

Integration of Governance, Risk, and Compliance and Environmental, Social, and Governance for the Indonesian Banking Sector

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Abstract

Coordination of state intelligence is one source of problems which also This article explores the integration of Governance, Risk, and Compliance (GRC) with Environmental, Social, and Governance (ESG) in the banking sector. The integration of GRC and ESG, known as ESGRC, plays a crucial role in mitigating both financial and non-financial risks, enhancing reputation, and creating long-term value through smarter risk management and sustainable governance. Additionally, ESGRC facilitates better responses to global challenges such as climate change and social inequality while unlocking new opportunities in sustainable finance, including carbon trading and green financing. Other strategic benefits include improved transparency, accountability, and corporate performance. However, the article highlights several major challenges, including the need for investment in advanced technologies like Big Data and Artificial Intelligence, as well as the cultural shifts required to support ESGRC adoption. Regulations like POJK 51/2017 and POJK 14/2023 in Indonesia serve as key drivers for ESGRC implementation, though global uncertainties remain significant barriers.

Introduction

The global banking sector has undergone major changes in regulation, stakeholder expectations, and an increasingly complex business environment over the past few decades, particularly since the turn of the 21st century. Banks are expected to be more trustworthy, to implement sound governance, to control dynamic risks, and to comply with legal and industry regulations while still optimizing revenue to ensure business continuity. In 2007, the idea of Governance, Risk, and Compliance (GRC) emerged as an important framework for financial institutions to manage risk, ensure regulatory compliance, and practice good governance (Mitchell, 2007). Mitchell had introduced the GRC acronym as early as 2003. This concept subsequently influenced stakeholders and the banking industry worldwide. In Indonesia, Governance, Risk, and Compliance is translated as Tata Kelola, Risiko, dan Kepatuhan. In subsequent developments, each GRC element governance, risk, and compliance has been described as comprising four fundamental components: strategy, processes, technology, and people. The disciplines, components, and rules of each GRC element are then integrated holistically and applied across the organization, aligned with business operations that are managed and supported through GRC (Racz et al., 2010). In Indonesia, the implementation of GRC in the banking industry has been pursued more seriously since 2018. This stemmed from a 2018 survey by the Asian Corporate Governance Association (ACGA) and CLSA Limited, which found that Indonesia required significant improvement to compete with other countries in Asia (ASEAN Corporate Governance Association, 2018). Since then, banking professionals in Indonesia have convened to formulate guidelines for GRC implementation in the Indonesian

banking industry. Gradually, GRC has shaped banking operations in Indonesia. The Financial Services Authority (OJK) has been highly committed to promoting integrated GRC adoption across the banking industry and the broader financial services sector through the issuance of OJK Regulation (POJK) No. 17 of 2023 on the Implementation of Governance for Commercial Banks (POJK 14 of 2023-Carbon Trading Through Carbon Exchanges, 2023). At the same time, there has been growing international pressure for industry and business to pay greater attention to sustainable development. As Chen and Xie (2022) note, many countries now require corporate disclosure related to environmental, social, and governance (ESG) management to support sustainable development (Chen & Xie, 2022). The idea of sustainable development emerged much earlier, beginning with the 1972 United Nations Conference on the Human Environment in Stockholm, Sweden. That UN conference, attended by an Indonesian delegation, produced agreement on the need to consider environmental aspects in development programs undertaken by all countries, in response to increasingly alarming environmental degradation. The business community responded to these demands several decades later. ESG became an investment concept and a standard for corporate evaluation, and it has since become a focal point for sustainable development (Brooks & Oikonomu, 2018). ESG is regarded as a key element of modern business operations.

A substantial body of literature finds a positive correlation between ESG implementation and corporate performance. High-quality ESG disclosure significantly reduces the cost of capital and alleviates firms' financial burdens (Cheng et al., 2014), increases corporate profitability (Yoo & Managi, 2022), and enhances shareholder value (Wang et al., 2022). In banking, ESG adoption can also improve reputation, minimize risks, and capitalize on sustainability opportunities (Friede et al., 2015). Dyllick & Hockerts (2002) further affirm that, in the ESG context, banking organizations focus not only on profitability but also on responsibility to society (social impact) and the environment (environmental impact) (Dyllick & Hockerts, 2002). In addition, research shows that ESG practices help firms manage non-financial risks such as reputational, regulatory, and market risks which are rising due to climate change and heightened social expectations (Khan et al., 2016). ESG offers opportunities to create long-term value by improving operational efficiency and strengthening relationships with stakeholders (Clark et al., 2015). In Indonesia, regulations from the Financial Services Authority (OJK) have encouraged ESG adoption in the financial sector, particularly through sustainable finance policies such as POJK 51/2017, which requires financial institutions to address environmental, social, and governance aspects in their annual reports (POJK 51 of 2017-Sustainable Finance, 2017; Setiawan, 2020). This aligns with global trends in which major banks have adopted ESG in their operations to minimize risks and maximize contributions to sustainable development (Scholtens, 2021). The simultaneous demands and obligations to implement both ESG and GRC make their integration an inevitability. Integrating ESG with GRC often referred to as ESGRC creates a holistic governance approach that is more responsive to global challenges such as climate change and social inequality (Eccles et al., 2014). Accordingly, the implementation of ESGRC is not merely an effort to comply with regulations but also part of corporate strategy to manage risks and seize opportunities arising from social and environmental change. However, implementing ESGRC in banking presents significant challenges. Some banks struggle to align sustainability strategies with short-term business objectives, particularly amid global economic uncertainty and market volatility (Jalilvand, 2020). Furthermore, there remains a gap between the theoretical understanding of ESG's importance and its practical implementation on the ground, especially in developing countries (McWilliams & Siegel, 2001). Against this backdrop, this article aims to analyze the integration of GRC and ESG in the banking sector, focusing on strategic benefits and challenges. Advances in technologies such as Big Data and Artificial

Intelligence (AI) can further enable ESGRC to become more proactive and responsive to increasingly complex global dynamics (Jensen & Meckling, 1976).

Theoretical Review

Governance, Risk, and Compliance as an Integrated Governance Foundation

Governance, Risk, and Compliance may be viewed as a combined base that helps organizations to guide operations in a responsible manner, handle uncertainty in a systematic way, and make sure that internal and external requirements are met. This framework is particularly relevant in the banking industry since a bank is continually working within a highly regulated environment, with multifaceted stakeholder pressures, reputational risk, and high expectations of institutional trust. GRC is not, therefore, a mere technical control tool of the organization. It is a strategic governance structure that assists the financial institutions to coordinate decision making, operational discipline, and accountability in a consistent way.

Theoretically speaking, the agency theory offers one of the first explanations of why organizations need governance and control systems. According to Jensen and Meckling, the division of ownership and management introduces the likelihood of divergent interest so that monitoring and control mechanisms are necessary to ensure that actions of the managers are consistent with organizational objectives. In the banking environment, this reasoning comes in very handy since the institution does not just deal with personal managerial motives, but also with depositor confidence, social trust and stability of the entire system. In this respect, GRC serves as a framework that diminishes the agency issues by defining responsibility, enhancing supervision, and instilling prudence into the organizational behaviours.

This governance orientation is broadened as customized by stakeholder theory. Freeman stresses that it is not only shareholders that organizations should be responsible to, but also to a broader group of stakeholders whose interests are directly or indirectly influenced by corporate decisions. In the case of banks, this involves regulators, customers, investors, employees, communities, and society in general. This view comes in handy especially in the explanation of why GRC in the banking industry cannot be narrowed down to internal efficiency. It should also concern itself with the question of legitimacy, ethical responsibility and long term implications of institutional behavior. In this light, governance is not just about power and oversight, but about having a responsible relationship between the bank and the wider environment in which it is situated.

The applicability of GRC is also supported by the theory of corporate governance where the authorities emphasize the necessity of institutional solutions governing the correlation between management, boards, and owners to decrease conflicts of interest and increase accountability. Good governance in the banking sector is strongly related to prudential regulation, transparency of decisions, internal control and alignment of executive actions with institutional mandates. This is the theoretical basis that GRC should be taken to imply as an inter-related system instead of the administrative functions that are independent. Governance offers guidance, risk management offers foresight and compliance ensures that the organizational behavior does not exceed the acceptable legal and ethical limits.

This is further enhanced by risk management theory that states that organizations need to find, evaluate and act upon the uncertainty to ensure continuity and performance is maintained. Risk in the banking sector is not limited to credit risk or market exposure. It contains operational, legal, reputational, technological, social, and environmental aspects as well that can influence the institutional resilience. This is what makes risk management one of the key elements of GRC. It helps banks to transcend reactive control and to a more intelligent type of governance that prepares to disruption, assesses the impact and informs strategic adjustment. The theory of

compliance management adds to this logic by emphasizing on the significance of systems that promote compliance to regulatory standards and institutional rules. Compliance is not a marginal aspect in a very regulated industry like the banking industry. It is among the circumstances upon which the credibility of governance and the trust of the people is held.

These theoretical views demonstrate that GRC can be best considered as a unified governance base that can be used to promote organizational discipline, strategic prudence, and institutional legitimacy. This conceptualization is entirely aligned to the discussion established in this article where the concept of governance, risk, and compliance are not considered in isolation, but rather as complementary dimensions, which help define the way in which banks can react to modern regulatory and strategic demands.

Environmental, Social, and Governance as a Sustainability Framework

Although GRC is the framework that offers the structural basis of institutional control and accountability, Environmental, Social, and Governance is a wider framework of sustainability that widens the scope of organization performance understanding. ESG can be traced back to the process of acknowledging that financial success cannot be measured and discussed only in monetary terms. Organizations are becoming more anticipated to be responsible in the preservation of the environment, social well being, and ethical governance. This expectation has taken a critical role in the banking sector as the banks have the power to determine the flow of investment, financing priorities, and the distribution of economic resources in the society. Consequently, the move towards the adoption of ESG is not just a reflection of the change in business values, but also the change in the way, in which financial institutions are supposed to outline their role in development.

The triple bottom line approach presents one of the most important theoretical entry points of ESG. The concept of profit, people and planet by Elkington puts organizations in the dilemma of pursuing economic success at the expense of social responsibility and environmental management. The view is very applicable in the banking industry since the industry is no longer viewed as a neutral dealer whose sole aim is profitability. There is a growing expectation that banks should be sustainable financiers, responsible investors, financial inclusionists, and climate accountable. In this perspective, ESG can be viewed as a system that expands the role of banking and introduces the element of sustainability into the institutional strategy.

The phenomenon of ESG becoming a strategically important concept can also be explained in terms of resource based thinking. In this view, organizational advantage is not simply created by the financial resources or the market power, but also the capacity to deal with the intangible resources, including the reputation, trust, relationships with stakeholders, and sustainability capability. In the case of banks, effective ESG performance can lead to credibility, attractiveness of investors, customer loyalty, and long term resilience. This is one of the reasons why ESG is not to be understood as just a form of external pressure or symbolic reporting. It may equally be used as a competitive tool that increases competitiveness in a market that is becoming more and more moulded by sustainability criteria and moral anticipations.

This insight is enhanced further by institutional theory which demonstrates that organizations do not exist in a vacuum. They are influenced by norms, rules and social expectations that shape what is regarded as appropriate and legitimate behavior. The emergence of ESG in banking could thus be seen as an institutional change that is broadly institutionalized whereby sustainability, transparency, and responsibility are turning into the new norms. Banks respond to these expectations not only due to the regulation, but also due to the fact that legitimacy is increasingly based on observable compliance with social and environmental issues. The same reasoning can be supported by the theory of legitimacy, which states that in order to avoid

losing the social approval and institutional stability, they need to be congruent with the values of society. In this respect, ESG reporting, sustainable governance are not just a technical reaction, but a form of the attempt of the bank to stay socially believable in the shifting environment.

The sustainability development theory also justifies the applicability of ESG by stating the necessity to find the middle ground between economic growth and the environment and social well-being. It is particularly significant in the banking sector since financial institutions have a major role in facilitating or limiting sustainable transitions by making decisions regarding their financing. Simultaneously, the socially responsible investment theory underscores the fact that investors are increasingly paying attention to ESG factors when assessing corporate conduct and long term value. In the case of the banking industry, this places further pressure on the need to incorporate sustainability in governance and strategy as the market confidence is no longer determined by profitability alone, but environmental and social performance as well. This is supplemented by stakeholder engagement theory that emphasizes that responsiveness and meaningful organizational responsibility cannot be achieved without dialogue and responsiveness to the interests of various constituencies. This is relevant in the banking industry whereby ESG should not be relegated to reporting language but also the substantive relationship to customers, regulators, communities, and the environment.

Due to these reasons, ESG in this article is perceived as not just a label of sustainability. It is a theoretical model that reinvents the understanding of the quality of governance, corporate responsibility, and long term value creation in the banking industry. This insight fits into the bigger picture of the article, which holds that banks are forced to respond more and more to sustainability demands in a manner that is both strategic, accountable, and institutionally entrenched.

The Integration of GRC and ESG as ESGRC

The main thesis of the given article is based on the notion that GRC and ESG cannot be discussed as similar frameworks that act separately. Rather, their combination constitutes a more holistic governance model that can respond to the institutional control as well as sustainability responsibility. This combined orientation may be termed as ESGRC, a scheme that integrates the discipline of governance, risk consciousness, regulatory conformity, environmental responsibility, social responsivity, and long term strategic value into one conceptual model. This integration is of paramount importance especially when it comes to the banking sector where financial institutions must stay prudent, compliant, trustworthy, and more responsive to the issues of sustainability.

In theory, the GRC and ESG need to be combined since the risks that modern banks are exposed to are not only financial risks anymore. Climate risk, social inequality, reputational vulnerability, failure in governance, and regulatory scrutiny now engage with each other in a more interactive manner and require a more holistic response. A GRC model that lacks ESG can be good in control, but weak in sustainability orientation. On the other hand, an ESG agenda that lacks GRC can be normatively appealing, though weak in implementation discipline and institutional assurance. ESGRC considers this gap through introducing sustainability issues into the business rationale of governance, risk and compliance. By so doing, it makes ESG an external obligation a built-in part of the institutional management.

The integration of this theory may also be perceived in terms of stakeholder and legitimacy. By engaging in ESGRC, a bank is not just insulating itself against operational and regulatory risks, but also addressing more general demands about fairness, accountability, the environment, and responsible financing. By this framework, governance is more responsive,

risk management is more future oriented, and compliance is more significant since it does not only foster legal compliance, but also ethical and sustainability informed responsibility. Through this, ESGRC indicates the evolving character of organizational legitimacy within the financial sector where institutional achievement is becoming more reliant on the capacity to integrate prudence with purpose.

In the Indonesian banking landscape, this incorporation gains special relevance due to the fact that the regulatory landscape has already started to shift towards a more sustainable finance-oriented approach, enhanced governance, and a more extensive accountability. The banking industry is thus faced with a two-fold imperative. It has to be in line with governance and prudential requirements as well as react to sustainability agendas that redefine stakeholder expectations and strategic opportunities. This is exactly the reason why the concept of ESGRC can be analytically useful in the current study. It offers a logical framework of analyzing how governance, risk, compliance and sustainability can be integrated in a manner that would support both institutional resilience and long term responsible growth.

According to this theoretical review, the article places ESGRC as a comprehensive view of governance that can be applied to explain the contemporary changes in the Indonesian banking industry. The above theories are not independent entities, but rather conceptual pillars, which can be interrelated to understand the need of integrating GRC and ESG, the nature of governance logic they embody, and how they can help in the generation of sustainable value within banking institutions.

Methods

The research design of this study was a qualitative descriptive study aimed at studying the issue of integrating Governance, Risk and Compliance and the Environmental, Social and Governance in the Indonesian banking industry. This design was deemed suitable since the research was not aimed at testing causal associations and making statistical inferences, but rather formulating a more qualitative and contextual insight into the appearance, perception, and implementation of the concept of ESGRC in the modern banking context, as well as its growing prominence in the modern financial context. Qualitative descriptive design was thus chosen as it gives the researcher an opportunity to be close to the phenomenon under study, and get a hold on the policy logic, institutional sense and strategic implications within the discourse of governance, sustainability, risk, and compliance. Being the banking industry, where regulatory pressures, reputational pressures and the sustainability pressure are so tightly interwoven, this methodology offers the flexibility to be able to view the phenomenon in a holistic, grounded sense.

This study was aimed at the conceptual and practical relationship between GRC and ESG as a combined governance framework in the banking sector. To be more precise, the research aimed at examining the ways in which the convergence of the two frameworks may help enhance the governance practices, become more responsive in terms of risk management, enhance the regulatory compliance, and become more committed to sustainability. Simultaneously the study also focused on the strategic advantages that can accrue due to such integration such as increased transparency, accountability and long term value creation, and the institutional and operational hurdles that could impede its execution. The framing of the inquiry in this manner enabled the study to transcend a simply definitional discourse and, instead, to discuss ESGRC as an evolving governance orientation that indicates regulatory transformation as well as evolving expectations of the banking industry.

The data utilized in the study were qualitative and were gained mostly by writing. The researcher has reviewed various written materials that were directly pertinent to the study area

such as academic journal articles, scholarly books, regulatory documents, policy papers, and institutional publications on the area of governance, risk management, compliance, sustainability, and banking transformation. Special attention was paid to the documents that assist in explaining the Indonesian regulatory environment, in particular, those provided by the Financial Services Authority, and scholarly publications, which comment on the theoretical and strategic basis of GRC and ESG. The choice of these materials was due to their ability to offer some conceptual depth as well as practical information on how the concept of governance and sustainability are being conceptualized in the banking sector. It is based on this documentary foundation that the study could build an informed interpretation of ESGRC without leaving the qualitative nature of the research.

The discourse and regulatory framework that has integrated GRC and ESG in the Indonesian banking sector became the unit of analysis in this research. In line with this, the analysis has not been centered on specific respondents or field based observation, but the meanings, assumptions, and policy directions contained in the chosen documents. This analytical interest is significant in that the question of ESGRC in banking is not just a practice based on organizational practice, but also regulatory requirements, institutional discourses, and the changing demands of the stakeholders. The banking sector was selected as the context of analysis due to its strategic location within the national economy and its pivotal role in facilitating financial stability, direction of investment and sustainable finance efforts. Being a social institution of trust, banks must maintain a very high level of governance quality in addition to keeping up with the rising demand in environmental and social responsibility. This makes the sector especially relevant for examining how GRC and ESG may be brought together within a unified governance perspective.

Data collection was done by systematic review of documents. In performing such a step, the researcher recognized, categorized, and analyzed documents according to their credibility to the study objectives. The sources were thoroughly read to extract the main thoughts, policy trends, theoretical reasoning, and practical issues regarding ESGRC implementation. Instead of seeing documents as fixed information, the researcher treated them as texts that express more generalized institutional interests and developments in governance in the banking sector. This procedure enabled the researcher to follow the process of the construction of the language of risk, compliance, sustainability and governance in various sources and how these aspects gradually amalgamate into an increasingly integrated strategic model.

Qualitative descriptive analysis was used to analyze the data. The analytical process was initiated through the data reduction where the researcher would classify the data gathered and choose the information that would be most important to the main themes of the study. The step entailed defining key concepts, argument circles, policy focus areas, and patterns of explanation in terms of the integration of ESG and GRC. Then the data were arranged and offered in the form of a logical story in order to analyze better the connections between ideas, regulation guidelines, and implementation problems. The last phase was to make conclusions based on the interpretation of patterns that arose based on the materials reviewed. The analysis was, in this respect, not only descriptive in a superficial sense, but interpretive in the sense that it aimed to uncover how ESGRC has been placed as a significant development of governance in the Indonesian banking industry and why its application holds promise and complexity at the same time.

Results and Discussion

ESGRC SYSTEM

Risk Management as an Intelligence System

Risk management within the framework of an Extended Integrated GRC System (GRC + ESG) serves a function far deeper than merely acting as a tool for identifying and mitigating threats. This system can operate as a cognitive intelligence mechanism that supports strategic decision-making through the mapping, analysis, and monitoring of risks relevant to various external and internal factors. In a broader context, this form of risk management is not only reactive to existing threats, but also proactive in detecting new opportunities arising from environmental changes, such as market conditions, regulations, technology, climate change, and social shifts. Risk management is useful to ensure that management makes decisions aligned with the firm's objectives and interests. Jensen dan Meckling (1976) emphasize that organizations are required to build monitoring and risk-mitigation systems that transparently protect the interests of owners while also fulfilling legal obligations (Jensen & Meckling, 1976). In a wider context, organizational responsibility also extends to all stakeholders, not merely shareholders. Freeman (1984), stresses that companies need to consider the impact of their business activities on society, the environment, employees, customers, and all parties involved or affected (Freeman, 1984). This approach is highly relevant in GRC + ESG. Risk management functions not only to minimize financial risk, but also to ensure that the social and environmental impacts of every business decision have been taken into account. Risk management must adopt a holistic perspective that enables the organization to identify and manage risks that may harm various parties, not only shareholders. Good governance also forms the basis for managing relationships among shareholders, management, and the board of directors. Shleifer dan Vishny (1997) highlight the importance of sound governance to minimize conflicts of interest that often arise in business relationships, and to ensure that decision-making processes are transparent and accountable (Shleifer & Vishny, 1997). Through risk management, good governance encourages the application of operational standards that prevent the risk of conflicts of interest. Thus, risk management plays an important role in keeping the company on a safe track, not only from internal threats, but also from various external compliance demands. Risk management in the GRC + ESG context is therefore not only aimed at reducing threats from business operations, but also at ensuring that the organization remains adaptive and competitive amid external environmental changes. Damodaran (2008) underscores the importance of identifying, measuring, and managing risk to protect the organization from potential business losses (Damodaran, 2008). This is where risk management serves as a dynamic component that enables the organization to seize opportunities amid change, while maintaining its continuity and stability. Within the GRC + ESG risk management framework, organizations must also ensure that every operational step and business decision complies with applicable legal and ethical standards. Weber (2011) stresses that this is essential to avoid reputational risks that may have long-term impacts on the organization's credibility (Weber, 2011). Effective compliance likewise ensures that the firm can protect itself from legal sanctions.

Proactive and dynamic risk management in GRC + ESG creates a foundation for governance that is more responsive to change. By using technologies such as Big Data and Artificial Intelligence (AI), risk analysis can be carried out in real time, enabling organizations to identify emerging risks or opportunities more quickly. With this approach, risk management acts not only as a risk blocker, but also as a driver capable of mapping opportunities amid challenges. Risk management systems can be continually adjusted through processes of calibration, feedback, and fine-tuning, so that they remain responsive to changes occurring in both the external and internal environment. Ultimately, risk management in GRC + ESG supports the

implementation of more comprehensive and adaptive Good Corporate Governance (GCG). Organizations can develop governance systems that integrate compliance, risk management, and the fulfillment of social responsibility while simultaneously leveraging opportunities to create value. This risk management approach ensures that every business decision has undergone careful consideration to balance the interests of all stakeholders. The result is a governance system that not only complies with regulation, but also creates sustainable value that benefits all parties.

Good Governance as an Integrated Moving System

Good Corporate Governance (GCG) within the framework of Environmental, Social, Governance, Risk, and Compliance (ESGRC) is not merely a structure for control and supervision. It is an integrated system that ensures the organization operates responsibly, both internally and externally. Embedded within it are check-and-balance mechanisms designed to ensure that every part of the organization understands and bears responsibility in preventing misuse of assets, abuse of power, or actions that may violate business ethics. This is vital in reducing governance failures that can lead to financial and reputational losses. A solid governance framework refers to the thinking of Jensen and Meckling (1976), who state that management acts as agents responsible on behalf of the owners of the company (Jensen & Meckling, 1976). From this perspective, management's task is to ensure that every operational action aligns with the company's objectives and complies with applicable regulations. Acting on behalf of the owners, they also ensure that risk management is conducted prudently, so that potential threats that could endanger the organization are identified and addressed. This governance principle then expands to encompass responsibility toward all stakeholders. Freeman (1984) emphasizes that organizations should not focus solely on generating profits for shareholders, but also consider the interests of society, employees, the environment, and consumers (Freeman, 1984). This approach reinforces the ESGRC aspects, ensuring that every business decision is evaluated based on its impact on various stakeholders. Accordingly, the company strives to balance the pursuit of financial returns with broader social responsibility. The principles of governance also underscore the need for clear arrangements governing the relationships among shareholders, management, and the board of directors. Shleifer and Vishny (1997) stress the importance of sound corporate governance mechanisms to minimize conflicts of interest among these parties (Shleifer & Vishny, 1997). Effective governance fosters harmonious working relationships among all parties involved in the organization, ensuring that every decision is made within the framework of compliance and business ethics. This forms a robust foundation for navigating complex operational and strategic challenges. Furthermore, Damodaran (2008) explains the importance of risk management in protecting organizations from potential losses that may arise (Damodaran, 2008). Risk management within ESGRC not only focuses on identifying and measuring risks but also on implementing concrete mitigation measures. This enables companies to maintain operational stability and continuity even amid uncertain external conditions. The system operates proactively to prepare the organization for changes in the business environment and to navigate potential financial, operational, or regulatory risks. The importance of regulatory compliance is also emphasized by Weber (2011), who states that effective compliance mechanisms help organizations meet applicable legal and regulatory standards. (Weber, 2011). By ensuring that every organizational action complies with regulations, the company not only avoids the risk of sanctions but also protects its long-term reputation in the eyes of the public. Sound compliance mechanisms form the foundation for transparent and accountable governance, safeguarding the organization's integrity at every step. Overall, GCG within ESGRC entails a dynamic integration of organizational structure, processes, and culture. The information generated by risk management serves as the foundation for data-driven decision-making, ensuring that

governance processes align with sustainability principles. Dynamic governance enables organizations to adapt quickly to regulatory changes and market demands, as stipulated in POJK No. 51 of 2017 on the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies (POJK 51 of 2017-Sustainable Finance, 2017). Effective governance not only serves to ensure regulatory compliance but also promotes more transparent and accountable decision-making (Kaplan & Norton, 1996). This aligns with global trends toward more sustainable governance that emphasizes social and environmental dimensions. Good governance also ensures that every organizational action aligns with sustainability principles, encompassing profitability, social responsibility, and environmental sustainability. Governance processes backed by in-depth, real-time risk analysis ensure that the organization is always ready to confront new challenges and seize opportunities arising from social and environmental change (Jones & Pollitt, 2002).

Compliance as an Assurance System to Support Dynamic Governance

Compliance within Environmental, Social, Governance, Risk, and Compliance (ESGRC) plays a role that goes beyond merely fulfilling regulations. The compliance system also functions as a mechanism that supports the continuity of the organization's governance and risk management. Jensen and Meckling (1976) state that management, as an agent, acts on behalf of the owners to manage the organization in accordance with sound governance principles. This includes ensuring that every corporate policy, procedure, and activity operates within the predetermined parameters. Such an approach creates a compliance system that strengthens governance and prevents conflicts of interest. In relation to responsibility toward various stakeholders, organizations need to broaden their orientation so that it is not solely focused on shareholders. According to Freeman (1984), organizations have responsibilities toward all stakeholders, such as employees, customers, the environment, and the wider community. This view underlies the holistic ESGRC approach, in which compliance covers not only legal aspects but also the dynamic social and environmental needs. Thus, organizations are expected to continuously adjust to public expectations and demands. Shleifer and Vishny (1997) emphasize that good corporate governance plays an important role in structuring the relationships among owners, management, and the board of directors. Effective governance enables organizations to minimize conflicts of interest and increase transparency in decision-making processes. This also supports the implementation of continuous risk management, in which organizations are expected to actively identify, measure, and manage potential business risks, as outlined by Damodaran (2008). This process creates a safety net for organizations to face challenges and protect their assets from unexpected losses. Furthermore, Weber (2011) emphasizes the importance of robust compliance mechanisms to ensure that organizations consistently adhere to applicable regulations and standards. In Indonesia, POJK No. 46 of 2017 stipulates that compliance serves a strategic function in maintaining a balance between governance and effective risk management (POJK 46 of 2017-General Bank Compliance Function, 2017). A reliable compliance system helps organizations remain consistent in implementing ethical governance while also supporting innovation and efficiency. With a feedback loop in place, organizations can continuously adapt to changes, whether in regulations or market needs. This system enables periodic policy adjustments that align with the organization's long-term sustainability vision. Organizations that implement governance in line with ESGRC principles will not only be better prepared to face risks, but will also be able to innovate and maintain operational efficiency. Compliance does not merely act as a gatekeeper to ensure regulatory adherence. The compliance system should function as an assurance system that supports consistency and alignment between governance and risk management. Compliance ensures that all organizational policies, provisions, systems, procedures, and activities are consistent with the results of risk management analyses, which

are formulated based on the organization's dynamic risk profile. Ultimately, compliance is a set of ex ante (preventive) actions or measures to ensure that policies, provisions, systems, procedures, and business activities conform to applicable laws and regulations. Indonesia's banking sector has a solid track record in implementing this compliance dimension. The industry is accustomed to being at the forefront of governance innovation and operational efficiency (Ackerman, 2009).

Integration of ESG into GRC: A Holistic Transformation

The integration of Environmental, Social, and Governance (ESG) dimensions into governance, risk, and compliance (GRC) creates a more holistic and sustainable management model. This ESGRC approach underscores the need to balance the interests of owners, shareholders, and other stakeholders to ensure transparent and accountable management. According to Jensen and Meckling (1976), management acts as an agent operating on behalf of the owners, ensuring regulatory compliance and effective risk management to prevent potential conflicts of interest.

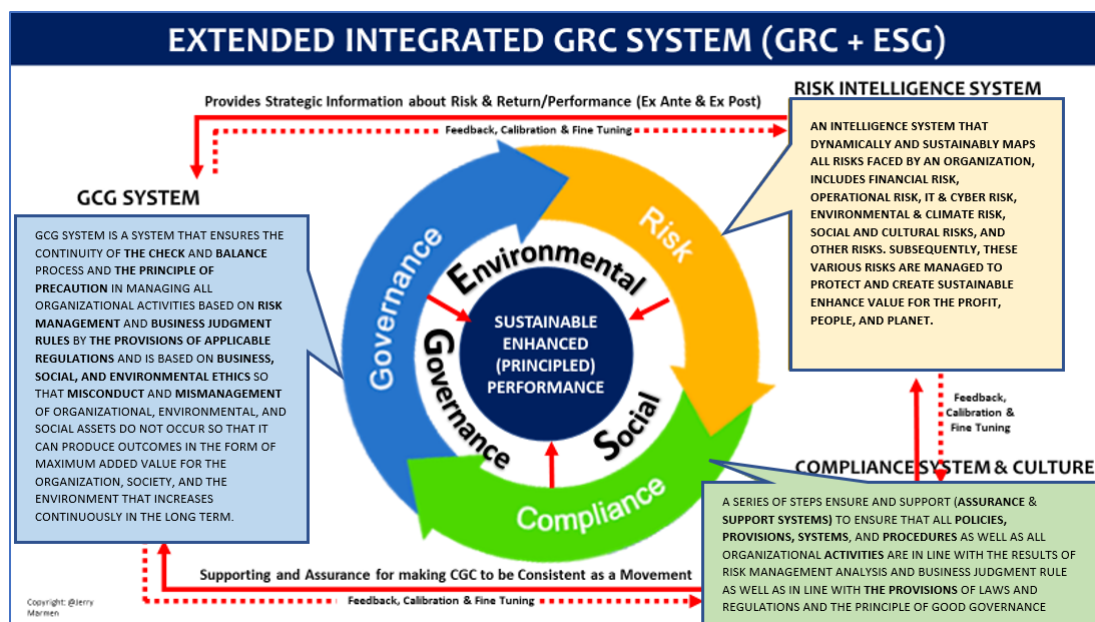


Figure 1. Extended Integrated GRC System

Freeman (1984) emphasizes that organizations are accountable not only to shareholders but also to all stakeholders, including employees, society, and the environment. With this approach, organizations are expected to conduct their operations in a way that takes social and environmental impacts into account. Shleifer and Vishny (1997) add that good corporate governance must strengthen the relationships between shareholders, management, and the board of directors in order to minimize conflicts and enhance transparency. Damodaran (2008) explains the importance of identifying, measuring, and managing risks so that organizations can protect themselves from potential losses. Reputational risks related to environmental and social issues have now become an important part of risk analysis. Organizations no longer view risk solely from a financial perspective but also consider reputational impacts that may reduce public trust and long-term value. Furthermore, Weber (2011) elaborates on the importance of an effective compliance system so that organizations consistently follow applicable regulations and standards. Such compliance mechanisms ensure that all organizational policies and practices are aligned with prevailing rules and are responsive to evolving regulations, particularly those related to sustainability and social impact. Thus, an integrated GRC approach combined with ESG enables organizations to adapt to market changes and regulatory demands, while also supporting innovation in ethical and sustainable decision-making. In Indonesia's

banking industry, the integration of ESG into GRC is reinforced by regulations such as OJK Regulation (POJK) No. 51 of 2017 on the Implementation of Sustainable Finance, which requires financial institutions to take environmental and social impacts into account in their operations. In addition, OJK Regulation No. 14 of 2023 on Carbon Trading through a Carbon Exchange opens new opportunities for banks to participate in the sustainability sector through green investments and carbon trading (POJK 14 of 2023-Carbon Trading Through Carbon Exchanges, 2023; POJK 51 of 2017-Sustainable Finance, 2017). By applying sustainable governance principles, banks can support sustainable development while at the same time maximizing their added value for society and the environment.

Sustainably Enhanced Principled Performance: Integrating the 3Ps

The integration of GRC and ESG into ESGRC (Environmental, Social, Governance, Risk, and Compliance) is likely to become a new standard increasingly needed by organizations seeking to achieve balanced sustainability across profit, social, and environmental dimensions. ESGRC is not merely an approach, but a framework that unifies these five aspects to achieve Sustainably Enhanced Principled Performance, or the 3Ps. The 3P concept profit, people, and planet is not only an ideal target but also an integrated benchmark within every strategic decision made by the organization. When properly implemented, this approach can generate long-term positive impacts not only on business profitability, but also on societal welfare and environmental preservation.

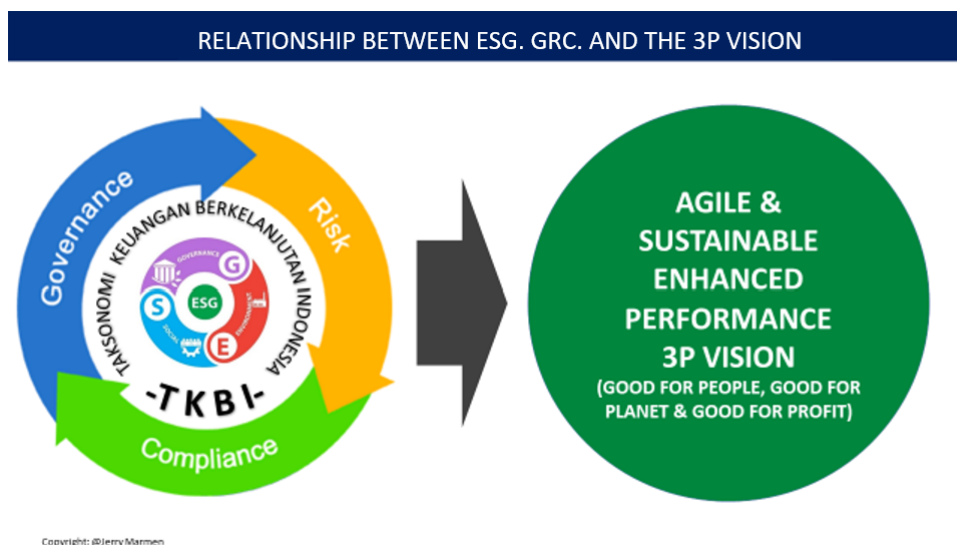


Figure 2. Relationship Between ESG, GRC, and The 3P Vision

The implementation of ESGRC supports sustainability and ethical performance by paying close attention to sound risk management and compliance. Barney (1991) states that environmental and social resources that are managed effectively can become a strong source of competitive advantage for firms. By managing these resources sustainably, companies can leverage their advantages to face market competition and gain the trust of consumers and investors. These benefits are also supported by the integration of strong governance principles that refer to social expectations and regulation, as explained by DiMaggio and Powell (1983), who underline that companies must adapt to social norms and expectations in order to be accepted and to adjust to changes occurring in society. In the banking context, the implementation of ESGRC provides significant benefits in dealing with dynamic and ever-changing markets. Banks that integrate ESGRC into their risk management structures not only maintain sound internal governance, but also have better capacity to deal with potential external

risks. Brundtland (1987) affirms that achieving a balance between economic growth, social welfare, and environmental preservation is a foundation for developing sustainable strategies in the financial sector. This means that through ESGRC, banks do not focus solely on short-term profitability, but also ensure long-term positive impacts on society and the environment.

A strong ESGRC implementation can also significantly enhance a company's reputation. This is because responsible governance and a commitment to environmental and social issues build a positive public image. Greenwood (2007) emphasizes the importance of engaging all stakeholders in every decision related to ESG, which enables companies not only to increase stakeholder trust but also to achieve higher customer loyalty. Active involvement of stakeholders—including employees, local communities, and government—contributes to the creation of strong long-term value for the organization. In the banking sector, the values promoted by ESGRC play an important role in improving market reputation, strengthening relationships with customers, and boosting customer loyalty. A commitment to sustainability and transparent governance attracts investors who prioritize positive social and environmental impact, as stated by Renneboog et al. (2008). Investors who support socially responsible investment tend to choose companies that prioritize ESGRC aspects, so banks that adopt these principles will have stronger investment appeal in the market. In Indonesia, the Financial Services Authority (OJK) plays an important role in encouraging the financial services sector to implement ESGRC in the banking industry. Efforts to promote ESGRC integration have been carried out by strengthening digital technology capabilities. The implementation of ESGRC that is integrated with technology will enable banks to predict risks more accurately and to seize opportunities arising from market changes. The adoption of technology in ESGRC becomes a pillar that strengthens sustainability strategies and supports the integration of data and information across the organization. In this way, organizations can carry out their role based on accurate information about social values and expectations obtained through technological adaptation. Suchman (1995) states that adherence to social values and expectations will strengthen a company's legitimacy in the eyes of the public. Thus, the application of strong governance and advanced technology will enable banks to improve the efficiency of financial reporting and to build a sound reporting ecosystem. By integrating these sustainability principles, organizations can ensure that growth and profitability achieved are not only beneficial in the short term but also generate long-term positive impacts for society and the environment. This allows organizations to enhance their reputation, strengthen competitiveness, and extend the sustainability of their business amid increasingly complex global challenges.

Holistic and Integrated ESGRC Implementation in Indonesian Banking

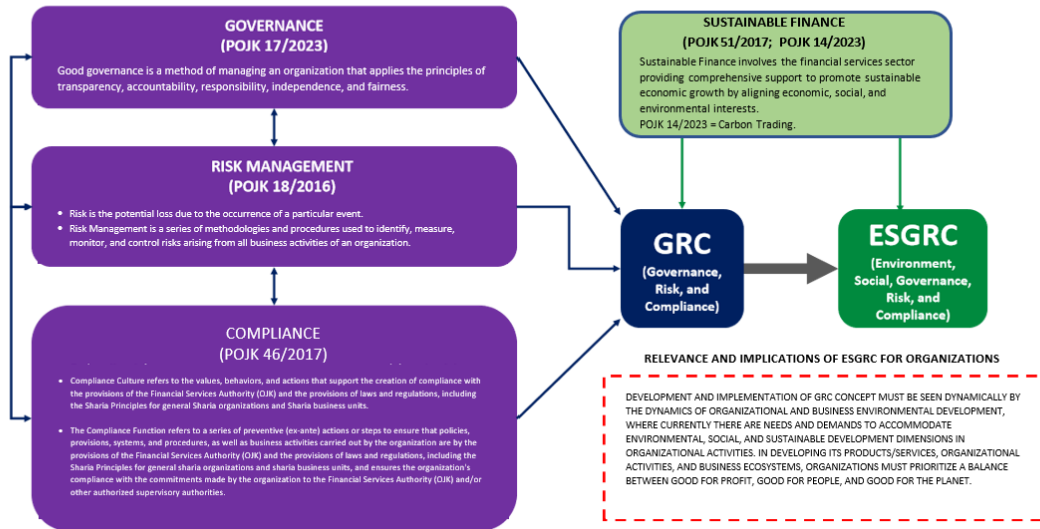
As previously explained, the banking sector in Indonesia has made significant progress in implementing Environmental, Social, and Governance (ESG) as well as Governance, Risk, and Compliance (GRC) principles in recent years. However, this implementation is still generally carried out separately and has not been fully integrated. In fact, a holistic implementation of ESG and GRC can become a strong foundation for banks to build sustainable and responsible business practices and to be able to face future challenges. Currently, the Indonesian financial services sector records asset exposure of around IDR 29,000 trillion, of which 36% comes from banking (OJK, 2023). Therefore, it is very important for the banking industry to strengthen governance and risk management comprehensively. ESG and GRC serve as the foundation for achieving this. ESG emphasizes environmental concern, social responsibility, and good governance, while GRC focuses on compliance, governance, and risk management.

An integrated ESGRC approach will consolidate ESG principles with the GRC framework into a single system that functions to manage sustainability, compliance, and risk aspects in a

comprehensive manner. This integration can increase operational efficiency and corporate transparency, as well as provide a competitive advantage in an industry that is increasingly paying attention to sustainability issues. The Triple I approach (Intention, Integration, Implementation) proposed by Pangaribuan & Idrianita (2024) offers a perspective on how companies can internalize ESG principles into their operations and governance. First, there is Intention, or a strong commitment from the company to implement ESG principles. This begins with setting a vision, mission, and objectives aligned with sustainability. Second, Integration, in which ESG principles are embedded into all operational aspects, including carbon footprint reduction, transparent governance, and product inclusiveness. Finally, Implementation, namely concrete implementation through transparent reporting and the development of sustainability-supporting products (Pangaribuan & Idrianita, 2024). Freeman's (1984) Stakeholder Theory also supports the application of ESGRC, stating that organizational sustainability does not depend solely on shareholders but also on other stakeholders. This theory emphasizes that banks must pay attention to the impact of their business on the environment, society, and other stakeholders as part of their social responsibility. Banks that implement ESG effectively will gain greater trust from stakeholders and have better relationships with the wider community. The implementation of ESG within the GRC framework can be carried out by strengthening the ESG framework within GRC policies. In doing so, every ESG aspect must be incorporated into GRC policies. The Financial Services Authority (OJK) can encourage banks to apply combined assurance with the three lines model that integrates governance, risk management, and compliance with ESG principles. This enables stronger layered supervision. In addition, digital technology must be used for risk analysis and governance. OJK, through the OSIDA (OJK Suptech Integrated Data Analytics) system, utilizes technology to process integrated data that facilitates the detection of business weaknesses. The use of technology in ESGRC implementation enables banks to monitor ESG compliance and risks in real time, making them more responsive to market dynamics (OJK, 2023). Furthermore, banks can develop environmentally friendly products or products that support financial inclusion. This step can expand the bank's service reach to segments concerned with sustainability issues, so that banks not only meet profitability targets but also increase customer loyalty. Another requirement is transparency in ESG reporting to build trust. According to research by Aziz (2022), good environmental, social, and governance performance reporting has a positive effect on stock prices and increases deposits (third-party funds) (Aziz, 2022). Such reporting must include performance results measured using international standards so that it is credible and accountable. If ESGRC can be implemented holistically, there are several benefits that banks can obtain. Banks can reduce risks and ensure sustainability. According to Lundstrom and Svensson (2014), investors are increasingly paying attention to ESG factors when selecting portfolios (Lundström & Svensson, 2014). Companies that implement ESG properly will attract more investment and reduce risks because of their compliance with regulations and their management of environmental impacts.

In addition, the application of technology within ESGRC enables banks to optimize processes, reduce costs, and minimize risks. This can increase productivity while at the same time lowering operational expenses. Banks that actively implement ESG will also be perceived as more responsible and concerned about society and the environment. This has a positive impact on reputation, which in turn can improve customer loyalty. Pertiwi & Muslih (2022) show that effective GRC can strengthen financial performance and enhance a company's positive image (Pertiwi & Muslih, 2022). With ESGRC in place, banks are also encouraged to develop innovative products and services, such as financing for renewable energy or financial inclusion services for broader segments.

TRANSFORMATION OF GRC INTO ESGRC IN THE FINANCIAL SERVICES SECTOR



Conceptualized from relevant POJKs. Copyright: @Jerry Marmen

Figure 3. Transformation of GRC into ESGRC in The Financial Services Sector

Such innovation can increase the company's competitiveness in an increasingly competitive market. However, comprehensive ESGRC integration requires investment in technology, changes in organizational culture, and alignment among various functions within the company. In addition, there remain regulatory and human resource challenges that must be addressed in order for ESGRC implementation to run optimally. The Financial Services Authority (OJK) has played a role in driving this change by providing supporting systems that assist Indonesian banks. Even so, the success of ESGRC implementation also depends on the commitment and collaboration of all parties, from top management to employees at every level of the organization. Integrating ESG into the GRC framework forming ESGRC is therefore a strategic step for Indonesian banking in facing sustainability challenges and global economic uncertainty. By leveraging technology and adopting a holistic approach, banks in Indonesia can not only improve operational efficiency and reduce risks, but also strengthen their reputation and increase customer loyalty. This becomes a solid foundation for sustainable and responsible business growth. As financial institutions that play a key role in the economy, banks must make ESGRC an integral part of their long-term strategy.

Conclusion

The Extended Integrated GRC System model (GRC + ESG), or the integration of ESG into the GRC framework known as ESGRC elevates organizations to a higher level in terms of risk management, governance, and compliance. By supporting value protection through intelligent and proactive risk management, and at the same time enabling value creation through sustainability-oriented governance, this model helps organizations remain relevant and competitive in the global business environment. Thus, ESGRC is not only about managing risks and complying with rules, but also about transforming risks into opportunities and ensuring that the value created by the organization does not focus solely on profit, but also generates positive impact for people and the planet as a whole. In the banking context, integrating ESGRC creates opportunities for banks to take advantage of new areas such as carbon trading and green financing, which not only increase revenue but also reinforce commitments to sustainability. Another benefit of ESGRC implementation is increased organizational transparency and accountability. With a dynamic and integrated risk

management and compliance system, organizations can quickly adapt to regulatory changes and market demands. This enables organizations not only to meet legal obligations but also to build trust with stakeholders such as investors, consumers, and the wider public (Buchanan & Huczynski, 2017). Regulations such as OJK Regulation No. 51 of 2017 and OJK Regulation No. 14 of 2023 support this implementation by encouraging the financial sector in Indonesia to strengthen sustainable finance practices and carbon trading (POJK 14 of 2023-Carbon Trading Through Carbon Exchanges, 2023; POJK 51 of 2017-Sustainable Finance, 2017). With this approach, risk management is understood as a more sophisticated and integrated system, while good corporate governance and compliance interact with one another to ensure that the organization remains dynamic, proactive, and adaptive to global challenges. Furthermore, integrating ESG into GRC thus forming ESGRC also becomes a strategic step for organizations to remain relevant and competitive, especially in facing the challenges of the VUCA (Volatile, Uncertain, Complex, Ambiguous), TUNA (Turbulence, Uncertainty, Novelty, Ambiguity), and BANI (Brittle, Anxiety, Non-linear, Incomprehensible) eras.

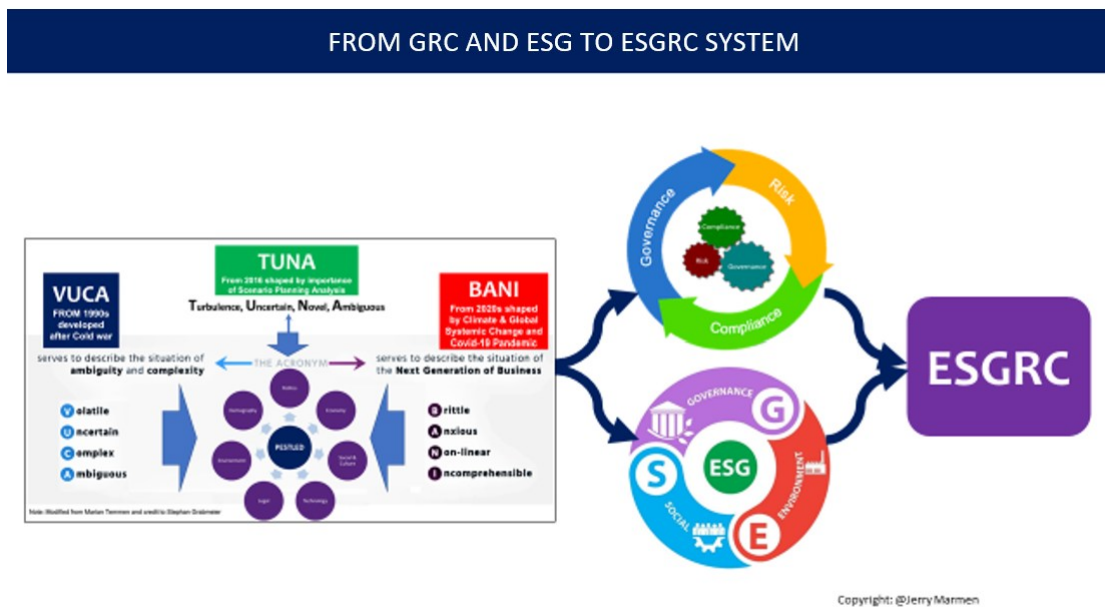


Figure 4. From GRC and ESG to ESGRC System

In facing a VUCA environment, organizations need to develop inclusive leadership, strategic thinking, and adaptability (Bennis, 1985), while TUNA underscores the importance of innovation capability and flexibility to anticipate market dynamics. The BANI challenge, according to Cascio (2020), describes organizations that are fragile, anxious, and confronted with non-linear uncertainty (Cascio, 2020). ESGRC plays a role in creating governance mechanisms that enable comprehensive monitoring of environmental, social, and governance risks, as well as in designing proactive responses to emerging threats and opportunities. Lundstrom and Svensson (2014) show that organizations that combine ESG and GRC can enhance their resilience and reputation. Analytical technologies also make it possible to monitor risks and sustainability performance in real time, helping organizations become more adaptive and innovative. The integration of ESGRC is expected not only to improve operational efficiency, but also to make organizations more robust and competitive in the global market. Another challenge in implementing ESGRC is the need to invest in advanced technologies, such as Big Data and Artificial Intelligence, which enable real-time and predictive data analysis (Merton et al., 2021). These technologies are not only costly, but also require human resources

with specialized expertise in managing and analyzing data within the context of risk management and sustainability. In addition, organizations need to invest in building an organizational culture that supports ESGRC implementation. Such cultural change requires significant effort because it involves all levels of the organization, from executives to operational staff. Every member of the organization must understand the long-term importance of ESG and be committed to applying it in every aspect of their work. Misalignment between organizational culture and ESG principles can hinder the effectiveness of ESGRC implementation. Global uncertainties such as climate change, political instability, and economic fluctuations also add complexity to ESGRC implementation. Organizations must remain flexible and adaptive in responding to these rapid changes. A proactive and dynamic risk management system can help organizations continuously monitor external changes and quickly adjust their strategies, but this requires long-term commitment from top management.

Thus, ESGRC implementation is not merely about regulatory compliance or risk mitigation. It is a strategic step to turn risks into opportunities and to ensure that the value created by the organization delivers a sustainable positive impact for people and the planet. Organizations that succeed in overcoming these challenges will be at the forefront of innovation and sustainability, and will be able to survive and grow in an increasingly complex global business environment (Shrivastava et al., 2021). In the future, organizational success will not be measured solely by financial performance, but also by its contribution to sustainability and social well-being.

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