Financing the Creative

Deanna Swisher
Foster Swift Finance, Real Estate & Bankruptcy News
August 26, 2014

AUTHORS/ CONTRIBUTORS
Deanna Swisher

PRACTICE AREAS
Business & Tax

It is time to turn around the phrase “creative financing” to consider financing the creative. Lansing Michigan’s newest incubator, The Runway, will open in August. At The Runway, ten fashion designers-in-residence will be learning how to get their creative ideas to market and move their fledgling Michigan business to the next level. When The Runway’s designers and other members of Michigan’s creative class look for ways to finance their vision, what should they expect?

They can expect to face an uphill challenge if they walk into their local bank and seek traditional financing. Ideally a designer has no inventory – they produce to meet purchase orders and place goods in the hands of the retailer as quickly as possible. A designer is not likely to own valuable equipment. The value of the new designer’s trademark is nominal. Valuation of a “fashion business” is difficult, even in an established market. In New York City, home to a very well-established fashion industry, only designers with two or more years of successful production could hope to obtain a traditional loan.

So the creative need to be creative about their financing, early in their career. As a result, my conversations with newly minted designers, professors and industry experts at Fordham Law’s Fashion Institute’s 2014 Summer Intensive Program frequently turned to non-traditional financing. Three sources of non-traditional financing are of particular interest to a fledgling designer: crowdfunding; loans from family or friends; and factoring.

Although not without its challenges, crowdfunding can be used to raise money and “market test” new designs. Where it has become common to offer a reward to prospective investors, designers may offer a variety of garments or accessories as a reward and use the choices made by investors to learn what is likely to sell. Also, if their goal is met, the designer is benefitted by the fact that they are effectively producing in response to pre-paid orders.

Family and friends who will invest can be a great, and in many instances the most likely, form of start-up funding for a designer. However, the designer and the prospective investor need to have a very candid conversation – to begin with “what happens if these amazing clothes or accessories just don’t sell?” Is the investor going to suffer the loss, and can they afford to suffer the loss? Is this instead a loan that the designer will repay and on what terms? Equally important – what happens if the designer succeeds? Friends and family will know when the orders are coming in – is that when they see a return? Ideally, from the designer’s perspective, their payback obligation will arise only when the designer’s gross exceeds a specified percentage. Both possibilities – failure and success, need to be addressed in a written agreement.

Although a friend or family member may provide enough start-up money to get the designer to the point of getting their creations in front of interested buyers, what happens when the designer receives their first order? Where most buyers pay net 45 or 90, the designer has to have a plan for paying the cost of material, the cost of production, their commissioned sales agent, and anyone else that won’t wait 45 to 90 days for payment. For decades, designers have bridged this funding gap by relying on a factor. A factor makes a loan to the designer, usually when delivery to the buyer is confirmed, for an amount that is likely to range from 50 to 90 percent of the total invoice. The factor will take a security interest in accounts receivables, file a UCC-1 on general intangibles, and of course charge interest on the loan. Where the factor will be repaid when the buyer pays the invoice, an experienced factor knows the creditworthiness of the prospective buyer, and as a result can steer the new designer away from unreliable buyers. The factor will also issue invoices and provide collection services for the designer. While an experienced factor can be very important to an inexperienced designer, the designer needs to appreciate that the factor is charging both a fee for their invoicing and collection services and interest on the money lent.

Deanna leads Foster*fashion*, a team of Foster, Swift attorneys that provide specialized services to designers, manufacturers, exporters, importers, and retailers.