

From Labour Exploitation to Financial Risk: A Labour Risk Transmission Framework and the Zara Case

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Abstract. Labour issues in global supply chains have become a growing concern in the fast-fashion industry. Existing studies have mainly examined these issues from the perspectives of corporate social responsibility and supply chain governance, while their potential financial implications remain underexplored. To address this gap, this study develops a Labour Risk Transmission Framework and applies it to the case of Zara. Using a qualitative case study approach, the study analyses the transmission of labour-related issues into financial risks through a cascading mechanism, in which labour exploitation and operational vulnerabilities escalate into reputational risk exposure and ESG-related pressures, ultimately resulting in financial consequences. The findings suggest that labour problems should not be viewed solely as ethical concerns, but also as potential sources of corporate risk. Although the financial effects are often delayed and partially obscured by brand strength and cost externalisation, labour-related risks can gradually affect firm performance through operational, reputational, regulatory, and financial channels. The study contributes to the literature by linking labour governance with corporate financial risk and provides practical implications for supply chain risk management in the fast-fashion industry.

Keywords: Labour Risk Transmission Framework, Fast Fashion, Supply Chain Governance

1. Introduction

1.1. Background and research problem

In the past 20 years, fast fashion has developed at a high speed. A short product life cycle, low-cost off-shore production and expanded global supply chains have all contributed to this increase. Fast fashion enterprises add new items often, keep a relatively small stock of goods and have high-turnover inventories. Among them, Zara is one of the more influential brands in the world today. In 2024, the parent company of Inditex had approximately €38.6 billion in revenue. Zara was responsible for about 73% of the total sales and had reached about €28.1 billion.

With this rapid development, attention has begun to shift to the problems of labour conditions in fast fashion supply chains. Research has shown that the world now conducts outsourcing and sets up dispersed production networks to reduce costs and quickly respond to changes in the market; however, this has also increased labour pressure on suppliers [1]. As a result, labour conditions have become one of the problems in fast fashion supply chain governance. Zara is a typical case that

shows the labour governance problems in the fast-fashion business model. Most of the production networks in the supply chain are in developing countries. According to the above information, about 72.4% of Zara's production workers in 2015 were in China, Bangladesh and other parts of Southeast Asia. Reports have also listed high-pressure production goals and long hours of work for some supplier factories. Female garment workers in some Indian factories were required to produce as many as 20 pieces per hour, and the monthly overtime could reach 140 hours. The above conditions indicate that the pursuit of cost efficiency and high-speed production will lead to serious labour governance problems.

1.2. Research gap and contribution

Labour problems in the fast-fashion industry have been attracting the attention of researchers more and more recently. Most of the previous studies have focused on the problems of corporate social responsibility (CSR), ESG performance and supply chain management. These studies help to explain why there are labour problems and what the social costs are. They are not concerned about the economy that will be damaged. Specifically, limited research has explored how labour problems can give rise to financial risks for a company through operational disruptions, damage to reputation and regulatory pressure.

Research on the Relationship between Labour Problems and Corporate Financial Risk. A framework of labour risk transmission is proposed in the paper to explore this. The framework shows that labour exploitation results in a series of interconnected risks and thus harms the company. Zara is used as the case study object to examine how labour problems are transmitted into financial problems in this study.

1.3. Research method

Zara and its parent company Inditex are the subjects of a qualitative single-case study in this paper. Zara is a typical case because of its worldwide supply network and its repeated exposure to labour problems. As a top-tier enterprise in the fast fashion sector, this company presents a case study for investigating the link between labour problems and other corporate risks.

All of the above are supporting materials for the analysis. The above sources include Inditex's annual reports from 2015 to 2024, academic studies, reports issued by international organisations and regulatory authorities, and publicly disclosed labour-related incidents in Zara's supply chain. No Econometrics will be applied in this paper. Thus, the three parts will be the framework analysis, case study and scenario analysis.

The remainder of this paper is as follows. Section 2 is the related work. Section 3 is the Labour Risk Transmission Framework and its application to the Zara case. Section 4 presents the main results of this paper, offers management recommendations and proposes directions for further research.

2. Literature review

2.1. Structural origins of labour exploitation in fast fashion supply chains

Labour problems in the fast-fashion industry are related to the structure of the whole industry, and they cannot be blamed on poor management at a single factory. Earlier studies have found that many large-scale fashion enterprises have added considerable cost pressure on their suppliers through

competitive procurement and short-term purchase contracts [1]. Suppliers need to meet the demand for low cost and rapid delivery profitably. Given the above circumstances, many suppliers are using low wages, long working hours and high-pressure production targets. Therefore, the pressure on costs is being passed down the supply chain from brands to suppliers and finally to workers. Therefore, labour exploitation can be attributed to the whole system of outsourcing production and intense cost competition.

In recent years, many fast-fashion enterprises have added considerable investment to the construction of digital supply-chain systems. The above technologies have enhanced information sharing, coordination and supervision of the supply chain [2]. However, the application of digital technology has not resolved the reasons for labour problems. Research on global value chains has shown that, at present, the power relations among the leading enterprise and its suppliers in the supply chain are uneven [3]. Digital tools can be used to enhance managerial supervision of production, and work intensity and pressure for performance may thus be increased. At the same time, deficiencies in corporate human rights due diligence may fail to identify labour risks during the initial stages of risk management. As a result, the labour-related risks may accumulate gradually and go unnoticed [4].

Most of the previous studies have shown that labour exploitation is still a problem in many fast-fashion supply chains. The above problems will affect workers and suppliers as well as the companies responsible for coordinating global production. Therefore, there may be problems with employment relationships and other risks to the company's operation and finances.

2.2. The broad corporate financial risk perspective

The first type of financial risk theory is the risk to the company's financial statements. Within the mean-variance framework, risk is often taken to be the uncertainty of expected returns [5]. Development of enterprise risk management has expanded the scope of understanding for corporate risk. In addition to the above financial risks, enterprises have gradually begun to pay more attention to operating risks, reputation risks and compliance risks, as these can also affect the company's business results [6].

Research has provided increasing amounts of evidence for the extensive financial damage caused by non-financial reasons. Failure to demonstrate social responsibility will likely result in a negative public perception, reduced trust from the public, increased pressure on the company, and thus impact financial performance [7]. Firms with lower ESG performance are also more likely to have higher financing costs and face more restrictions in accessing capital markets [8]. Based on the above analysis, social and governance factors may affect a company's financial results without being directly related to financial activities.

Labour problems can be viewed in the context of the above risks. Problems of labour are often seen as the responsibility of society and the government, but their consequences are far-reaching. Labour disputes, poor working conditions and labour rights violations will cause a production stoppage and damage the company's image due to regulatory fines. The company will be unable to operate normally due to these risks and will face financial difficulties. Therefore, the labour problems are both moral issues and potential financial risks for the company.

3. Comprehensive analysis

3.1. Theoretical framework: the labour risk transmission framework

According to the literature, labour problems may lead to a number of financial risks through a series of links. Therefore, the process will be introduced in the Labour Risk Transmission Framework. The four links in the chain of labour-related risk transmission are as follows:

- Stage 1 Labour Exploitation → Operational Vulnerability: Extended working hours, high-pressure production goals and poor working environments will increase employee turnover and lower product quality. The above reasons may also lead to production delays and supply chain disruptions [1]. Zara, a fast-fashion company, is relatively high-risk. The business model of fast fashion is to have frequent updates, small-batch production, and close coordination in the supply chain [9]. Therefore, even a small interruption in production will affect the following links in the supply chain and spread widely.

- Stage 2 Operational Vulnerability → Reputational Risk Exposure: When a labour-related incident gains the attention of the media and the public, it may evolve into a reputational risk. Negative reports about the work environment at the company will damage its public image, reduce consumer confidence, and cause a loss of trust among all parties concerned. These cases will make it harder for the company to hire and keep employees. Zara is a fast-fashion company that has built a brand and thus enjoys some competitive advantages. As a result, the harm to reputation will affect consumers' purchasing decisions and thus harm sales performance over time [10].

- Stage 3 Reputational Risk Exposure → Compliance and ESG Pressure: Given the higher public attention on labour-related incidents, regulators, investors and ESG rating agencies will pay more attention to a company's labour practices. Heightened Supervision will further increase the demands on compliance and governance. Recently, labour rights in the world's supply chain have drawn the attention of governments and institutional investors. At the same time, regulations have also expanded the scope of disclosure for this area. Under the Corporate Sustainability Reporting Directive (CSRD), more particular information on sustainability and labour issues must be disclosed by the company, etc. Labour problems are no longer just a question of honour in light of the above events. They will also be subject to compliance obligations and governance problems under the stronger regulatory oversight.

- Stage 4 Compliance and ESG Pressure → Financial Consequences: Compliance and governance demands may impose a direct financial burden on the company. Additional Funds will be needed for supervision, reporting and regulatory compliance. The company will be fined by the government because of a labour violation and failed to report it in time. At the same time, investors and creditors will consider such problems to be higher risks. According to the above studies, enterprises with relatively weaker ESG performance face a higher cost of capital and are under greater pressure from the market [11]. In short, the above problems will reduce a company's profitability, increase its cost of capital and lower its value.

The problem of labour will not lead to a financial loss immediately. Labour exploitation is not considered to be an immediate risk, but rather a relatively delayed accumulation of risks. Branding can also provide a buffer effect, and as for supply chain labour costs, they are externalised. Therefore, good current financial health does not guarantee that there are no labour-related risks. The following chapter will use the above framework to study the case of Zara and investigate how labour-related risks arise and spread during the transmission process.

3.2. Labour risk transmission mechanism in Zara

3.2.1. Labour exploitation → operational vulnerability

Labours in Zara's supply chain include long working hours. Media investigations have shown high-pressure production goals, long hours of overtime, and a large concentration of production workers in China, Bangladesh and Southeast Asia. Based on the results above, both labour and geography are concentrated in Zara's supply chain.

Labour intensification will change the structure of the supply chain in many ways over time. Too long of a work day will make the workers tired and thus more likely to make mistakes. A large amount of work also leads to higher employee turnover; as a result, experienced staff have left and production stability has been affected. Therefore, the supplier will be forced to reduce investment in worker training and safety facilities due to ongoing cost pressures. It will decrease the fault tolerance of the production system and raise the risk of failure. The previous studies have presented this process as a structural consequence of cost pressure transmission in the supply chain and, finally, absorption by workers [1]. Therefore, operational vulnerability is not only the result of external shocks but also stems from the internal logic of cost-driven production systems.

Zara's fast-fashion business model has made this vulnerability more severe. Zara is a small-batch production model that quickly responds to demand by adding new items frequently through a streamlined supply chain [9]. Therefore, the production delay will promptly shift the release time of the product and reduce the company's response capability to changing market demands.

A small-scale supplier or a late-delivery from them will also damage the production line. Fashion products are very time-sensitive, and missing the sales window will result in lost demand. Therefore, the company will reduce the price of goods and lower profits. Labour-related disruptions thus affect both the operational efficiency and the time of value creation and realisation.

As shown in the 2020 full-year report of Inditex, due to serious disruptions in the supply chain, the company's net profit dropped to 1.10 billion euros in 2020 from 3.65 billion euros in 2019. Although this shock was caused by the COVID-19 pandemic and not labour-related incidents, the case shows that Zara is highly dependent on supply chain stability and can be used to explore the possible financial risks of labour-related risks.

3.2.2. Operational vulnerability → reputational risk exposure

Labour-related operating problems will be only reputational risks if they attract public attention. A change occurs when information from the production process leaves the supplier's factory and is spread to the public through media reports, social investigation and public discussion. Labour problems are thus no longer just operational issues but have started to be regarded as indicators of a company's social responsibility and corporate governance.

Labour disputes at Zara have repeatedly drawn the attention of the public due to excessive overtime, low wages and poor working conditions. At that time, the public will be aware of it and so on. Labour problems among the suppliers have now been included in the governance risks of the brand and are no longer addressed separately. Therefore, the subject of stakeholder evaluation has moved from specific products to the company's overall conduct.

The speed of change in the fast-fashion industry is relatively high. Fast-fashion companies do not have technology or patents; they have built a brand through fashion identity and consumer loyalty. Therefore, the brand will be associated with consumers' desire for consumption. When labour-related disputes repeatedly attract the attention of the public, the damage will be more severe than

that caused by a single incident; thus, people will have a negative view of the company as well. Gradually, these perceptions will damage brand equity.

Reputation risk will also harm the labour market in this way. Zara's business model continues to use designers, buyers and other skilled employees. The above abilities are based on the ability to attract and retain talented employees. Repeated labour disputes involving the company can also harm its employer brand in the eyes of the public. It will be inconvenient for new employees' work and reduce their enthusiasm for joining the company.

The Reasons for this are to build a series of problems. One case will not have an impact; however, if it occurs repeatedly, the parties concerned will start to be convinced and may maintain a negative perception for a long time. A decline in consumer confidence will also make it harder for the company to hire and retain good staff; thus, damage will be done to the brand and its competitiveness in the future.

3.2.3. Reputational risk exposure → compliance and ESG pressure

As public attention on labour disputes has risen, so too has the scope of harm; now, these problems also affect governance and regulation. Stronger external supervision is being introduced, and public opinion, investor behaviour and regulatory changes are all shifting simultaneously.

At this time, the impact of third-party assessment systems is also gradually expanding. For instance, the Corporate Human Rights Benchmark released by the World Benchmarking Alliance has identified defects in the implementation of the company's human rights policies and a lack of transparency in the related practice at Inditex. Although the above evaluations do not directly lead to financial losses, they will alter the perception of risk by investors and other participants in the capital market, thus affecting the company's position in the ESG rating system.

ESG investment has gradually become popular, so the demand for these assessments has been rising. Investors and credit rating agencies will consider the management and risk-control situation of the company. Firms that have been repeatedly involved in labour disputes will be more strictly monitored for governance defects and failures in information disclosure.

Regulatory Changes have added to the pressure. In accordance with the requirements of the Corporate Sustainability Reporting Directive (CSRD), more organised and standardised reports on labour and human rights conditions in the supply chain need to be disclosed by the company. Therefore, labour governance is no longer regarded as voluntary corporate social responsibility but is gradually assuming the shape of mandatory compliance.

Due to the above reasons, the harm to the company's reputation will be widespread among all parties involved. ESG assessment systems and changes in investor behaviour and regulatory requirements have started to address labour issues through corporate governance and compliance mechanisms, thereby increasing the pressure on these companies to improve supervision and disclosure.

3.2.4. Compliance and ESG pressure → financial consequences

At the end of the transmission process, compliance and ESG pressure result in financial costs of operating expenses and capital markets. The main reasons for the above effects are higher compliance costs, increased financing costs and reduced corporate value.

From an operational standpoint, more funds will be needed to meet the rising demands of regulations and disclosure. The above are the costs of audits, due diligence, disclosure systems and

governance reform. These investments are not one-off corrective measures; they will be included in the normal course of business and will continue to put pressure on profits.

Under the risk-pricing mechanism, ESG performance has begun to affect the cost of capital for funding. Companies with weaker ESG performance generally have a higher cost of debt [11]. Given that ESG considerations are gradually being included in lending and bond pricing, labour governance performance is now regarded as a substitute for credit risk. Therefore, because of the higher regulatory exposure and governance risks, investors will demand a higher risk premium, increase the cost of capital, and possibly reduce long-term profits.

Labour-related risks and the value of the company are also correlated. Zara is a fast-fashion enterprise that has established a high-market-value company through its brand, a stable supply chain, and overseas development prospects. Labour problems have started to be related to governance and regulatory risks, so investors have reduced their expectations for future growth and stable profits. The Adjustment will result in a lower valuation multiple and thus a lower market value.

In short, the Zara case shows that labour problems are not solely the fault of corporate social responsibility. Alternatively, these risks will be manifested as a chain of operational failure, loss of reputation, non-compliance and ESG pressure, and so on, leading to financial harm. Labour-related risks will affect the cost structure and value-creation ability of the company at this time.

At present, only some of these effects are shown in the financial statements. Although the company has been highly profitable in recent years, labour-related risks have not yet resulted in obvious financial losses; thus, the financial impact of such risks may be postponed or otherwise concealed. Based on the above studies, a considerable proportion of the costs of labour issues in the global supply chain are borne by workers, suppliers and host countries rather than by leading enterprises themselves [1]. Therefore, the company's current financial health may not fully reflect the actual extent of labour risk exposure. Given the introduction of regulations such as CSRD and deeper integration of ESG into capital markets, the extent of risk externalisation will be reduced; thus, the financial impact of labour-related risks will likely be felt more readily in the future.

4. Conclusion

4.1. Main findings

Build a labour risk transmission mechanism to explore how labour problems in a company can lead to financial risks for the company and its suppliers around the world. Zara is used as a case study to examine the transmission path of labour exploitation and operational vulnerability, as well as reputational risk exposure, compliance and ESG pressure, and finally the impact on finances.

Therefore, the problems of labour are also extensions of ethics and social responsibility. They can also be sources of corporate risk and affect the performance of the company through operating, reputation, regulation and finance. The Zara case shows that labour problems in the supply chain can cause risks far from the actual place of production.

Analysis has also shown that the financial impact of labour-related risks is often delayed and partially hidden by brand power, externalisation of supply chain costs, and favourable short-term financial results. Therefore, the current profit level may not fully reflect the extended risk of poor labour management in the future.

4.2. Managerial implications

Based on the Labour Risk Transmission Framework in this paper, different management strategies should be employed at each link of the transmission process to prevent labour-related risks in operations from turning into financial problems. Table 1 shows the main intervention priorities and the reasons for them at all links in the transmission path.

Table 1. Risk management along the labour risk transmission process

Risk Transmission Stage	Management Priority	Mechanism
Labour Exploitation → Operational Vulnerability	Integrate labour standards into supplier governance systems and strengthen labour compliance audits and continuous monitoring.	This helps reduce excessive overtime, employee turnover, and production instability at the source, which in turn lowers the risk of operational vulnerability.
Operational Vulnerability → Reputational Risk Exposure	Improve supply chain transparency and establish third-party monitoring and disclosure mechanisms.	This reduces information asymmetry and makes it less likely that operational problems escalate into wider reputational crises.
Reputational Risk Exposure → Compliance and ESG Pressure	Incorporate labour governance into corporate governance structures and strengthen board-level oversight.	This improves governance credibility and limits the extent to which reputational concerns turn into regulatory and ESG-related pressures.
Compliance and ESG Pressure → Financial Consequences	Develop compliance and ESG management systems proactively and explore sustainable financing instruments.	This helps contain future increases in compliance and financing costs while supporting investor confidence.

As shown in Table 1, the purpose of the above measures is to prevent labour risks from becoming financial problems. Labour risks generally accumulate over time and do not have immediate harm. Therefore, the company may be able to achieve better results if it takes action earlier. Early intervention is also more economically and conveniently feasible in the long run.

Supply Chain Governance will be the object of reform. Strengthen procurement at the company level and adjust the incentives given to suppliers. Otherwise, the following measures will be invalid. Reputation management, ESG disclosure and green finance can be used to mitigate some of the negative impacts; however, they do not address the root causes of labour-related risks.

4.3. Limitations and future research

This study has the following deficiencies. Only one case study of Zara was used to gather this data. Therefore, the results may not be suitable for other companies or industries. The analysis will also be based on the public data. Thus, the study will not be able to reveal the entire situation of work in the supplier's factory.

Several other paths will also be taken. Other studies have selected various companies and applied the same framework. Some studies have used a large number of people to confirm the results through other means. Gather data directly from the supplier and workers to learn more about the working conditions. New research will be carried out in the future to study how companies have modified their behaviour in response to the new labour disclosure rules over time.

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