Finance and funding for upscaling sustainable fashion

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Introduction

There are a growing number of sustainable fashion design entrepreneurs who are looking to scale up their businesses. This can have a beneficial impact on sustainability through their greater reach and a wider and often more innovative offering of better products and services to consumers. However, these entrepreneurs face challenges in getting the resources needed to expand their businesses and to take a market share from traditional business with no or limited sustainability goals. Challenges may be related to identifying markets and opportunities or having the capabilities within the business to scale up (Elf et al., 2022). There may also be a desire to bring in external finance to pay for innovation, research and development, salaries, stock and other costs while the business reaches a profitable stage. Drawing on qualitative interviews with business founders, company directors , financiers and other stakeholders over a two-year time period, this chapter follows a case study approach providing novel insights into how a diverse group of sustainable fashion entrepreneurs access finance. From an initial list of 36 small and medium sized sustainable fashion businesses (SFBs), 12 were interviewed in detail at several points over the course of the research endeavour. Of these, four reported that they were using external finance. This chapter explores their different approaches to seeking external finance. The case study SFBs cover a range of products and services aimed at womenswear, sportswear and childrenswear). The businesses range in age from two to sixteen years (at time of first interview).

Finance theory for sustainable entrepreneurs

Creative and sustainable ventures in the UK fashion industry face considerable barriers to accessing the external financing required to gain market traction and growth. Since Macmillan (1931) first recognized a finance gap for new and early-stage innovative ventures, the evidence base has continuously grown showing that such ventures suffer from private finance market failures and are worst affected at times of economic recession and credit rationing (Lee et al, 2015). The causes of this failure are often attributed to potential investors not having enough information about the innovative venture founders (Carpenter and Petersen, 2003) and their lack of collateral and track record that can support bank debt finance (North et al, 2013).

New SFB ventures present a particularly high risk to potential investors as early-stage businesses have a high rate of failure. As Fraser et al (2014) and O'Dair and Owen (2019) note, new emerging creative sectors, such as sustainable fashion, pose various challenges to traditional formal bank debt and venture capital (VC) equity financing Sustainable business models present a further complication to investor risk assessment with a stronger focus on longer-term viability and wider sustainability rather than delivering quick profits and/or financial sustainability. For investors, this may mean that repayments are expected over an extended period (Owen et al, 2020).

In this chapter, we examine the different sources of finance as businesses mature. We follow Nightingale et al.'s (2009) framework of a 'finance escalator' where businesses can use different types of finance for start-up and the succeeding stages of venture growth (see Figure 1 for an overview). Whilst the finance escalator can highlight gaps from the perspective of those providing finance (supply-side), North et al. (2013) and Owen et al (2019) point also to

failures of potential finance applicants (demand-side) especially where they lack capability to present investable propositions. These demand-side gaps are particularly prevalent amongst first time venture founders who lack business and finance-raising acumen and younger entrepreneurs that have little or no prior work experience (Owen et al, 2018).

Insert Figure 1 here

Solving early-stage venture finance gaps for complex businesses such as SFBs requires a holistic approach (Owen et al, 2019). For instance, equity investors can provide non-financial support to improve business management and networking whilst on the demand-side there is a need for investment readiness support to enable young entrepreneurs to access and successfully pitch to investors (Mason and Kwok, 2010). Furthermore, in the wider creative and sustainable sectors, incubator provision of space and equipment and the emergence of accelerator investment and training have transformed the UK early-stage support and investment market during the last decade (Owen et al, 2020). In the decade since the Global Financial Crisis in 2007/2008, crowdfunding has also become established as a significant source of creative enterprise financing generally (via peer-to-peer lending, equity, reward-based and donation platforms, or blockchain financing mechanisms), notably for known market brands (O'Dair and Owen, 2019). Lastly, the public sector can be an important player in supporting businesses with grants, investor tax breaks (e.g. for [Seed] Enterprise Investment Schemes) and co-financing of business angels and seed VCs.

Accessing finance in four case studies of sustainable fashion enterprises

Case 1.

Case 1 is an innovative brand that embeds sustainability in a variety of ways as the company seeks to design garments that are built for purpose and longevity. They work with suppliers to enable the use of innovative recycled materials in their garments and aim for more circular design approaches. Complementing their design efforts, they also offer repair and trade-in resale services. The brand has grown over time with the support from a range of investment Starting off with their own resources and time, they initially relied on fabric suppliers to give them goods on credit and good payment terms.

"We were just bold as brass and said trust us, we're going to get there. So they believed in us, they supported us, they gave us payment terms, they held stock for us" (Company Director 1)

They were also able to get access to a range of grants which were available to businesses located in priority areas for regional development funding. A major change to the business came with the decision to seek equity finance as an investor took a stake in the business allowing them to move from online sales only to having a physical retail spaces. The owners took particular care in researching the approach and values of potential investors and selected one who supports the company's philosophy and their ingrained respect for the environment and focus on long-term performance rather than short-term profit and a quick exit.

"We funded ourselves for the first 10 years, and that was all based on our suppliers helping us out on that front. Now we have got a private equity fund which really helped us go to the next level. So retail for us was our missing link really". (Company Director 1)

The investment and support has allowed greater reach and upscaling with more people being introduced to their sustainable products and brand philosophy. The investment also required a restructuring including the appointment of two new board members by the private equity

investor and the introduction of a new CEO who is closely working with the founder. Another result is a greater emphasis on financial growth while previously there had been an aspiration to organically grow to a certain level they felt was generating adequate profit for the owners.

"I always struggled with the idea of growth. I always thought you could get to a place and you could be happy and you just keep doing that, but I guess as soon as we got a board and we got investors that really changed the landscape a bit, because you are then accountable to someone." (Company Director 2)

More recently, the company has been involved in raising investment through crowdfunding to accelerate growth of the business and for financing the development of innovative new products. This has shown the brand's close connection to its customers with many of them willing to be small investors in the business to feel involved in the brand and part of a wider community.

Case 2

This company was set up by its female founders to enable women from deprived communities to earn a decent livelihood from their garment making skills. Set up as an 'ethical, feminist, sustainable' womenswear brand, case 2 has used investment to meet its objective of creating positive social impact paying living wages to the garment makers and also support local women's and community organisations from their profits. Initial funding came from the founders' own work, friends and family. They also borrowed money from a lender that focuses on social issues in order to buy stock, and they run on a 'pre-order' model which allows them to have payments before clothes are made.

At an early stage, they successfully applied to be part of an impact investment accelerator programme that came with some equity investment. This required them to report on their financial position every quarter and on their social impact. Not only has the finance helped them survive, it has also come with ongoing advice and mentoring.

The company has found that seeking funds is difficult as grant givers consider them overly commercial while investors consider them too charitable. The founders were careful not to take on too much seed funding before they had a clear ability to generate revenues. They wanted to avoid venture capitalists pursuing quick exits, that is, looking to take a stake in the business and then sell this soon after for a profit. The company has kept focused on its own vision and is not willing to compromise in order to meet the requirements of investors. This has made obtaining further funding harder.

To circumvent this limitation, the founders used a crowd funding platform to access further finance This crowdfunding includes a number of their existing customers wanting a small stake in the business.

"So we had a couple of bigger investors but …we had our models, photographers, customers, people who hadn't even heard of us yet. People who liked the idea ….. and wanted to see it get better". (CEO/founder)

Case 3.

Case 3 provides an online platform designed to change behaviour on fashion consumption by enabling its users to increase the wear rate and 'life' of existing garments. The founders see having investment as a necessary way to raise the profile of their brand to sign up more users. They also refer to investment acting as a 'runway' allowing them to grow the business to the level of a viable business that can pay salaries. At the start, the founder used their own time

and resources while leaving their job and moving back to their family home. They had some early stage investment from an 'angel investor', that is, an individual willing to put their own money into new businesses. They found raising further funding difficult in the city in which they started-up, as they felt investors did not understand their sustainability objectives. They therefore moved to London where they felt there was better understanding of sustainability from impact investors focusing on sustainability.

An impact investment company focused on social and sustainable businesses provided them with 'pre-seed' funding and a place on their accelerator programme that offered ongoing support over 6 months. This investor has provided further funding since and persuaded two other impact investors to also take a stake in the business. These investors continue to offer advice on seeking new investors and contacts.

The founder has a strong vision of their mission and is putting this ahead of generating short-term growth in revenues. This makes generating further funding challenging as *"there are metrics we need to hit if we are trying to fundraise"* (Chief Operating Officer). The management team is keen to retain control and maintain the freedom to build the business as they wish.

They have been more successful in financing upscaling through crowdfunding with over 300 investors getting shares in the business. The crowdfunding platform has a nominated person to represent these investors rather than there being 300 board members. Furthermore, the business retains control over strategy and direction with a continued focus on how it can change the fashion industry with its innovative services.

Case 4.
Guided by its mission is to reduce waste and emissions and instil the slowing of consumption, case 4 is a small yet growing company that develops innovative designs and textiles which extend the life of garments. Initially having focused on childrenswear, the company employs a diverse team to research how to increase and improve product range and expand into other markets to achieve greater environmental impact.
In the initial stages of the business evolution, investment came in the form of the founder's own time and resourcefulness. The company was also relying on existing sales to reinvest in the business, which is termed 'bootstrapping'. It was fortunate to have an early impact investor that was also running an accelerator programme and allowed the company to join. Since leaving the accelerator programme, the portfolio manager of the impact investor has continued to act as a mentor providing support for pitches and grant applications. This support has been important in learning how to pitch an idea to investors, and altering messaging to tell their story about how they want to grow. The company has been successful in obtaining innovation grants that part-fund their product development, alongside further equity investment.

The company has been approached by a number of potential investors and has been very selective to ensure that any potential investor is aligned with its sustainability objectives and not looking for a quick profit and exit.
"I think we played hard ball with a lot of investors ... it was very important for us to get the right investors, so it was tough, and you had a lot of meetings with people who you knew just did not align at all, who just saw this as a revenue generating thing that would be popular with the people. We were fortunate enough to be in a position where we could say actually, we don't want to be with you, and then we found a funder and they fund sustainable businesses and we thought that [our mutual objectives] were well-aligned. Yes, they wanted the business to grow

but that's the way economic systems work and you need a business that grows if you're going to invest in it. But they only invest in sustainable businesses." (Chief Executive)

The investors require the company to do financial reporting as well as impact reporting on its contribution to the United Nation's Sustainable Development Goals. They have encouraged the founder to do more financial modelling that shows growth trajectories and pushed him to prepare a business plan with commercial metrics. The current investors have not asked to be on the official board of the business but act as an informal board of advisers. They have also been important in introducing the business to other mentors for marketing and licencing strategies.
"All our investors really want us to succeed. They are really into sustainability and innovation, so that's perfect because they then have networks within sustainability and innovation that are not necessarily focused on fashion". (Chief Executive)

Conclusion
As new SFBs grow, there is demand for finance to support their upscaling. Examining a sample of four fashion businesses that have sought external finance, we demonstrate the common finding that there is a ''finance escalator' in operation as businesses move from initial stages requiring small amounts of money to scaling up stages where there is a need for large capital injections. Early-stage businesses are reliant on entrepreneurs' own investment and that of family and friends, complemented by grant finance. As these businesses become more established and mature, they seek other types of finance such as alternative forms of borrowing and equity investment from social and sustainable investors and business angels who are aligned with their sustainability goals. Some of these are large investors with extensive past experience in other deals, while other investors can become involved on a small scale as they participate in crowd funding. Notably, our findings show that SFBs are purpose-led and, therefore, cautious as they take on external finance as they prioritise control over their sustainability goals over rapid growth and quick exits. A comparison of the four cases show that three were using crowdfunding as an opportunity to bring in many small investors that shared their vision and therefore avoid a loss of control when there are a smaller number of large investors.

Other, yet related challenges include the supply of finance (supply-side issues) and the capability of businesses demanding financing to present investable propositions (demand-side issues). Supply of finance from conventional sources of bank and institutional investment may be limited because finance providers are risk averse when faced with the 'liability of newness and smallness'. Each of the four case SFBs have sought out non-bank sources of finance as these investors are willing to take the risk, usually based on having an equity stake in the ownership of the business. The 'liability of smallness' can be exacerbated when there are multiple goals related to sustainability alongside profit. In two of the cases, interviewees reported some differences between the objectives of the investors and the objectives of the business. In one of these cases, the business was sticking to their vision of prioritising social and environmental value while not pursuing rapid growth. In the other case, the decision was made to scale up impact by allowing the business to grow rapidly while also giving more priority to commercial objectives. The other two case studies had found investors that shared their vision for an approach of incremental growth.

The demand side challenges relate to the lack of investment readiness of many young businesses, as they may not have businesses models that allow them to make the profit needed to repay borrowed money with interest or to provide a return to investors. They also

may not possess the necessary capabilities related to writing business plans required by investors, or the ability to 'pitch' their business ideas to investors, which makes them appear not to be investment-ready. To tackle the lack of investment readiness, this chapter shows how social and sustainable investors are supporting their investees with mentoring and advice to build their capability to grow and seek further finance. This support can start when a business is part of an 'accelerator programme' run by the investor and continue once the business has left this supportive programme. In addition, and as mentioned previously, we found that crowd-funding, featured in three of the four case studies and these investors can bring wider support and advice for the business as it grows.

Lastly, this chapter also shows that there is a tension between the ambitions of businesses to provide sustainable alternatives and the demands of investors to make a profit when they exit from the business. Many sustainable businesses challenge the objectives of conventional businesses in their short-term goal to maximise profit for individual shareholders. This can be called a 'post-growth' approach where scaling-up impact for people and planet is prioritised over financial gains, demanding more patient investments. As our case studies show, where investors are aligned with the goals of the business, there is potential for substantial upscaling of impact. It is this alignment between investor and sustainable fashion business that needs to be encouraged to ensure the innovations being developed can be scaled up and transform the wider fashion industry.

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