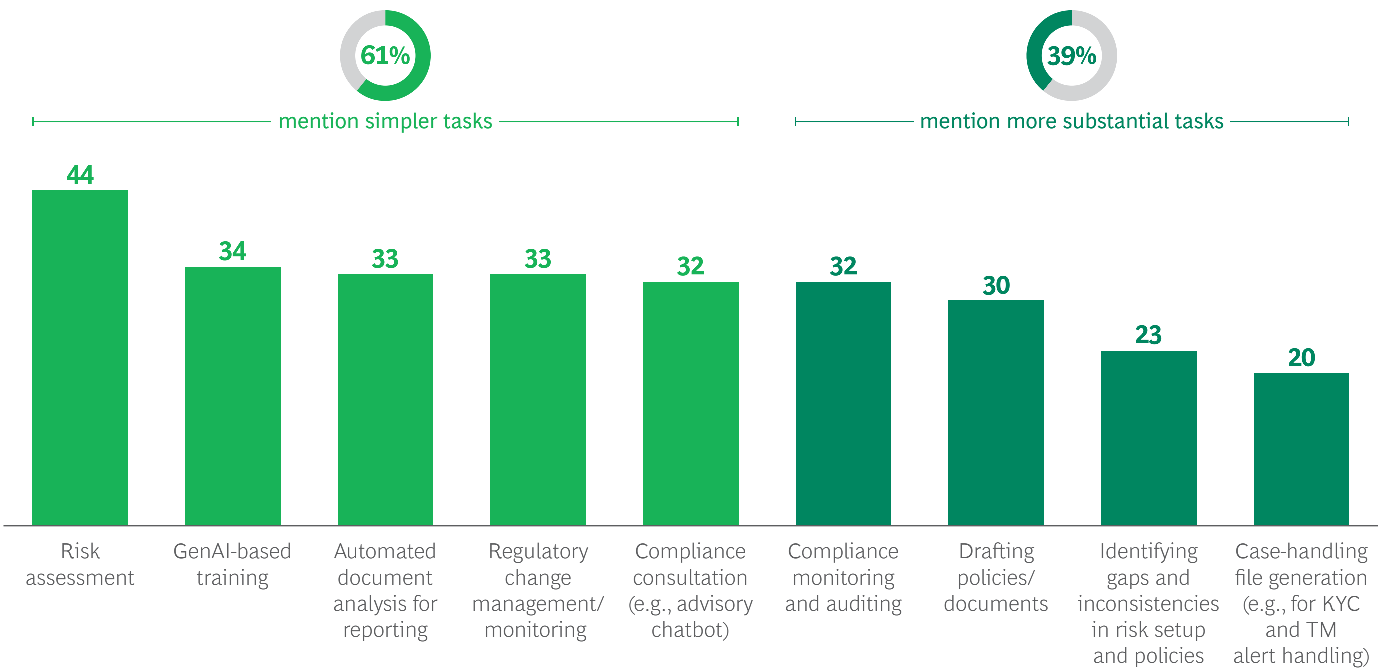
GenAI is a potentially powerful tool for managing rising risks and adapting to a changing environment. Yet survey respondents ranked it as only the 17th-most-important vehicle for tackling complexity. GenAI remains massively underutilized as a tool for risk management, and most companies do not recognize the potential of using AI and data analytics to boost efficiency and reduce costs.

Overall, 61% of respondents identify GenAI as a possible solution for at least one simple task—such as training or automated document analysis for reporting purposes. (See Exhibit 9.) Only 39% see it as a possible solution for one or more substantial tasks, such as identifying gaps in the risk setup or drafting policies. Use cases involving potentially greater benefits—for example, real-time auditing, enhanced anomaly detection, and stakeholder communication—lie well outside the scope of most companies' GenAI implementations. In contrast, innovative companies are pushing the boundaries of GenAI applications and achieving significant efficiency gains. (See "GenAI Reduces the Complexity of the Export Classification Process.")

In any event, companies must ensure that their GenAI implementations comply with increasingly stringent regulatory requirements. To successfully scale AI solutions, organizations must integrate a comprehensive responsible AI framework that will help them identify, measure, mitigate, and steer the associated risks.

Exhibit 9 - GenAI Remains Underutilized and Is Mainly Used to Solve Simple Problems

Which of the following generative AI use cases are you considering or implementing for compliance and risk management? (%)



Sources: BCG's 2024 Global ESG, Compliance, and Risk Survey; BCG analysis.

Note: KYC = know your customer; TM = transaction monitoring.

GenAI Reduces the Complexity of the Export Control Classification Process

The export control classification process, which is typically manual and resource intensive, illustrates the potential positive impact of GenAI implementation. GenAI use cases across several key areas can contribute to building a streamlined, future-proof system that improves cost-effectiveness, ease of use, risk mitigation, adaptability, and scalability:

- GenAI enhances the filtering and prioritization process by assessing risk exposure at the level of individual items, excluding irrelevant items, and prioritizing those that remain.
- It supports data cleansing by consolidating and integrating relevant data and then categorizes items based on similar attributes.
- To improve regulatory compliance, the GenAI system identifies applicable regulations and data needs, streamlines the assessment of classification-relevant regulations, and monitors changes via natural language processing.
- GenAI facilitates data gathering by parsing documents, recognizing images, and assisting in drafting information requests to suppliers.
- The technology recommends classifications on the basis of regulations and available information, using machine learning for increased accuracy.
- It enhances documentation processes through centralized reporting and automated documentation of classification results.

Conclusion: The Imperatives for Combating Complexity

Our survey findings reveal that risk management and compliance functions today face more intense pressure to respond to the ever-changing risk environment. These pressures affect not only risk and compliance but also most companies' broader operations. Yet most organizations are not equipped to reduce the complexity that comes with more rigorous requirements, and the resulting significantly higher costs.

Four imperatives are critical for companies to combat complexity and reduce costs while positioning themselves to manage emerging and evolving risks more effectively:

- **Adjust approaches to risk management on the basis of risk priorities.** Adopt a top-down approach to compliance and risk management that relies on a comprehensive assessment of the risk landscape to set priorities. Identify all potential risks that the company might face, and categorize them according to their severity and potential impact on the organization. For higher-priority risks, allocate more resources—including specialized teams, advanced monitoring systems, and senior executive oversight—to ensure that the organization actively manages and mitigates them. For lower-priority risks, take a more streamlined approach that includes basic controls and monitoring mechanisms and relatively cost-efficient delivery models.

- **Simplify risk management holistically.** Simplification involves optimizing organizational structures, clarifying roles and responsibilities, and refining processes. It also involves aligning and integrating risk management frameworks with audit and assurance activities to prevent duplication and ensure a robust three-lines-of-defense model. Another crucial measure is to streamline policies and employ consistent methodologies. By simplifying and streamlining policies, companies can reduce the number of risk and compliance topics that it no longer needs to actively manage by 20% to 25% and can eliminate 20% to 50% of documents and regulations within the document hierarchy. This will reduce resource requirements throughout the three lines of defense.

- **Enhance risk and compliance frameworks to adapt faster.** Implementing comprehensive, real-time monitoring and response systems is key to managing evolving risks effectively. For instance, the US Department of Justice's September 2024 update to its Evaluation of Corporate Compliance Programs guidelines highlights the importance of addressing the risks associated with using new technology. Effective measures include using advanced data analytics and AI-driven tools to predict potential risks and suggest proactive responses. Another key is to develop a rapid response protocol to address newly identified risks. This may involve predefined escalation procedures, clear lines of communication, and access to necessary resources. Updating these systems as needed will ensure that they satisfy the latest regulatory requirements and industry best practices.

- **Harness GenAI for advanced risk mitigation and compliance tasks.** Companies must significantly increase their expectations for and investments in GenAI technologies. Successful implementations using the technology will not only reduce complexity and ensure effectiveness but also enhance long-term efficiency and reduce costs. Because the use of GenAI brings its own risks, companies need to implement a responsible AI framework governing its use.

By addressing these imperatives, companies can combat complexity while implementing robust risk and compliance frameworks to ensure resilience.

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