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The difficult path to financing

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PARIS: Merger mania appear to be the new buzzwords for the fashion industry with investors on both sides of the Atlantic hunting for deals, both large and small. But will this be the case several years from now?

It is a tough call as the next generation of independent fashion designers and their companies struggle to reach critical mass.

Some of today's most successful luxury fashion designers have flirted more than once with bankruptcy. One of them, Marc Jacobs, is now expanding his company with strategically structured growth while managing the creative direction of the entire Louis Vuitton label.

It is no secret that fashion trends can be unpredictable, but what is even more unpredictable is the chance of survival of a designer fashion label. What Marc Jacobs has endured is not unusual. The chances for a new label's longevity is particularly fragile today since the financial community often looks at designers and their new labels as if they were some new hybrid of the plague.

"We don't believe that strongly in independent designers," says Patrick Guillou, the business center director for Fortis Bank's Louvre unit, which boasts a majority of clients in the apparel and textile industries. "The small designer who tries to launch a collection today has very little chance to succeed."

The reticence of the financial community is understandable. Fashion firms have no receivables for long stretches of time.

The fashion creation-production-delivery cycle can be simplified like this. A designer buys fabrics for a collection roughly nine months before the clothes hit the selling floor. Patterns and prototypes have to be made, and a "prototype can cost three to four times" the retail price of a garment, explained Sylvie Coumau, the investment director for the Paris-based private equity firm Mode & Finance. The firm generally considers fashion investments in companies that are two to three years old, that export and that have a designer supported by a business manager.

Next, the collection has to be made and shipped, and many stores demand 30- to 60-day payment terms. Even before that collection is shipped, the designer has already started spending for the next season's line but has not touched any revenues.

"Designers go into the red regularly," said Didier Grumbach, the president of France's *Chambre Syndicale*, which is working with the French government and financial institutions here to establish new loan programs to bridge the gap between collection development and payment for fashion designers.

Many non-fashion professionals assume that the biggest challenge facing a new designer line is the collection's launch. Not so. Designers often get financial support from family or friends, or support in kind from suppliers when they start out. If the designer launches with a fashion show, the models or hair and makeup teams will often work for free. Sometimes sponsors come in, as in the case of the Swiss jeweler Chopard, which sponsored the shows of six designers during haute couture week in January in Paris.

The trickiest time for designers is when they go from launch phase to international expansion. At this point, a designer's collection is sizable, with a large number of prototypes to manufacture and deliver. This increased production has to be financed and the economies of scale are very difficult to achieve, said Jean-Marc Lucchese, a delegate to the Research and Strategy Division of the *Oseo Bdpme*, a development bank for small and mid-size companies.

"If the designer cannot make this transition, they will remain small," Lucchese said. Or they can disappear.

At this point in growth, the companies are usually too big for most individual investors and too small for private equity investors, said Elizabeth Pearce, a New York-based attorney specialized in intellectual property and contracts for emerging designers and other creative talent.

"Investors don't see any good reason to finance these kinds of businesses," Pearce said. "Investments won't lead to returns unless you are certain that the designer can bring in management, improve development and production. The likelihood for all these things coming together is increasingly rare."

Despite this grim financial outlook, designers do have options. Ultimately, it is the creative credibility and retail performance of the product that will determine a designer's success.

A self-financed company is probably one of the most personally satisfying ways for a designer to expand his or her business. This approach is one that assumes slow, stable growth over time. It means extraordinary hours of work by a small team including the designer.

Take Andrew Gn, a Paris-based designer from Singapore who is celebrating his 10th year in business. Gn sells to top international stores such as Bergdorf Goodman in New York. He founded his company with money from his father and has constantly reinvested funds in the company.

His first collection was a tiny 12-style range of knits. "I sold 36 pieces to Barneys New York and Maria Luisa and I wanted to frame the first check," he recalled, referring to a Paris boutique. "A year and a half later, I got an assistant."

It was only a few years ago that Gn obtained credit instruments from a bank that have given him the financial flexibility to introduce eveningwear and exceptional pieces with high development costs, notably for exclusive fabric and embroidery designs and for custom-made buttons and other closures.

"Banks are there, but they're always a little bit late," said Gn, who has nearly 150 sales points worldwide. "When you start making money and grow, that's when the banks knock at your door. It's like they're saying: 'These guys have money, why don't we give them money?'"

Another example is Martin Grant, a transplanted Australian in Paris who launched his first full-fledged collection about eight years ago. He got a financial boost two years ago when he signed with Barneys New York, a major client of his signature collection, as its private label designer.

While many designers have design contracts on the side and rely on the fees to develop their collection, Martin refuses to depend on the Barneys deal to grow his company. "That could be a trap," he says. "If the contract doesn't get renewed, you cannot count on the funds."

Grant has gotten offers from private investors. He said some "could be interesting, but I would not go out there looking for them." He added that the risk "would be if it seemed like you were going to lose power."

Today the industry is questioning whether a designer should work with an investor who holds a sizable stake, either majority or minority, and notably after watching Helmut Lang walk out the door of Prada. Lang sold a majority stake in his signature brand to Prada in 1999 and that company bought the remaining 49 percent at the end of last year. Lang presumably left Prada abruptly over business strategy disagreement with Prada management.

In another business model, designers license the production and distribution of their fashion to a manufacturer. This model, which puts the bulk of financial risk on the manufacturer but runs a risk for the designer that he or she may lose control, is used by several European or American designers and Italian manufacturers.

Giambattista Valli has chosen this model for the launch of his signature line thanks to a partnership signed last year with Italy's Gilmar.

After 19 years of design work at Capucci, Fendi, Krizia and Emanuel Ungaro, the company he left last year as a creative director, Valli decided to set up his own company. Gilmar handles the manufacture and the distribution of the Valli collection, while Valli retains creative control over design and distribution choices, among other points.

Valli has also set up consulting agreements with an attorney and a business strategist. "I think I am good at what I do, but everyone has their profession," said Valli. "You cannot do everything by yourself."