How to Raise Capital for Your Business:
You Already Know the Investors

Todd Schmitt, Controller
Patriot Software, Inc.

***If you're looking to raise capital for your business*, you may be overlooking an opportunity – your own network of friends and family members. Think of conversations you've had with a relative about investing in mutual funds, or the advice your neighbor asked before investing some of her hard-earned money into gold coins. People close to you may be looking for new places to invest their cash reserves and reap modest returns.**

Your friends and family members may be willing to take a measured risk. They know you well and trust you, and they're tired of dealing with complicated investment schemes that just do not live up to the hype. Some are ready to take on more risk, especially to get better returns than from traditional money markets, CDs, and savings accounts.

Stop for a moment, and make a list of people you know well who invest excess funds. How many did you think of – 5, 10, 20, or more? These individuals may be willing to loan you funds to help build *your* business. By creating a private loan program, you may be able to obtain the funds at a reasonable interest rate and accomplish it through a private transaction. I can say from experience that it's worth exploring. With a private lender investment program, our company raised capital to expand our business. And, we offered our investors an attractive interest rate that made their investment worthwhile.

A Caveat

Before I explain how our private loan investment program worked, I must emphasize that if you ask investors to help you raise capital, *you must pay them back*. It's fundamentally wrong to borrow money that you have no intention of repaying, or to pursue a half-baked business idea and abandon it halfway. They know you well, and they're placing their trust in you. Do your homework on the business venture, and be prepared to do whatever it takes -- including losing your own personal assets -- to pay them back. Whether you repay them quickly or over a period of time, you need to make good on their investment in your business.

For instance, through our own private loan program, we raised more than $1 million dollars in a short time. We ran our program year by year for over five years and paid back every dollar we borrowed, plus interest! Everybody was happy: investors received interest, and we received the cash we needed for our business. Everybody won. *But we were willing to put everything on the line to repay our investors in good faith.*

About Securities Laws

If you're wondering whether securities laws restrict such activities, you're correct. The Securities and Exchange Commission (SEC) provides guidance at the federal level, and each state has its own "Blue Sky" laws as well. We recommend that you consult an attorney with securities law experience before embarking on any form of structured private loan program to ensure SEC and state compliance. However, there are opportunities to raise capital that are exempt from these restrictions.

Typically, federal securities laws cover larger national public offerings of securities. By limiting the scope of a private loan program to meet exemption requirements under your state's Blue Sky laws, your program may be exempt from federal statutes requiring registration of the securities as well as your state's. State Blue Sky laws vary significantly from state to state; a good securities lawyer can help you meet your state's requirements for exemption. Common restrictions include:

- The number of participants in the program,
- The type of participants (usually referring to the participant's level of investing sophistication),
- The location of the participants (i.e., limiting the offering to participants who reside in a single state),
- The method of communicating the offering,
- The amount of capital raised in the program,
- The offering of commissions or discounts in conjunction with the program, and/or
- The length of time of the program investments.

Our Program

In accordance with Blue Sky laws of our state, as interpreted by our corporate counsel, our Private Lender Investment Program could involve no more than 10 participants, all residents of Ohio (excluding company officers and directors, which actually enabled us to include 12 participants in our program.) The length of the investment program could not exceed a year.

To extend the time the company had use of the funds, we ended the program at the end of a year and offered participants the option of enrolling in a completely new program for another year. The new program included new loan terms. Some participants opted to cash out, while others opted to roll over all or a portion of the principal and interest earned from the prior loan. Still others wanted to invest even more. For those rolling their investment into the new program, we issued reports consistent with the proper tax treatment for the repayment of a loan with interest.

I***n accordance with Blue Sky laws***, the program could not be advertised or publicized in any fashion; it was conducted solely by private mailings or hand-delivery. We instructed prospective participants not to tell anyone else about the program and accepted only offers to invest from individuals we specifically targeted. There were no commissions or discounts offered in connection with the program. Finally, we repeatedly made it abundantly clear that there was significant risk involved with the investment, and that the investor could even lose their entire investment.

Planning Your Own Private Lender Investment Program

If you are interested in trying a private lender program to raise capital for your business, be prepared to:

1. Write the story of your business – where it has been and where you plan to take it,
2. Give a candid, detailed description of the risks and obstacles your company faces,
3. Introduce key management personnel in brief biographies,
4. Disclose your current financial condition as indicated by your financial statements,

5. Explain in detail how the loans will be administered through the life of the program (for example, we offered three types of loans, each with its own terms),
6. Track the funds received, and maintain the loan schedules, and
7. Communicate to the investors as needed, including final reports and letters.

In our program, we included Items 1-5 listed above in a document we titled the “Lender Program Offering” which accompanies this white paper as Exhibit #1. We have included some of our language in the document to give you a jump start.

Fill in the “Lender Program Offering” with your company’s information, and then take it along with this white paper to your attorney. Your attorney will be able to use it as a starting point to provide tailored legal advice when creating a similar program for your company.

Items 6 and 7 above are largely administrative duties that you can do in-house or with an accountant. Item 6 is accounting-related; someone familiar with applying interest rates and using loan amortization schedules may be best for this task. Cash management can be handled within your normal accounting functions. Item 7 requires someone with writing, planning, and organizational skills to make sure all forms and communications are tracked and maintained. To facilitate this process, we included Exhibit #2 as a suggested step-by-step approach for handling the general administrative duties of a program.

Most importantly, and I must say it again, make sure your lawyer creates a lender program that meets federal requirements as well as your state’s exemption requirements. Seek expert legal advice. And, make sure you show appreciation to your investors for helping your business to grow.

This document(s) does not pertain to be legal advice and it must not be used as a substitute for the advice of a lawyer qualified in the particular areas of law to which this document relates. Patriot Software, Inc. cannot give legal advice and this document is for informational purposes only.

(Exhibit 1)

LENDER PROGRAM OFFERING

Dear Investor:

The purpose of this Offering is to acquaint you with the Company owned by _________________, to share with you its progress and success, to advise you of its future plans and goals, and to introduce you to its Lender Program. This Offering has only been released to a select and limited number of potential lenders in the State of ____________________. The information contained in this Offering is confidential, so please do not disclose this information to anyone else. After reviewing this Offering, please complete and return the attached Subscription Agreement. A self-addressed return envelope has been included for this purpose. We would like to thank you in advance for your time, consideration, and response.

{COMPANY NAME}

{Insert Company bio here. Include pertinent background information about the Company, such as when it was formed and by whom; who currently owns the company and in what entity structure; the Company's purpose and goals; and, where the Company is today on the road to meet these goals, etc. Basically, tell the Company's story to whet the interest of a potential investor}.

KEY PEOPLE PROVIDING MANAGEMENT OF THE COMPANY

The following are brief profiles of key people playing a role in the development of the Companies:
{Insert bios of your Upper Management Team here. Include the individual's name, title, education, employment history, current duties and responsibilities, and some personal data. While the bios do not need to be lengthy, maybe 100 words, it should give the prospective investor comfort that the management team consists of experienced, competent, real people.}

FINANCIAL HISTORY

The Companies' unaudited Financial Statements for 2010 and 2009 are attached hereto for your convenience. *{Your financial statements may be audited, which is even better. You may want to include Selected Financial Data in a summary table here as well. Such a table could be expanded to cover a longer period of time to show trends if this would be helpful to the investor.}*

GROWTH POTENTIAL

{This section may be included with the Company bio that follows the introductory paragraph at the beginning. Use this section to continue telling the corporate story – casting the corporate vision.}

NEED FOR CAPITAL

{Insert a description of why you need the funding and how you plan to use the funds raised. Note business uses such as operating capital, investment in technology, investment in property/equipment, research and development projects, marketing/advertising, etc. Again, tell the story that will entice a potential investor to lend you money.}

POTENTIAL RISKS

As a part of this program, your loan would be classified as unsecured debt of the Company. As such, there are no underlying Company assets securing your loan, and any claims made against the Company related to your loan would be considered subordinate to all secured debt of the Company. In addition, your loan would not be guaranteed by any government agency or any person.

This offering circular contains forward-looking statements. These statements involve known and unknown risks and uncertainties that may cause the Company's actual results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by such forward-looking statements. The Company undertakes no obligation to update any of the forward-looking statements after the date of this Circular.

Important risk factors affecting the Company's business include but are not limited to . . .
{It's important to honestly inform potential investors of any and all risks. Don't skimp here; identify and explain as many known risks as you can. You never want to hear an investor say, "You never told me ..."}

PRIOR LENDER PROGRAM EXPERIENCE

{Insert a summary of your past program's experience, if applicable.}

LOAN TYPES

{Briefly describe the investment options. Detailed information can be provided in a separate addendum to this document. The following is an example from one of our programs.}

Currently three loan types exist: (1) Balloon Repayment Plan, (2) Interest-Only Repayment Plan, and (3) the Principal & Interest Repayment Plan. Each loan type has a one-year loan amortization schedule and requires a minimum deposit of $20,000. Interest rates are locked in for the one-year term and are as follows:

Balloon Repayment Plan	=	7.00%
Interest-Only Repayment Plan	=	6.50%
Principal & Interest Repayment Plan	=	6.00%

Accompanying this letter is a description of the Loan Options and a Subscription Agreement (not included). This information provides brief explanations of the loan types. Payment frequencies and amounts will vary based on the type of loan you select. At the end of the one-year term, the initial loan amount and any applicable interest earned will be paid to you. Renewal options may also be presented at this time. After reviewing this information, if you are interested in investing, please take time to fill out the Subscription Agreement and return it to us in the enclosed self-addressed envelope.

Thank you again for your time and consideration. If, after reviewing this information, you should have any additional questions, please do not hesitate to contact me at ________________________________.

Sincerely,

{Company name}

{Signer's name and title}

LOAN OPTIONS

Currently three loan types exist. Each loan type has a one-year term and requires a minimum loan amount of $20,000.00. Interest rates are fixed for the one-year term. Payment frequencies and amounts will vary based on the loan type you select. At the end of the one-year term, the principal loan amount and any applicable interest earned will be dispersed to you. Renewal options may also be presented at this time.

Balloon Repayment Plan: This payment plan consists of one installment payment that is made at the end of the loan term. Under this loan type, the original principal amount plus all interest earned during the loan term will be paid in full at the end of the one-year term. Interest is calculated at 7.00% and is compounded monthly on the unpaid principal balance and accumulated interest to date. A $20,000 loan will pay out approximately $1,446 in interest at the end of the one-year term.

Interest-Only Payment Plan: This plan consists of monthly interest payments. These payments are comprised of interest only. Interest is calculated monthly at 6.50% on the unpaid principal balance. The original principal amount will be paid in full at the end of the one-year term. A $20,000 loan will generate, throughout the one-year term, interest payments of approximately $108 each month for a total annual interest return of $1,300, followed by the original $20,000 principal amount to be paid out at the end of the one-year term.

Principal & Interest Repayment Plan: This plan consists of equal monthly installment payments. These payments are comprised of interest and principal portions. Interest is calculated monthly at 6.00% on the unpaid principal balance. At the time of the final installment payment at the end of the investment period, the principal amount will have been paid in full. A $20,000 loan will generate installment payments of approximately $1,721 each month throughout the one-year term resulting in an aggregate interest payout of approximately $656.

Summary:

PLAN TYPE	LOAN AMOUNT	INTEREST RATE	ESTIMATED TOTAL INTEREST PAYOUT	TOTAL PRINCIPAL PAYOUT
Balloon	$20,000	7.0%	$1,446	$20,000
Interest Only	$20,000	6.5%	$1,300	$20,000
Principal & Interest	$20,000	6.0%	$656	$20,000

(Exhibit #2)

PRIVATE LENDER INVESTMENT PROGRAM: STEP-BY-STEP

A. DEFINE YOUR PROGRAM

1. Consult your lawyer to determine what current rules and regulations apply to your program. The lawyer will determine the restrictions necessary to exempt your private offering from registration with the SEC or with the State.

2. Answer the following questions as you plan your program:
   a. To whom will the lender program offering be made?
   b. How much capital funding does the Company need to raise?
   c. How much should the minimum investment be?
   d. When does the Company need the funds? (Begin the initial administration of the Program at least 45 days prior to the date the Company needs the funds.)
   e. What will the loan terms be (i.e. maturity date of the loan, the interest rate, the pay-back provisions, etc.)?
   f. How will the company use the newly raised funds?

3. Establish a control spreadsheet to store pertinent personal information for each prospective investor and to track responses to the offer, as well as administrative processes completed for each. Typical information should include: name, Social Security Number, address, email, phone, date documents mailed, date of response to the offer, loan amount, loan type, loan maturity date, final disposition of the loan, etc.

4. Establish a primary file for the current program with subfiles for each prospective investor.

B. OFFER THE PLAN TO PROSPECTIVE INVESTORS

1. Prepare the Offering Circular.
   a. See exhibit #1 for a template.
   b. Use this document to “tell the Company’s story” – explaining the Company’s current financial condition, goals, need for capital, etc.
   c. Incorporate your specific program terms and conditions.
   d. Pay particular attention to the company descriptions and key employees, and dates.
   e. This form is the same for all prospective participants.

2. Prepare the Subscription Agreement.
   a. Consult your attorney for assistance in writing this document. The purpose of this document is to make the formal offering to the interested parties to subscribe. It should provide the investor the opportunity to tell you how much they wish to invest, and in which investment option.
   b. Incorporate your specific program terms and conditions.
   c. Pay particular attention to dates in the agreement.
   d. This form is the same for all prospective participants.

3. Prepare Introductory Letters.
   a. The purpose of this letter is to accompany the Lender Program Offering and Subscription Agreement and provide basic instructions to the investor on how to proceed through the paperwork to make an investment.
   b. This letter will be conformed to each participant’s individual information. Once the general form is finalized, make a copy for each participant and save it under that participant’s last name. The form letter should be kept intact, without any specific participant’s information.

c. Pay particular attention to dates in this letter.
d. The letter should be printed on company letterhead.

4. Mail a copy of the Offering Circular, a copy of the Subscription Agreement, and the individual Introductory Letter to each prospective participant via certified mail.
    a. Keep copies of each letter in each participant's subfile.
    b. Include a stamped, self-addressed envelope for return of the Subscription Agreement.

C. RECEIVE ELECTION DOCUMENTATION FROM PARTICIPANTS

1. If no response is received after two weeks, track the location of the certified mail.

2. Document progress in the control spreadsheet.

D. COMMENCE THE PRIVATE LENDER INVESTMENT PROGRAM

1. Correspond with electing participants to receive funds and deliver Promissory Notes.

2. Prepare Promissory Notes.
    a. Consult your attorney to write a general form for the promissory note(s) you will be offering. Incorporate your specific program terms and conditions.
    b. Once you know the participation levels of all investors, update the control spreadsheet with investment amount, type of loan, and maturity date. All maturity dates are one year from current maturity dates.
    c. Update the form with each investor's information, and then make a copy for each participant with their specific information. Save as separate documents.
        (1) Double-check the names, amounts, interest rates, and dates on the notes.
        (2) Keep the original form document blank.
    d. Promissory notes are printed on bond paper.
    e. Deliver the Promissory Note and collect funds according to agreed upon method. If done through the mail, use certified mail.

E. ADMINISTER PAYMENTS AS NECESSARY OVER THE LIFE OF THE PROGRAM

1. Produce a loan amortization schedule or interest payment schedule for each participant pursuant to the type of loan selected.

2. Establish monthly, quarterly, and/or annual reminders for payments based on the terms of the loans for the life of the program.

3. Cut checks based on the scheduled due dates, and mail them to the respective participants.

4. Record payments made on the loan amortization and/or interest payment schedules to track your progress through the program.

5. Maintain these schedules in the individual participant files.

F. CONCLUDE THE PRIVATE LENDER INVESTMENT PROGRAM

1. Begin wrapping up the private lender investment program about two weeks prior to the first loan maturity date.

2. Prepare Lost Promissory Note forms.
   a. Consult your attorney to craft a substitute Promissory Note form. The purpose of this document is to allow for the possibility that the investor is unable to locate the Promissory Note issued to them a year ago. The investor will need to return the note for cancellation upon maturity and payment of the Note. If they are unable to find the original Note: this document will be the substitute form.
   b. Update names, dates and amounts.
   c. Lost Note forms are printed on bond paper.

3. Prepare Final Letters for each participant.
   a. The purpose of the Final Letter is to accompany the Lost Note form and the final payment where applicable. It should provide basic instructions, explain how to work through the final paperwork, and give information on final payments. The letter should offer your appreciation for their investment and communicate the success of the program in helping the Company achieve certain goals. The letter may also mention if a new program will be offered in the future.
   b. Enter name, address, dates, and amounts to the form letter.
      (1) Pay attention to any unusual circumstances: early payouts, electronic payment, or payment by check, etc. Revise individual letters as necessary.
   c. Final Letters are printed on company letterhead.

4. Mail Final Letter, Lost Note form, and any check for payout. Include a self-addressed, stamped envelope, to each participant via certified mail to return the original Promissory Note or Lost Note form.
   a. Keep a copy of each document.
   b. Double-check all information against actual notes and Introductory Letters.

5. Make sure all information is updated in the control spreadsheet.

G. RECEIVE PAST PROGRAM PROMISSORY NOTES FROM PARTICIPANTS

1. Mark each returned original note “Canceled” on all pages.

2. Once marked Canceled, original notes are filed in the file for that plan year.

3. If no note is received, you must have a Lost Note form. If you have neither, you must follow up with the investors.

4. Completed physical file should be stored in a secure location for at least seven years.

H. HOW TO ADMINISTER A SUBSEQUENT PROGRAM

1. Use prior year documents and update as necessary.

2. Pay special attention to dates.

3. Tailor the prior Introductory Letter and Subscription Agreement to include language for rollover options not included in the original documents.