

HARRIS & HARRIS GROUP INC /NY/  
Form 10-K  
March 13, 2008

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

**Form 10-K**

**x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2007

or

**o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 0-11576

**HARRIS & HARRIS GROUP, INC.®**

(Exact Name of Registrant as Specified in Its Charter)

New York  
(State or Other Jurisdiction  
of Incorporation or Organization)

13-3119827  
(I.R.S. Employer  
Identification No.)

111 West 57th Street, New York, New York  
(Address of Principal Executive Offices)

10019  
(Zip Code)

Registrant's telephone number, including area code (212) 582-0900

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$.01 par value	Nasdaq Global Market

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes x No



Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes  No

The aggregate market value of the common stock held by non-affiliates of Registrant as of June 29, 2007 was \$244,666,430 based on the last sale price as quoted by the Nasdaq Global Market on such date (only officers and directors are considered affiliates for this calculation).

As of March 12, 2008, the registrant had 23,314,573 shares of common stock, par value \$.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

INCORPORATED AT

Harris & Harris Group, Inc. Proxy Statement for the 2008 Annual Meeting of Shareholders

Part III, Items 10, 11, 12, 13 and 14

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## PART I

### Item 1. Business.

Harris & Harris Group, Inc.<sup>®</sup> (the "Company," "us," "our," and "we"), is an internally managed venture capital company specializing in tiny technology that has elected to operate as a business development company ("BDC") under the Investment Company Act of 1940, which we refer to as the 1940 Act. For tax purposes, we have elected to be a regulated investment company ("RIC") under Subchapter M of the Internal Revenue Code of 1986, which we refer to as the Code. Our investment objective is to achieve long-term capital appreciation, rather than current income, by making venture capital investments in early-stage companies. We incorporated under the laws of the state of New York in August 1981. Our investment approach is comprised of a patient examination of available opportunities, thorough due diligence and close involvement with management. As a venture capital company, we invest in and provide managerial assistance to our portfolio companies which, in our opinion, have significant potential for growth. We are managed by our Board of Directors and officers and have no investment advisor.

We make initial venture capital investments exclusively in "tiny technology," which we define as nanotechnology, microsystems and microelectromechanical systems ("MEMS"). Nanotechnology is measured in nanometers, which are units of measurement in billionths of a meter. Microsystems and microelectromechanical systems are measured in micrometers, which are units of measurement in millionths of a meter. We consider a company to be a tiny technology company if the company employs or intends to employ technology that we consider to be at the microscale or smaller and if the employment of that technology is material to its business plan. Because it is in many respects a new field, tiny technology has significant scientific, engineering and commercialization risks.

At December 31, 2007, 54.7 percent of our total assets and 99.9 percent of our venture capital portfolio were invested in tiny technology investments. The remaining 0.1 percent of our venture capital portfolio represents one non-tiny technology investment made prior to 2001. We may make follow-on investments in any of our portfolio companies. By making these investments, we seek to provide our shareholders with an increasingly specific focus on tiny technology through a portfolio of venture capital investments that address a variety of markets and products. This investment policy is not a fundamental policy and accordingly may be changed without shareholder approval, although we intend to give shareholders at least 60 days prior notice of any change in our policy.

Tiny technology is multidisciplinary and widely applicable, and it incorporates technology that was not previously in widespread use. Products enabled by tiny technology are applicable to a large number of industries including pharmaceuticals, medical devices, electronics and alternative (clean) energy. The use of nanotechnology-enabled advanced materials for clean energy in particular is an area of increasing global interest, and these types of materials are the cornerstones of new generations of photovoltaics, batteries, solid-state lighting, fuel cells, bio-fuels and other energy-related applications that are the focus of a number of recently funded early-stage companies. Although we have not specifically targeted investments in alternative energy companies, as of December 31, 2007, eight of our 30 active portfolio companies are focused on the commercialization of alternative energy-related products. These companies represent 33.4 percent of our venture capital portfolio based on value as of December 31, 2007.

Neither our investments, nor an investment in us, is intended to constitute a balanced investment program. We expect to be risk seeking rather than risk averse in our investment approach. To such end, we reserve the fullest possible freedom of action, subject to our certificate of incorporation, applicable law and regulations, and policy statements contained herein. There is no assurance that our investment objective will be achieved.

We expect to invest a substantial or major portion of our assets in securities that we consider to be venture capital investments. These venture capital investments usually do not pay interest or dividends and usually are subject to legal or contractual restrictions on resale that may adversely affect the liquidity and marketability of such securities.

We expect to make speculative venture capital investments with limited marketability and a greater risk of investment loss than less speculative venture capital issues. Although we currently restrict our initial venture capital investments to tiny technology, such technology is enabling technology applicable to a wide range of fields and businesses, and we do not seek to invest in any particular industries or categories of investments. Our securities investments may consist of private, public or governmental issuers of any type. Subject to the diversification requirements applicable to a RIC, we may commit all of our assets to only a few investments.

Achievement of our investment objective is basically dependent upon the judgment of a team of six professional, full-time members of management, five of whom are designated as Managing Directors: Charles E. Harris, Douglas W. Jamison, Alexei A. Andreev, Michael A. Janse and Daniel B. Wolfe. One of our directors, Lori D. Pressman, is also a consultant to us. This team collectively has expertise in venture capital investing, intellectual property and nanotechnology. There can be no assurance that a suitable replacement could be found for any of our officers upon their retirement, resignation, inability to act on our behalf, or death. Charles E. Harris is our Chairman and Chief Executive Officer and a "control" person as defined in the 1940 Act. On December 31, 2008, Mr. Harris will be subject to mandatory retirement pursuant to the Company's mandatory retirement policy for senior executives. The Board of Directors may extend the mandatory retirement age for a given senior executive for one additional year. On November 2, 2006, the Board of Directors named Douglas W. Jamison as Mr. Harris's successor upon Mr. Harris's retirement.

Subject to continuing to meet the compliance tests applicable to BDCs, there are no limitations on the types of securities or other assets in which we may invest. Investments may include the following:

- Equity, equity-related securities (including warrants) and debt with equity features from either private or public issuers;

- Venture capital investments, whether in corporate, partnership or other form, including development stage or start-up entities;
- Intellectual property or patents or research and development in technology or product development that may lead to patents or other marketable technology;
- Debt obligations of all types having varying terms with respect to security or credit support, subordination, purchase price, interest payments and maturity;
  - Foreign securities; and
  - Miscellaneous investments.

### **Investments and Strategies**

The following is a summary description of the types of assets in which we may invest, the investment strategies we may utilize and the attendant risks associated with our investments and strategies.

#### **Equity, Equity-Related Securities and Debt with Equity Features**

We may invest in equity, equity-related securities and debt with equity features. These securities include common stock, preferred stock, debt instruments convertible into common or preferred stock, limited partnership interests, other beneficial ownership interests and warrants, options or other rights to acquire any of the foregoing.

We may make investments in companies with operating histories that are unprofitable or marginally profitable, that have negative net worth or that are involved in bankruptcy or reorganization proceedings. These investments would involve businesses that management believes have turnaround potential through the infusion of additional capital and management assistance. In addition, we may make investments in connection with the acquisition or divestiture of companies or divisions of companies. There is a significantly greater risk of loss with these types of securities than is the case with traditional investment securities.

We may also invest in publicly traded securities of whatever nature, including relatively small, emerging growth companies that management believes have long-term growth possibilities.

Warrants, options and convertible or exchangeable securities generally give the investor the right to acquire specified equity securities of an issuer at a specified price during a specified period or on a specified date. Warrants and options fluctuate in value in relation to the value of the underlying security and the remaining life of the warrant or option, while convertible or exchangeable securities fluctuate in value both in relation to the intrinsic value of the security without the conversion or exchange feature and in relation to the value of the conversion or exchange feature, which is like a warrant or option. When we invest in these securities, we incur the risk that the option feature will expire worthless, thereby either eliminating or diminishing the value of our investment.

Investments in equity securities of private companies involve securities that are restricted as to sale and cannot be sold in the open market without registration under the Securities Act of 1933 or pursuant to a specific exemption from these registrations. Opportunities for sale are more limited than in the case of marketable securities, although these investments may be purchased at more advantageous prices and may offer attractive investment opportunities. Even if one of our portfolio companies completes an initial public offering, we are typically subject to a lock-up agreement for 180 days, and the stock price may decline substantially before we are free to sell. Even if we have registration rights to make our investments more marketable, a considerable amount of time may elapse between a decision to sell or register the securities for sale and the time when we are able to sell the securities. The prices obtainable upon sale may be adversely affected by market conditions or negative conditions affecting the issuer during the intervening time. We may elect to hold formerly restricted securities after they have become freely marketable, either because they remain relatively illiquid or because we believe that they may appreciate in value, during which holding period they may decline in value and be especially volatile as unseasoned securities. If we need funds for investment or working capital purposes, we might sell marketable securities at disadvantageous times or prices.

### **Venture Capital Investments**

We define venture capital as the money and resources made available to start-up firms and small businesses with exceptional growth potential. We expect our venture capital investments to be largely in development stage or start-up businesses. Substantially all of our long-term venture capital investments are in thinly capitalized, unproven, small companies focused on risky technologies. These businesses also tend to lack management depth, to have limited or no history of operations and to have not attained profitability. Because of the speculative nature of these investments, these securities have a significantly greater risk of loss than traditional investment securities. Some of our venture capital investments will be complete losses or unprofitable, and some will never realize their potential.

We may own 100 percent of the securities of a start-up investment for a period of time and may control the company for a substantial period. Start-up companies are more vulnerable than better capitalized companies to adverse business or economic developments. Start-up businesses generally have limited product lines, markets and/or financial resources. Start-up companies are not well-known to the investing public and are subject to potential bankruptcy, general movements in markets and perceptions of potential growth.

In connection with our venture capital investments, we may participate in providing a variety of services to our portfolio companies, including the following:



- recruiting management;
- formulating operating strategies;
- formulating intellectual property strategies;
  - assisting in financial planning;
- providing management in the initial start-up stages; and
  - establishing corporate goals.

We may assist in raising additional capital for these companies from other potential investors and may subordinate our own investment to that of other investors. We typically find it necessary or appropriate to provide additional capital of our own. We may introduce these companies to potential joint venture partners, suppliers and customers. In addition, we may assist in establishing relationships with investment bankers and other professionals. We may also assist with mergers and acquisitions. We do not derive income from these companies for the performance of any of the above services.

We may control, be represented on, or have observer rights on the Board of Directors of a portfolio company through one or more of our officers or directors, who may also serve as officers of the portfolio company. We indemnify our officers and directors for serving on the Boards of Directors or as officers of portfolio companies, which exposes us to additional risks. Particularly during the early stages of an investment, we may, in rare instances, in effect be conducting the operations of the portfolio company. As a venture capital backed company emerges from the developmental stage with greater management depth and experience, we expect that our role in the portfolio company's operations will diminish. Our goal is to assist each company in establishing its own independent capitalization, management and Board of Directors. We expect to be able to reduce our involvement in those start-up companies that become successful, as well as in those start-up companies that fail.

### **Intellectual Property**

We believe there is a role for organizations that can assist in technology transfer. Scientists and institutions that develop and patent intellectual property perceive the need for and rewards of entrepreneurial commercialization of their inventions.

Our form of investment may be:

- funding research and development in the development of a technology;
  - obtaining licensing rights to intellectual property or patents;
  - acquiring intellectual property or patents; or
- forming and funding companies or joint ventures to commercialize further intellectual property.

Income from our investments in intellectual property or its development may take the form of participation in licensing or royalty income, fee income, or some other form of remuneration. In order to satisfy RIC requirements, these investments will normally be held in an entity taxable as a corporation. Investment in developmental intellectual property rights involves a high degree of risk that can result in the loss of our entire investment as well as additional risks including uncertainties as to the valuation of an investment and potential difficulty in liquidating an investment. Further, investments in intellectual property generally require investor patience, as investment return may be realized only after or over a long period. At some point during the commercialization of a technology, our investment may be transformed into ownership of securities of a development stage or start-up company, as discussed under "Venture Capital Investments" above.

### **Debt Obligations**

We may hold debt securities for income and as a reserve pending more speculative investments. Debt obligations may include U.S. government and agency securities, commercial paper, bankers' acceptances, receivables or other asset-based financing, notes, bonds, debentures, or other debt obligations of any nature and repurchase agreements related to these securities. These obligations may have varying terms with respect to security or credit support, subordination, purchase price, interest payments and maturity from private, public or governmental issuers of any type located anywhere in the world. We may invest in debt obligations of companies with operating histories that are unprofitable or marginally profitable, that have negative net worth or are involved in bankruptcy or reorganization proceedings, or that are start-up or development stage entities. In addition, we may participate in the acquisition or divestiture of companies or divisions of companies through issuance or receipt of debt obligations. As of December 31, 2007, the debt obligations held in our portfolio consisted of convertible bridge notes and U.S. Treasury securities.

It is likely that our investments in debt obligations will be of varying quality, including non-rated, unsecured, highly speculative debt investments with limited marketability. Investments in lower-rated and non-rated securities, commonly referred to as "junk bonds," are subject to special risks, including a greater risk of loss of principal and non-payment of interest. Generally, lower-rated securities offer a higher return potential than higher-rated securities, but involve greater volatility of price and greater risk of loss of income and principal, including the possibility of default or bankruptcy of the issuers of these securities. Lower-rated securities and comparable non-rated securities will likely have large uncertainties or major risk exposure to adverse conditions and are predominantly speculative with respect to the issuer's capacity to pay interest and repay principal in accordance with the terms of the obligation. The occurrence of adverse conditions and uncertainties to issuers of lower-rated securities would likely reduce the value of lower-rated securities held by us, with a commensurate effect on the value of our shares.

The markets in which lower-rated securities or comparable non-rated securities are traded generally are more limited than those in which higher-rated securities are traded. The existence of limited markets for these securities may restrict our ability to obtain accurate market quotations for the purposes of valuing lower-rated or non-rated securities and calculating net asset value or to sell securities at their fair value. Any economic downturn could adversely affect the ability of issuers' lower-rated securities to repay principal and pay interest thereon. The market values of lower-rated and non-rated securities also tend to be more sensitive to individual corporate developments and changes in economic conditions than higher-rated securities. In addition, lower-rated securities and comparable non-rated securities generally present a higher degree of credit risk. Issuers of lower-rated securities and comparable non-rated securities are often highly leveraged and may not have more traditional methods of financing available to them, so that their ability to service their debt obligations during an economic downturn or during sustained periods of rising interest rates may be impaired. The risk of loss owing to default by these issuers is significantly greater because lower-rated securities and comparable non-rated securities generally are unsecured and frequently are subordinated to the prior payment of senior indebtedness. We may incur additional expenses to the extent that we are required to seek recovery upon a default in the payment of principal or interest on our portfolio holdings.

The market value of investments in debt securities that carry no equity participation usually reflects yields generally available on securities of similar quality and type at the time purchased. When interest rates decline, the market value of a debt portfolio already invested at higher yields can be expected to rise if the securities are protected against early call. Similarly, when interest rates increase, the market value of a debt portfolio already invested at lower yields can be expected to decline. Deterioration in credit quality also generally causes a decline in market value of the security, while an improvement in credit quality generally leads to increased value.

### **Foreign Securities**

We may make investments in securities of issuers whose principal operations are conducted outside the United States, and whose earnings and securities are stated in foreign currency. In order to maintain our status as a business development company, our investments in the stocks of companies organized outside the U.S. would be limited to 30 percent of our assets, because we must invest at least 70 percent of our assets in "qualifying assets," and securities of foreign companies are not "qualifying assets."

Compared to otherwise comparable investments in securities of U.S. issuers, currency exchange risk of securities of foreign issuers is a significant variable. The value of these investments to us will vary with the relation of the currency in which they are denominated to the U.S. dollar, as well as with intrinsic elements of value such as credit risk, interest rates and performance of the issuer. Investments in foreign securities also involve risks relating to economic and political developments, including nationalization, expropriation of assets, currency exchange freezes and local recession. Securities of many foreign issuers are less liquid and more volatile than those of comparable U.S. issuers. Interest and dividend income and capital gains on our foreign securities may be subject to withholding and other taxes that may not be recoverable by us. We may seek to hedge all or part of the currency risk of our investments in foreign securities through the use of futures, options and forward currency purchases or sales.

### **Borrowing and Margin Transactions**

We may from time to time borrow money or obtain credit by any lawful means from banks, lending institutions, other entities or individuals, in negotiated transactions. We may issue, publicly or privately, bonds, debentures or notes, in series or otherwise, with interest rates and other terms and provisions, including conversion rights, on a secured or unsecured basis, for any purpose, up to the maximum amounts and percentages permitted for business development companies under the 1940 Act. The 1940 Act currently prohibits us from borrowing any money or issuing any other senior securities (other than preferred stock and other than temporary borrowings of up to five percent of our assets), if in giving effect to the borrowing or issuance, the value of our total assets would be less than 200 percent of our total liabilities (other than liabilities not constituting senior securities). We may pledge assets to secure any borrowings. We currently have no leverage and have no current intention to issue preferred stock.

A primary purpose of our borrowing power is for leverage, to increase our ability to acquire investments both by acquiring larger positions and by acquiring more positions. Borrowings for leverage accentuate any increase or decrease in the market value of our investments and thus our net asset value. Because any decline in the net asset value of our investments will be borne first by holders of common stock, the effect of leverage in a declining market would be a greater decrease in net asset value applicable to the common stock than if we were not leveraged. Any decrease would likely be reflected in a decline in the market price of our common stock. To the extent the income derived from assets acquired with borrowed funds exceeds the interest and other expenses associated with borrowing, our total income will be greater than if borrowings were not used. Conversely, if the income from assets is not sufficient to cover the borrowing costs, our total income will be less than if borrowings were not used. If our current income is not sufficient to meet our borrowing costs (repayment of principal and interest), we might have to liquidate some or all of our investments when it may be disadvantageous to do so. Our borrowings for the purpose of buying most liquid equity securities will be subject to the margin rules, which require excess liquid collateral marked to market daily. If we are unable to post sufficient collateral, we will be required to sell securities to remain in compliance with the margin rules. These sales might be at disadvantageous times or prices.

### **Repurchase of Shares**

Our shareholders do not have the right to compel us to redeem our shares. We may, however, purchase outstanding shares of our common stock from time to time, subject to approval of our Board of Directors and compliance with applicable corporate and securities laws. The Board of Directors may authorize purchases from time to time when they are deemed to be in the best interests of our shareholders, but could do so only after notification to shareholders. The Board of Directors may or may not decide to undertake any purchases of our common stock.

Our repurchases of our common shares would decrease our total assets and would therefore likely have the effect of increasing our expense ratio. Subject to our investment restrictions, we may borrow money to finance the repurchase of our common stock in the open market pursuant to any tender offer. Interest on any borrowings to finance share repurchase transactions will reduce our net assets. If, because of market fluctuations or other reasons, the value of our assets falls below the required 1940 Act coverage requirements, we may have to reduce our borrowed debt to the extent necessary to comply with the requirement. To achieve a reduction, it is possible that we may be required to sell portfolio securities at inopportune times when it may be disadvantageous to do so. Since 1998, we have repurchased a total of 1,828,740 shares of our common stock at a total cost of \$3,405,531, or \$1.86 per share. On July 23, 2002, because of our strategic decision to invest in tiny technology, our Board of Directors reaffirmed its commitment not to authorize the purchase of additional shares of our common stock.

### **Portfolio Company Turnover**

Changes with respect to portfolio companies will be made as our management considers necessary in seeking to achieve our investment objective. The rate of portfolio turnover will not be treated as a limiting or relevant factor when circumstances exist, which are considered by management to make portfolio changes advisable.

Although we expect that many of our investments will be relatively long term in nature, we may make changes in our particular portfolio holdings whenever it is considered that an investment no longer has substantial growth potential or has reached its anticipated level of performance, or (especially when cash is not otherwise available) that another investment appears to have a relatively greater opportunity for capital appreciation. We may also make general portfolio changes to increase our cash to position us in a defensive posture. We may make portfolio changes without regard to the length of time we have held an investment, or whether a sale results in profit or loss, or whether a purchase results in the reacquisition of an investment which we may have only recently sold. Our investments in privately held companies are illiquid, which limits portfolio turnover.

The portfolio turnover rate may vary greatly from year to year as well as during a year and may also be affected by cash requirements.

### **Competition**

Numerous companies and individuals are engaged in the venture capital business, and such business is intensely competitive. We believe the perpetual nature of our corporate structure enables us to be a better long-term partner for our portfolio companies than if we were organized as a traditional private equity fund, which typically has a limited life. We believe that we have invested in more nanotechnology-enabled companies than any venture capital firm and that we have assembled a team of investment professionals that have scientific and intellectual property expertise that is relevant to investing in tiny technology. Nevertheless, many of our competitors have significantly greater financial and other resources and managerial capabilities than we do and are therefore, in certain respects, in a better position than we are to obtain access to attractive venture capital investments, particularly as a lead investor in capital-intensive companies. There can be no assurance that we will be able to compete against these venture capital businesses for attractive investments, particularly as a lead investor in capital-intensive companies.

## **Regulation**

The Small Business Investment Incentive Act of 1980 added the provisions of the 1940 Act applicable to BDCs. BDCs are a special type of investment company. After a company files its election to be treated as a BDC, it may not withdraw its election without first obtaining the approval of holders of a majority of its outstanding voting securities. The following is a brief description of the 1940 Act provisions applicable to BDCs, qualified in its entirety by reference to the full text of the 1940 Act and the rules issued thereunder by the SEC.

Generally, to be eligible to elect BDC status, a company must primarily engage in the business of furnishing capital and making significant managerial assistance available to companies that do not have ready access to capital through conventional financial channels. Such portfolio companies are termed "eligible portfolio companies." In general, in order to qualify as a BDC, a company must: (i) be a domestic company; (ii) have registered a class of its securities pursuant to Section 12 of the Securities Exchange Act of 1934; (iii) operate for the purpose of investing in the securities of certain types of portfolio companies, including early stage or emerging companies and businesses suffering or just recovering from financial distress (see following paragraph); (iv) make available significant managerial assistance to such portfolio companies; and (v) file a proper notice of election with the SEC.

An eligible portfolio company generally is a domestic company that is not an investment company or a company excluded from investment company status pursuant to exclusions for certain types of financial companies (such as brokerage firms, banks, insurance companies and investment banking firms) and that: (i) does not have a class of equity securities listed on a national securities exchange or (ii) is controlled by the BDC by itself or together with others (control under the 1940 Act is presumed to exist where a person owns at least 25 percent of the outstanding voting securities of the portfolio company).

We may be periodically examined by the SEC for compliance with the 1940 Act.

As with other companies regulated by the 1940 Act, a BDC must adhere to certain substantive regulatory requirements. A majority of the directors must be persons who are not interested persons, as that term is defined in the 1940 Act. Additionally, we are required to provide and maintain a bond issued by a reputable fidelity insurance company to protect the BDC. Furthermore, as a BDC, we are prohibited from protecting any director or officer against any liability to us or our shareholders arising from willful malfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of such person's office.

The 1940 Act provides that we may not make an investment in non-qualifying assets unless at the time at least 70 percent of the value of our total assets (measured as of the date of our most recently filed financial statements) consists of qualifying assets. Qualifying assets include: (i) securities of eligible portfolio companies that are not part of a public offering; (ii) securities of certain companies that were eligible portfolio companies at the time we initially acquired their securities and in which we retain a substantial interest; (iii) securities of certain controlled companies; (iv) securities of certain bankrupt, insolvent or distressed companies; (v) securities received in exchange for or distributed in or with respect to any of the foregoing; and (vi) cash items, government securities and high quality short-term debt. The SEC has adopted a rule permitting a BDC to invest its cash in certain money market funds. The 1940 Act also places restrictions on the nature of the transactions in which, and the persons from whom, securities can be purchased in some instances in order for the securities to be considered qualifying assets.

We are permitted by the 1940 Act, under specified conditions, to issue multiple classes of debt and a single class of preferred stock if our asset coverage, as defined in the 1940 Act, is at least 200 percent after the issuance of the debt or the preferred stock (i.e., such senior securities may not be in excess of our net assets). Under specific conditions, we are also permitted by the 1940 Act to issue warrants.

Except under certain conditions, we may sell our securities at a price that is below the prevailing net asset value per share only after a majority of our directors and our disinterested directors have determined that such sale would be in the best interest of us and our stockholders and upon the approval by the holders of a majority of our outstanding voting securities voting on the matter at a meeting at which a quorum is present. If the offering of the securities is underwritten, a majority of the disinterested directors must determine in good faith that the price of the securities being sold is not less than a price which closely approximates market value of the securities, less any distribution discount or commission.

Certain transactions involving certain closely related persons of the Company, including its directors, officers and employees, may require the prior approval of the SEC. However, the 1940 Act ordinarily does not restrict transactions between us and our portfolio companies.

### **Subchapter M Status**

We elected to be treated as a regulated investment company (a "RIC"), taxable under Subchapter M of the Internal Revenue Code (the "Code"), for federal income tax purposes. In general, a RIC is not taxable on its income or gains to the extent it distributes such income or gains to its shareholders. In order to qualify as a RIC, we must, in general, (1) annually derive at least 90 percent of our gross income from dividends, interest and gains from the sale of securities and similar sources (the "Income Source Rule"); (2) quarterly meet certain investment asset diversification requirements; and (3) annually distribute at least 90 percent of our investment company taxable income as a dividend (the "Income Distribution Rule"). Any taxable investment company income not distributed will be subject to corporate level tax. Any taxable investment company income distributed generally will be taxable to shareholders as dividend income.

In addition to the requirement that we must annually distribute at least 90 percent of our investment company taxable income, we may either distribute or retain our realized net capital gains from investments, but any net capital gains not distributed may be subject to corporate level tax. It is our current intention not to distribute net capital gains. Any net capital gains distributed generally will be taxable to shareholders as long-term capital gains.

In lieu of actually distributing our realized net capital gains, we as a RIC may retain all or part of our net capital gains and elect to be deemed to have made a distribution of the retained portion to our shareholders under the "designated undistributed capital gain" rules of the Code. We currently intend to retain and designate all of our net capital gains. In this case, the "deemed dividend" generally is taxable to our shareholders as long-term capital gains. Although we pay tax at the corporate rate on the amount deemed to have been distributed, our shareholders receive a tax credit equal to their proportionate share of the tax paid and an increase in the tax basis of their shares by the amount per share retained by the Company.

To the extent that we declare a deemed dividend, each shareholder will receive an IRS Form 2439 that will reflect each shareholder's receipt of the deemed dividend income and a tax credit equal to each shareholder's proportionate share of the tax paid by us. This tax credit, which is paid at the corporate rate, is often credited at a higher rate than the actual tax due by a shareholder on the deemed dividend income. The "residual" credit can be used by the shareholder to offset other taxes due in that year or to generate a tax refund to the shareholder. Tax exempt investors may file for a refund.

The following simplified examples illustrate the tax treatment under Subchapter M of the Code for us and our individual shareholders with regard to three possible distribution alternatives, assuming a net capital gain of \$1.00 per share, consisting entirely of sales of non-real property assets held for more than 12 months.

**Under Alternative A:** 100 percent of net capital gain declared as a cash dividend and distributed to shareholders:

- 1.No federal taxation at the Company level.
- 2.Taxable shareholders receive a \$1.00 per share dividend and pay federal tax at a rate not in excess of 15 percent\* or \$.15 per share, retaining \$.85 per share.
- 3.Non-taxable shareholders that file a federal tax return receive a \$1.00 per share dividend and pay no federal tax, retaining \$1.00 per share.

**Under Alternative B:** 100 percent of net capital gain retained by the Company and designated as "undistributed capital gain" or deemed dividend:

- 1.The Company pays a corporate-level federal income tax of 35 percent on the undistributed gain or \$.35 per share and retains 65 percent of the gain or \$.65 per share.



2. Taxable shareholders increase their cost basis in their stock by \$.65 per share. They pay federal capital gains tax at a rate not in excess of 15 percent\* on 100 percent of the undistributed gain of \$1.00 per share or \$.15 per share in tax. Offsetting this tax, shareholders receive a tax credit equal to 35 percent of the undistributed gain or \$.35 per share.

3. Non-taxable shareholders that file a federal tax return receive a tax refund equal to \$.35 per share.

\*Assumes all capital gains qualify for long-term rates of 15 percent.

**Under Alternative C:** 100 percent of net capital gain retained by the Company, with no designated undistributed capital gain or deemed dividend:

1. The Company pays a corporate-level federal income tax of 35 percent on the retained gain or \$.35 per share plus an excise tax of four percent of \$.98 per share, or about \$.04 per share.

2. There is no tax consequence at the shareholder level.

Although we may retain income and gains subject to the limitations described above (including paying corporate level tax on such amounts), we could be subject to an additional four percent excise tax if we fail to distribute 98 percent of our aggregate annual taxable income.

As noted above, in order to qualify as a RIC, we must meet certain investment asset diversification requirements each quarter. Because of the specialized nature of our investment portfolio, in some years we have been able to satisfy the diversification requirements under Subchapter M of the Code primarily as a result of receiving certifications from the SEC under the Code with respect to each taxable year beginning after 1998 that we were "principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available" for such year.

Although we received SEC certifications for 1999-2006, there can be no assurance that we will receive such certification for 2007 or subsequent years (to the extent we need additional certifications as a result of changes in our portfolio). If we require, but fail to obtain, the SEC certification for a taxable year, we may fail to qualify as a RIC for such year. We will also fail to qualify as a RIC for a taxable year if we do not satisfy the Income Source Rule or Income Distribution Rule for such year. In the event we do not qualify as a RIC for any taxable year, we will be subject to federal tax with respect to all of our taxable income, whether or not distributed. In addition, all our distributions to shareholders in that situation generally will be taxable as ordinary dividends.

Although we generally intend to qualify as a RIC for each taxable year, under certain circumstances we may choose to take action with respect to one or more taxable years to ensure that we would be taxed under Subchapter C of the Code (rather than Subchapter M) for such year or years. We will choose to take such action only if we determine that the result of the action will benefit us and our shareholders.

Prior to 1999, we were taxable under Subchapter C of the Code (a "C Corporation"). Under the Code, a C Corporation that elects to be treated as a RIC for federal tax purposes is taxable on the effective date of the election to the extent of any gain built into its assets ("C Corporation Assets") on such date ("Built-In Gain"). However, a C Corporation may elect alternatively to be taxable on such Built-In Gain as such gain is realized during the 10-year period beginning on the effective date of its RIC election (the "Inclusion Period"). We had Built-In Gains at the time of our qualification as a RIC and elected to be taxed on any Built-In Gain realized during the Inclusion Period. Prior to 1999, we carried forward ordinary and capital losses from our operations. After our election of RIC status, those losses remained available to be carried forward to subsequent taxable years. Recently issued Internal Revenue Service regulations confirm that such losses may be used to offset realized Built-In Gains and, to the extent so used, to eliminate C Corporation taxation of such gains. We have previously used loss carryforwards to offset Built-In Gains. As of January 1, 2006, the Company had utilized all of its remaining pre-1999 loss carryforwards and unrealized Built-In Gains.

### **Subsidiaries**

Harris & Harris Enterprises, Inc. ("Enterprises"), is a 100 percent wholly owned subsidiary of the Company and is consolidated in our financial statements. Enterprises is a partner in Harris Partners I, L.P., and is taxed as a C Corporation. Harris Partners I, L.P., is a limited partnership. Harris Partners I, L.P., owned our interest in AlphaSimplex Group, LLC, until AlphaSimplex was sold to Natixis Global Asset Management. We received our share of the proceeds on October 30, 2007. The partners of Harris Partners I, L.P., are Harris & Harris Enterprises, Inc. (sole general partner) and the Company (sole limited partner).

### **Available Information**

Additional information about us, including our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, are available on our website at [www.TinyTechVC.com](http://www.TinyTechVC.com). Information on our website is not part of this annual report on Form 10-K.

### **Employees**

We currently employ directly 13 full-time employees.

**Item 1A. Risk Factors.**

Investing in our common stock involves significant risks relating to our business and investment objective. You should carefully consider the risks and uncertainties described below before you purchase any of our common stock. These risks and uncertainties are not the only ones we face. Unknown additional risks and uncertainties, or ones that we currently consider immaterial, may also impair our business. If any of these risks or uncertainties materialize, our business, financial condition or results of operations could be materially adversely affected. In this event, the trading price of our common stock could decline, and you could lose all or part of your investment.

**Risks related to the companies in our portfolio.**

**A continuing lack of initial public offering opportunities may cause companies to stay in our portfolio longer, leading to lower returns, write-downs and write-offs.**

Beginning in about 2001, many fewer venture capital-backed companies per annum have been able to complete initial public offerings (IPOs) than in the years of the previous decade. Moreover, in 2007, according to VentureSource, the venture capital-backed companies that completed IPOs had a median age of about 8.3 years, which was older than the median age of venture capital-backed IPOs in any period since 2001-2002. Now that some of our companies are becoming more mature, a continuing lack of IPO opportunities for venture capital-backed companies could lead to companies staying longer in our portfolio as private entities still requiring funding. In the best case, such stagnation would dampen returns, and in the worst case, could lead to write-downs and write-offs as some companies run short of cash and have to accept lower valuations in private fundings or are not able to access additional capital at all. A continuing lack of IPO opportunities for venture capital-backed companies is also causing some venture capital firms to change their strategies, which is causing some of them to reduce funding of their portfolio companies, making it more difficult for such companies to access capital and to fulfill their potential, leading in some cases to write-downs and write-offs of such companies by other venture capital firms, such as ourselves, who are co-investors in such companies.

**Investing in small, private companies involves a high degree of risk and is highly speculative.**

We have invested a substantial portion of our assets in privately held development stage or start-up companies, the securities of which are inherently illiquid. These businesses tend to lack management depth, to have limited or no history of operations and to have not attained profitability. Tiny technology companies are especially risky, involving scientific, technological and commercialization risks. Because of the speculative nature of these investments, these securities have a significantly greater risk of loss than traditional investment securities. Some of our venture capital investments are likely to be complete losses or unprofitable, and some will never realize their potential. We have been and will continue to be risk seeking rather than risk averse in our approach to venture capital and other investments. Neither our investments nor an investment in our common stock is intended to constitute a balanced investment program.

**We may invest in companies working with technologies or intellectual property that currently have few or no proven commercial applications.**

Nanotechnology, in particular, is a developing area of technology, of which much of the future commercial value is unknown, difficult to estimate and subject to widely varying interpretations. There are as of yet relatively few nanotechnology-enabled products commercially available. The timing of additional future commercially available nanotechnology products is highly uncertain.

**Our portfolio companies may not successfully develop, manufacture or market their products.**

The technology of our portfolio companies is new and in many cases unproven. Their potential products require significant and lengthy product development, manufacturing and marketing efforts. To date, many of our portfolio companies have not developed any commercially available products. In addition, our portfolio companies may not be able to manufacture successfully or to market their products in order to achieve commercial success. Further, the products may never gain commercial acceptance. If our portfolio companies are not able to develop, manufacture or market successful tiny technology-enabled products, they will be unable to generate product revenue or build sustainable or profitable businesses. Adverse conditions in the target markets of our portfolio companies may limit or prevent commercial success regardless of the contribution of tiny technology to these products.

**Our portfolio companies working with tiny technology may be particularly susceptible to intellectual property litigation.**

Research and commercialization efforts in tiny technology are being undertaken by a wide variety of government, academic and private corporate entities. As additional commercially viable applications of tiny technology emerge, ownership of intellectual property on which these products are based may be contested. From time to time, our portfolio companies are or have been involved in intellectual property disputes and litigation. Any litigation over the ownership of, or rights to, any of our portfolio companies' technologies or products could have a material adverse effect on those companies' values.

**Unfavorable general economic conditions, as well as unfavorable conditions specific to the venture capital industry or a segment of portfolio companies, could result in the inability of our portfolio companies to access additional capital, leading to financial losses in our portfolio.**

Most of the companies in which we have made or will make investments are susceptible to economic slowdowns or recessions. An economic slowdown or adverse capital or credit market conditions may affect the ability of a company in our portfolio to raise additional capital from venture capital or other sources or to engage in a liquidity event such as an initial public offering or merger. Certain types of portfolio companies, such as those engaged in solar, solid-state lighting and other alternative energy (cleantech) applications, which are currently in favor with the media and investors generally, may have a harder time accessing capital in the future if their industries subsequently fall out of fashion. Adverse economic, capital or credit market conditions may lead to financial losses in our portfolio.

**The value of our portfolio could be adversely affected if the technologies utilized by our portfolio companies are found, or even rumored or feared, to cause health or environmental risks, or if legislation is passed that limits the commercialization of any of these technologies.**

Nanotechnology has received both positive and negative publicity and is the subject increasingly of public discussion and debate. For example, debate regarding the production of materials that could cause harm to the environment or the health of individuals could raise concerns in the public's perception of nanotechnology, not all of which might be rational or scientifically based. Tiny technology in general and nanotechnology in particular are currently the subject of health and environmental impact research. If health or environmental concerns about tiny technology or nanotechnology were to arise, whether or not they had any basis in fact, our portfolio companies might incur additional research, legal and regulatory expenses, and might have difficulty raising capital or marketing their products. Government authorities could, for social or other purposes, prohibit or regulate the use of nanotechnology. Legislation could be passed that could circumscribe the commercialization of any of these technologies.

**Our portfolio companies may generate revenues from the sale of non-tiny technology-enabled products.**

We consider a company to be a tiny technology company if a product or products, or intellectual property covering a product or products, that we consider to be at the microscale or smaller is material to its business plan. The core business of some of these companies may not be tiny technology-enabled products, and therefore their success or failure may not be dependent upon the tiny technology aspects of their business. In addition to developing products that we consider tiny technology, some of these companies may also develop products that we do not consider enabled by tiny technology. Some of these companies will generate revenues from the sale of non-tiny technology-enabled products. Additionally, it is possible that a portfolio company may decide to change its business focus after our initial investment and decide to develop and commercialize non-tiny technology-enabled products.

**Risks related to the illiquidity of our investments.**

**We invest in illiquid securities and may not be able to dispose of them when it is advantageous to do so, or ever.**

Most of our investments are or will be equity or equity-linked securities acquired directly from small companies. These equity securities are generally subject to restrictions on resale or otherwise have no established trading market. The illiquidity of most of our portfolio of equity securities may adversely affect our ability to dispose of these securities at times when it may be advantageous for us to liquidate these investments. We may never be able to dispose of these securities.

**Unfavorable economic conditions and regulatory changes could impair our ability to engage in liquidity events.**

Our business of making private equity investments and positioning our portfolio companies for liquidity events might be adversely affected by current and future capital markets and economic conditions. The public equity markets currently provide less opportunity for liquidity events than at times in the past when there was more robust demand for initial public offerings, even for more mature technology companies than those in which we typically invest. The potential for public market liquidity could further decrease and could lead to an inability to realize potential gains or could lead to financial losses in our portfolio and a decrease in our revenues, net income and assets. Recent government reforms affecting publicly traded companies, stock markets, investment banks and securities research practices have made it more difficult for privately held companies to complete successful initial public offerings of their equity securities, and such reforms have increased the expense and legal exposure of being a public company. Slowdowns in initial public offerings may also be having an adverse effect on the frequency and prices of acquisitions of privately held companies. A lack of merger and/or acquisition opportunities for privately held companies also may be having an adverse effect on the ability of these companies to raise capital from private sources. Public equity market response to companies offering nanotechnology-enabled products is uncertain. An inability to engage in liquidity events could negatively affect our liquidity, our reinvestment rate in new and follow-on investments and the value of our portfolio.

**Even if some of our portfolio companies complete initial public offerings, the returns on our investments in those companies would be uncertain.**

When companies in which we have invested as private entities complete initial public offerings of their securities, these newly issued securities are by definition unseasoned issues. Unseasoned issues tend to be highly volatile and have uncertain liquidity, which may negatively affect their price. In addition, we are typically subject to lock-up provisions that prohibit us from selling our investments into the public market for specified periods of time after initial public offerings. The market price of securities that we hold may decline substantially before we are able to sell these securities. Most initial public offerings of technology companies in the United States are listed on the Nasdaq Global Market. Government reforms of the Nasdaq Global Market have made market-making by broker-dealers less profitable, which has caused broker-dealers to reduce their market-making activities, thereby making the market for unseasoned stocks less liquid than they might be otherwise.

**Risks related to our Company.**

**Because there is generally no established market in which to value our investments, our Valuation Committee's value determinations may differ materially from the values that a ready market or third party would attribute to these investments.**

There is generally no public market for the equity securities in which we invest. Pursuant to the requirements of the 1940 Act, we value all of the private equity securities in our portfolio at fair value as determined in good faith by a committee of independent members of our Board of Directors, which we call the Valuation Committee, pursuant to Valuation Procedures established by the Board of Directors. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment pursuant to specified valuation principles and processes. We are required by the 1940 Act to value specifically each individual investment on a quarterly basis and record unrealized depreciation for an investment that we believe has become impaired. Conversely, we must record unrealized appreciation if we believe that our securities have appreciated in value. Our valuations, although stated as a precise number, are necessarily within a range of values that vary depending on the significance attributed to the various factors being considered.

We use the Black-Scholes option pricing model to determine the fair value of warrants held in our portfolio. Option pricing models, including the Black-Scholes model, require the use of subjective input assumptions, including expected volatility, expected life, expected dividend rate, and expected risk-free rate of return. In the Black-Scholes model, variations in the expected volatility or expected term assumptions have a significant impact on fair value. Because the securities underlying the warrants in our portfolio are not publicly traded, many of the required input assumptions are more difficult to estimate than they would be if a public market for the underlying securities existed.

Without a readily ascertainable market value and because of the inherent uncertainty of valuation, the fair value that we assign to our investments may differ from the values that would have been used had an efficient market existed for the investments, and the difference could be material. Any changes in fair value are recorded in our consolidated statements of operations as a change in the "Net (decrease) increase in unrealized appreciation on investments."

In the venture capital industry, even when a portfolio of early-stage, high-technology venture capital investments proves to be profitable over the portfolio's lifetime, it is common for the portfolio's value to undergo a so-called "J-curve" valuation pattern. This means that when reflected on a graph, the portfolio's valuation would appear in the shape of the letter "J," declining from the initial valuation prior to increasing in valuation. This J-curve valuation pattern results from write-downs and write-offs of portfolio investments that appear to be unsuccessful, prior to write-ups for portfolio investments that prove to be successful. Because early-stage companies typically have negative cash flow and are by their nature inherently fragile, a valuation process can more readily substantiate a loss of value than an increase in value. Even if our venture capital investments prove to be profitable in the long run, such J-curve valuation patterns could have a significant adverse effect on our net asset value per share and the value of our common stock in the interim. Over time, as we continue to make additional tiny technology investments, this J-curve pattern may be less relevant for our portfolio as a whole, because the individual J-curves for each investment, or series of investments, may overlap with previous investments at different stages of their J-curves.

**Changes in valuations of our privately held, early stage companies tend to be more volatile than changes in prices of publicly traded securities.**

Investments in privately held, early stage companies are inherently more volatile than investments in more mature businesses. Such immature businesses are inherently fragile and easily affected by both internal and external forces. Our investee companies can lose much or all of their value suddenly in response to an internal or external adverse event. Conversely, these immature businesses can gain suddenly in value in response to an internal or external positive development. Moreover, because our ownership interests in such investments are valued only at quarterly intervals by our Valuation Committee, a committee made up of all of our independent members of our Board of Directors, changes in valuations from one valuation point to another tend to be larger than changes in valuations of marketable securities which are revalued in the marketplace much more frequently, in some highly liquid cases, virtually continuously.

**We expect to continue to experience material write-downs of securities of portfolio companies.**

Write-downs of securities of our privately held companies have always been a by-product and risk of our business. We expect to continue to experience material write-downs of securities of privately held portfolio companies. Write-downs of such companies occur at all stages of their development. Such write-downs may increase in dollar terms, frequency and as a percentage of our net asset value as our dollar investment activity in privately held companies continues to increase, and the number of such holdings in our portfolio continues to grow. Because the average size of each of our investments in tiny technology has increased from year to year and continues to increase, the average size of our write-downs will probably also increase.

**Because we do not choose investments based on a strategy of diversification, the value of our business is subject to greater volatility than the value of companies with more broadly diversified investments.**

We do not choose investments based on a strategy of diversification. Therefore, we may be more vulnerable to events affecting a single sector or industry and therefore subject to greater volatility than a company that follows a diversification strategy. Accordingly, an investment in our common stock may present greater risk to you than an investment in a diversified company.



**We are dependent upon key management personnel for future success, and may not be able to retain them.**

We are dependent upon the diligence and skill of our senior management and other key advisers for the selection, structuring, closing and monitoring of our investments. We utilize lawyers, and we utilize outside consultants, including one of our directors, Lori D. Pressman, to assist us in conducting due diligence when evaluating potential investments. There is generally no publicly available information about the companies in which we invest, and we rely significantly on the diligence of our employees and advisers to obtain information in connection with our investment decisions. Our future success to a significant extent depends on the continued service and coordination of our senior management team, and particularly on Charles E. Harris, our Chairman, Chief Executive Officer and a Managing Director, who will be subject to mandatory retirement pursuant to the Company's mandatory retirement policy for senior executives on December 31, 2008; on Douglas W. Jamison, our President, Chief Operating Officer and a Managing Director, who has been designated by our Board of Directors as the successor to Mr. Harris in his positions of Chairman and Chief Executive Officer as of January 1, 2009 upon his retirement; on Daniel B. Wolfe, our Chief Financial Officer and a Managing Director; on Alexei A. Andreev and Michael A. Janse, each an Executive Vice President and Managing Director; and on Sandra M. Forman, our General Counsel, Chief Compliance Officer and Director of Human Resources. The departure of any of our executive officers, key employees or advisers could materially adversely affect our ability to implement our business strategy. We do not maintain for our benefit any key-man life insurance on any of our officers or employees.

**We will need to hire additional employees as the size of our portfolio increases.**

We anticipate that it will be necessary for us to add investment professionals with expertise in venture capital and/or tiny technology and administrative and support staff to accommodate the increasing size of our portfolio. We may need to provide additional scientific, business, accounting, legal or investment training for our hires. There is competition for highly qualified personnel. We may not be successful in our efforts to recruit and retain highly qualified personnel because the expenses that we incur as a heavily regulated, publicly held company preclude our paying as high a percentage of our total expenses in cash compensation for employees as the private partnerships with which we compete. Although we have the advantage of offering equity incentive compensation, unlike those private partnerships, we cannot permit co-investment in our investments by our employees, and we cannot give our employees 20 percent or higher carried interests in our investments as incentive compensation taxable as long-term capital gains.

**The market for venture capital investments, including tiny technology investments, is highly competitive.**

We face substantial competition in our investing activities from many competitors, including but not limited to: private venture capital funds; investment affiliates of large industrial, technology, service and financial companies; small business investment companies; hedge funds; wealthy individuals; and foreign investors. Our most significant competitors typically have significantly greater financial resources than we do. Greater financial resources are particularly advantageous in securing lead investor roles in venture capital syndicates. Lead investors typically negotiate the terms and conditions of such financings. Many sources of funding compete for a small number of attractive investment opportunities. Hence, we face substantial competition in sourcing good investment opportunities on terms of investment that are commercially attractive.

**In addition to the difficulty of finding attractive investment opportunities, our status as a regulated business development company may hinder our ability to participate in investment opportunities or to protect the value of existing investments.**

We are required to disclose on a quarterly basis the names and business descriptions of our portfolio companies and the type and value of our portfolio securities. Most of our competitors are not subject to these disclosure requirements. Our obligation to disclose this information could hinder our ability to invest in some portfolio companies. Additionally, other current and future regulations may make us less attractive as a potential investor than a competitor not subject to the same regulations.

**Our failure to make follow-on investments in our portfolio companies could impair the value of our portfolio.**

Following an initial investment in a portfolio company, we may make additional investments in that portfolio company as "follow-on" investments, in order to: (1) increase or maintain in whole or in part our ownership percentage; (2) exercise warrants, options or convertible securities that were acquired in the original or subsequent financing; or (3) attempt to preserve or enhance the value of our investment.

We may elect not to make follow-on investments or lack sufficient funds to make such investments. We have the discretion to make any follow-on investments, subject to the availability of capital resources. The failure to make a follow-on investment may, in some circumstances, jeopardize the continued viability of a portfolio company and our initial investment, or may result in a missed opportunity for us to increase our participation in a successful operation, or may cause us to lose some or all preferred rights pursuant to "pay-to-play" provisions that have become common in venture capital transactions. These provisions require proportionate investment in subsequent rounds of financing in order to preserve preferred rights such as anti-dilution protection, liquidation preferences and preemptive rights to invest in future rounds of financing. Even if we have sufficient capital to make a desired follow-on investment, we may elect not to make a follow-on investment because we may not want to increase our concentration of risk, because we prefer other opportunities or because we are inhibited by compliance with business development company requirements or the desire to maintain our tax status.

**Bank borrowing or the issuance of debt securities or preferred stock by us, to fund investments in portfolio companies or to fund our operating expenses, would make our total return to common shareholders more volatile.**

Use of debt or preferred stock as a source of capital entails two primary risks. The first is the risk of leverage, which is the use of debt to increase the pool of capital available for investment purposes. The use of debt leverages our available common equity capital, magnifying the impact on net asset value of changes in the value of our investment portfolio. For example, a business development company that uses 33 percent leverage (that is, \$50 of leverage per \$100 of common equity) will show a 1.5 percent increase or decline in net asset value for each 1 percent increase or decline in the value of its total assets. The second risk is that the cost of debt or preferred stock financing may exceed the return on the assets the proceeds are used to acquire, thereby diminishing rather than enhancing the return to common shareholders. If we issue preferred shares or debt, the common shareholders would bear the cost of this leverage. To the extent that we utilize debt or preferred stock financing for any purpose, these two risks would likely make our total return to common shareholders more volatile. In addition, we might be required to sell investments, in order to meet dividend, interest or principal payments, when it might be disadvantageous for us to do so.

As provided in the 1940 Act and subject to some exceptions, we can issue debt or preferred stock so long as our total assets immediately after the issuance, less some ordinary course liabilities, exceed 200 percent of the sum of the debt and any preferred stock outstanding. The debt or preferred stock may be convertible in accordance with SEC guidelines, which might permit us to obtain leverage at more attractive rates. The requirement under the 1940 Act to pay, in full, dividends on preferred shares or interest on debt before any dividends may be paid on our common stock means that dividends on our common stock from earnings may be reduced or eliminated. An inability to pay dividends on our common stock could conceivably result in our ceasing to qualify as a regulated investment company, or RIC, under the Code, which would in most circumstances be materially adverse to the holders of our common stock. As of the date hereof, we do not have any debt or preferred stock outstanding.

**We are authorized to issue preferred stock, which would convey special rights and privileges to its owners senior to those of common stock shareholders.**

We are currently authorized to issue up to 2,000,000 shares of preferred stock, under terms and conditions determined by our Board of Directors. These shares would have a preference over our common stock with respect to dividends and liquidation. The statutory class voting rights of any preferred shares we would issue could make it more difficult for us to take some actions that might, in the future, be proposed by the Board and/or holders of common stock, such as a merger, exchange of securities, liquidation or alteration of the rights of a class of our securities, if these actions were perceived by the holders of the preferred shares as not in their best interests. The issuance of preferred shares convertible into shares of common stock might also reduce the net income and net asset value per share of our common stock upon conversion.

**Loss of status as a RIC would reduce our net asset value and distributable income.**

We currently intend to qualify as a RIC for 2007 under the Code. As a RIC, we do not have to pay federal income taxes on our income (including realized gains) that is distributed to our shareholders. Accordingly, we are not permitted under accounting rules to establish reserves for taxes on our unrealized capital gains. If we failed to qualify for RIC status in 2007 or beyond, to the extent that we had unrealized gains, we would have to establish reserves for taxes, which would reduce our net asset value, accordingly. In addition, if we, as a RIC, were to decide to make a deemed distribution of net realized capital gains and retain the net realized capital gains, we would have to establish appropriate reserves for taxes that we would have to pay on behalf of shareholders. It is possible that establishing reserves for taxes could have a material adverse effect on the value of our common stock.

**We operate in a heavily regulated environment, and changes to, or non-compliance with, regulations and laws could harm our business.**

We are subject to substantive SEC regulations as a business development company. Securities and tax laws and regulations governing our activities may change in ways adverse to our and our shareholders' interests, and interpretations of these laws and regulations may change with unpredictable consequences. Any change in the laws or regulations that govern our business could have an adverse impact on us or on our operations. Changing laws, regulations and standards relating to corporate governance, valuation and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations, new federal accounting standards and Nasdaq Global Market rules, are creating additional expense and uncertainty for publicly held companies in general, and for business development companies in particular. These new or changed laws, regulations and standards are subject to varying interpretations in many cases because of their lack of specificity, and as a result, their application in practice may evolve over time, which may well result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices.

We are committed to maintaining high standards of corporate governance and public disclosure. As a result, our efforts to comply with evolving laws, regulations and standards have and will continue to result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. In particular, our efforts to comply with Section 404 of the Sarbanes-Oxley Act of 2002 and the related regulations regarding our required assessment of our internal controls over financial reporting and our external auditors' audit of that assessment has required the commitment of significant financial and managerial resources.

Moreover, even though business development companies are not mutual funds, they must comply with several of the regulations applicable to mutual funds, such as the requirement for the implementation of a comprehensive compliance program and the appointment of a Chief Compliance Officer. Further, our Board members, Chief Executive Officer and Chief Financial Officer could face an increased risk of personal liability in connection with the performance of their duties. As a result, we may have difficulty attracting and retaining qualified board members and executive officers, which could harm our business, and we have significantly increased both our coverage under, and the related expense for, directors' and officers' liability insurance. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies, our reputation may be harmed. Also, as business and financial practices continue to evolve, they may render the regulations under which we operate less appropriate and more burdensome than they were when originally imposed. This increased regulatory burden is causing us to incur significant additional expenses and is time consuming for our management, which could have a material adverse effect on our financial performance.

**Market prices of our common stock will continue to be volatile.**

We expect that the market price of our common stock price will continue to be volatile. The price of the common stock may be higher or lower than the price you pay for your shares, depending on many factors, some of which are beyond our control and may not be directly related to our operating performance. These factors include the following:

- stock market and capital markets conditions;
- internal developments in our Company with respect to our personnel, financial condition and compliance with all applicable regulations;
- announcements regarding any of our portfolio companies;
- announcements regarding developments in the nanotechnology field in general;
- environmental and health concerns regarding nanotechnology, whether real or perceptual;
- announcements regarding government funding and initiatives related to the development of nanotechnology;
- general economic conditions and trends; and/or
- departures of key personnel.

We will not have control over many of these factors, but expect that our stock price may be influenced by them. As a result, our stock price may be volatile, and you may lose all or part of your investment.

**Quarterly results fluctuate and are not indicative of future quarterly performance.**

Our quarterly operating results fluctuate as a result of a number of factors. These factors include, among others, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which we and our portfolio companies encounter competition in our markets and general economic and capital markets conditions. As a result of these factors, results for any one quarter should not be relied upon as being indicative of performance in future quarters.

**To the extent that we do not realize income or choose not to retain after-tax realized capital gains, we will have a greater need for additional capital to fund our investments and operating expenses.**

As a RIC, we must annually distribute at least 90 percent of our investment company taxable income as a dividend and may either distribute or retain our realized net capital gains from investments. As a result, these earnings may not be available to fund investments. If we fail to generate net realized capital gains or to obtain funds from outside sources, it would have a material adverse effect on our financial condition and results of operations as well as our ability to make follow-on and new investments. Because of the structure and objectives of our business, we generally expect to experience net operating losses and rely on proceeds from sales of investments, rather than on investment income, to defray a significant portion of our operating expenses. These sales are unpredictable and may not occur. In addition, as a business development company, we are generally required to maintain a ratio of at least 200 percent of total assets to total borrowings and preferred stock, which may restrict our ability to borrow to fund these requirements. Lack of capital could curtail our investment activities or impair our working capital.

**Investment in foreign securities could result in additional risks.**

We may invest in foreign securities, and we currently have one investment in a foreign security. When we invest in securities of foreign issuers, we may be subject to risks not usually associated with owning securities of U.S. issuers. These risks can include fluctuations in foreign currencies, foreign currency exchange controls, social, political and economic instability, differences in securities regulation and trading, expropriation or nationalization of assets and foreign taxation issues. In addition, changes in government administrations or economic or monetary policies in the United States or abroad could result in appreciation or depreciation of our securities and could favorably or unfavorably affect our operations. It may also be more difficult to obtain and enforce a judgment against a foreign issuer. Any foreign investments made by us must be made in compliance with U.S. and foreign currency restrictions and tax laws restricting the amounts and types of foreign investments.

Although most of our investments are denominated in U.S. dollars, our investments that are denominated in a foreign currency are subject to the risk that the value of a particular currency may change in relation to the U.S. dollar, in which currency we maintain financial statements and valuations. Among the factors that may affect currency values are trade balances, the level of short-term interest rates, differences in relative values of similar assets in different currencies, long-term opportunities for investment and capital appreciation and political developments.

**Investing in our stock is highly speculative and an investor could lose some or all of the amount invested.**

Our investment objective and strategies result in a high degree of risk in our investments and may result in losses in the value of our investment portfolio. Our investments in portfolio companies are highly speculative and, therefore, an investor in our common stock may lose his or her entire investment. The value of our common stock may decline and may be affected by numerous market conditions, which could result in the loss of some or all of the amount invested in our common stock. The securities markets frequently experience extreme price and volume fluctuations that affect market prices for securities of companies in general, and technology and very small capitalization companies in particular. Because of our focus on the technology and very small capitalization sectors, and because we are a very small capitalization company ourselves, our stock price is especially likely to be affected by these market conditions. General economic conditions, and general conditions in tiny technology in general and nanotechnology in particular and in the semi-conductor and information technology, life sciences, materials science and other high technology industries, may also affect the price of our common stock.

**Our shares might trade at discounts from net asset value or at premiums that are unsustainable over the long term.**

Shares of business development companies like us may, during some periods, trade at prices higher than their net asset value and during other periods, as frequently occurs with closed-end investment companies, trade at prices lower than their net asset value. The possibility that our shares will trade at discounts from net asset value or at premiums that are unsustainable over the long term are risks separate and distinct from the risk that our net asset value per share will decrease. The risk of purchasing shares of a business development company that might trade at a discount or unsustainable premium is more pronounced for investors who wish to sell their shares in a relatively short period of time because, for those investors, realization of a gain or loss on their investments is likely to be more dependent upon changes in premium or discount levels than upon increases or decreases in net asset value per share. Our common stock may not trade at a price higher than or equal to net asset value per share. On December 31, 2007, our stock closed at \$8.79 per share, a premium of \$2.86 over our net asset value per share of \$5.93 as of December 31, 2007.

**The Board of Directors intends to grant stock options to our employees pursuant to the Company's Equity Incentive Plan. When exercised, these options may have a dilutive effect on existing shareholders.**

In accordance with the Company's Equity Incentive Plan, the Company's Compensation Committee may grant options from time to time for up to 20 percent of the total shares of stock issued and outstanding. When options are exercised, net asset value per share will decrease if the net asset value per share at the time of exercise is higher than the exercise price. Alternatively, net asset value per share will increase if the net asset value per share at the time of exercise is lower than the exercise price. Therefore, existing shareholders will be diluted if the net asset value per share at the time of exercise is higher than the exercise price of the options. Even though issuance of shares pursuant to exercises of options increases the Company's capital, and regardless of whether such issuance results in increases or decreases in net asset value per share, such issuance results in existing shareholders owning a smaller percentage of the shares outstanding.

**You have no right to require us to repurchase your shares.**

You do not have the right to require us to repurchase your shares of common stock.

**Item 1B. Unresolved Staff Comments.**

None.

**Item 2. Properties.**

The Company maintains its offices at 111 West 57<sup>th</sup> Street, New York, New York 10019, where it leases approximately 3,540 square feet of office space pursuant to lease agreements expiring in 2010. (See "Note 9 of Notes to Consolidated Financial Statements" contained in "Item 8. Consolidated Financial Statements and Supplementary Data.")

**Item 3. Legal Proceedings.**

The Company is not a party to any legal proceedings.

**Item 4. Submission of Matters to a Vote of Security Holders.**

None.

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**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.****Market Information**

Our common stock is traded on the Nasdaq Global Market under the symbol "TINY." The following table sets forth the range of the high and low sales price of the Company's shares during each quarter of the last two fiscal years, as reported by Nasdaq Global Market. The quarterly stock prices quoted represent interdealer quotations and do not include markups, markdowns or commissions.

<b>2007 Quarter Ending</b>	<b>Low</b>	<b>High</b>
March 31	\$ 11.00	\$ 13.58
June 30	\$ 11.01	\$ 14.32
September 30	\$ 9.51	\$ 11.79
December 31	\$ 8.00	\$ 11.10
<b>2006 Quarter Ending</b>	<b>Low</b>	<b>High</b>
March 31	\$ 12.75	\$ 16.10
June 30	\$ 9.57	\$ 14.26
September 30	\$ 9.38	\$ 12.99
December 31	\$ 11.80	\$ 15.16

**Shareholders**

As of March 12, 2008, there were approximately 134 holders of record of the Company's common stock which, the Company has been informed, hold the Company's common stock for approximately 20,971 beneficial owners.

**Dividends**

We did not pay a cash dividend or declare a deemed dividend for 2007 or 2006. For more information about deemed dividends, please refer to the discussion under "Subchapter M Status."

**Securities Authorized for Issuance Under Equity Compensation Plans****EQUITY COMPENSATION PLAN INFORMATION**  
**As of December 31, 2007**

<b>Plan category</b>	<b>Number of securities to be issued upon exercise of outstanding options, warrants and rights</b>	<b>Weighted-average exercise price of outstanding options, warrants and rights</b>	<b>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in Column (a))</b>
	(a)	(b)	(c)
Equity compensation plans approved by security holders	3,967,744	\$ 10.54	(1)
Equity compensation plans not approved by security holders			
<b>TOTAL</b>	<b>3,967,744</b>	<b>\$ 10.54</b>	<b>(1)</b>

(1) A maximum of twenty percent (20%) of our total shares of our common stock issued and outstanding, calculated on a fully diluted basis, will be available for awards under the plan, subject to adjustment as described below. Shares issued under the plan may be authorized but unissued shares or treasury shares. If any shares subject to an award granted under the plan are forfeited, cancelled, exchanged or surrendered, or if an award terminates or expires without a distribution of shares, or if shares of stock are surrendered or withheld as payment of either the exercise price of an award and/or withholding taxes in respect of an award, those shares will again be available for awards under the plan.

**Recent Sales of Unregistered Securities**

The Company did not sell any equity securities during 2007 that were not registered under the Securities Act of 1933.

**Performance Graph**

The graph below matches the cumulative five-year total return of holders of the Company's common stock with the cumulative total returns of the Nasdaq Composite index and the Nasdaq Financial index. The graph assumes that the value of the investment in the Company's common stock and in each of the indexes (including reinvestment of dividends) was \$100 on December 31, 2002 and tracks it through December 31, 2007.

	12/02	12/03	12/04	12/05	12/06	12/07
<b>Harris &amp; Harris Group, Inc.</b>	<b>100.00</b>	<b>468.70</b>	<b>665.85</b>	<b>565.04</b>	<b>491.46</b>	<b>357.32</b>
<b>NASDAQ Composite</b>	<b>100.00</b>	<b>149.75</b>	<b>164.64</b>	<b>168.60</b>	<b>187.83</b>	<b>205.22</b>
<b>NASDAQ Financial</b>	<b>100.00</b>	<b>133.86</b>	<b>149.89</b>	<b>156.52</b>	<b>178.54</b>	<b>157.20</b>

*The stock price performance included in this graph is not necessarily indicative of future stock price performance.*

*Source: Research Data Group, Inc.*

### **Stock Transfer Agent**

American Stock Transfer & Trust Company, 59 Maiden Lane, New York, New York 10038 (Telephone 800-937-5449, Attention: Mr. Joe Wolf) serves as transfer agent for our common stock. Certificates to be transferred should be mailed directly to the transfer agent, preferably by registered mail.

**Item 6. Selected Financial Data.**

The information below was derived from the audited Consolidated Financial Statements included in this report and in previous annual reports filed with the SEC. This information should be read in conjunction with those Consolidated Financial Statements and Supplementary Data and the notes thereto. These historical results are not necessarily indicative of the results to be expected in the future.

**Financial Position as of December 31:**

	2007	2006	2005	2004	2003
Total assets	\$ 142,893,332	\$ 118,328,590	\$ 132,938,120	\$ 79,361,451	\$ 44,115,128
Total liabilities	\$ 4,529,988	\$ 4,398,287	\$ 14,950,378	\$ 4,616,652	\$ 3,432,390
Net assets	\$ 138,363,344	\$ 113,930,303	\$ 117,987,742	\$ 74,744,799	\$ 40,682,738
Net asset value per outstanding share	\$ 5.93	\$ 5.42	\$ 5.68	\$ 4.33	\$ 2.95
Cash dividends paid	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
Cash dividends paid per outstanding share	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
Shares outstanding, end of year	23,314,573	21,015,017	20,756,345	17,248,845	13,798,845

**Operating Data for Year Ended December 31:**

	2007	2006	2005	2004	2003
Total investment income	\$ 2,705,636	\$ 3,028,761	\$ 1,540,862	\$ 637,562	\$ 167,785
Total expenses <sup>1</sup>	\$ 14,533,179	\$ 10,641,696	\$ 7,006,623	\$ 4,046,341	\$ 2,731,527
Net operating (loss) income	\$ (11,827,543)	\$ (7,612,935)	\$ (5,465,761)	\$ (3,408,779)	\$ (2,563,742)
Total tax (benefit) expense <sup>2</sup>	\$ 87,975	\$ (227,355)	\$ 8,288,778	\$ 650,617	\$ 13,761
Net realized income (loss) from investments	\$ 30,162	\$ 258,693	\$ 14,208,789	\$ 858,503	\$ (984,925)
Net decrease (increase) in unrealized depreciation on investments	\$ 5,080,936	\$ (4,418,870)	\$ (2,026,652)	\$ 484,162	\$ 343,397
Net (decrease) increase in net assets resulting from operations	\$ (6,716,445)	\$ (11,773,112)	\$ 6,716,376	\$ (2,066,114)	\$ (3,205,270)

(Decrease) increase in net assets resulting from operations per average outstanding share	\$	(0.30)	\$	(0.57)	\$	0.36	\$	(0.13)	\$	(0.28)
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<sup>1</sup> Included in total expenses is non-cash, stock-based, compensation expense of \$8,050,807 in 2007 and \$5,038,956 in 2006. Also included in total expenses are the following profit-sharing expenses: \$0 in 2007; \$50,875 in 2006; \$1,796,264 in 2005; and \$311,594 in 2004. There was no stock-based compensation expense in 2005, 2004, or 2003.

<sup>2</sup> Included in total tax expense are the following taxes paid by the Company on behalf of shareholders: \$0 in each of 2007 and 2006; \$8,122,367 in 2005; \$0 in each of 2004 and 2003.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The information contained in this section should be read in conjunction with the Company's 2007 Consolidated Financial Statements and notes thereto.

**Forward-Looking Statements**

The information contained herein may contain "forward-looking statements" based on our current expectations, assumptions and estimates about us and our industry. These forward-looking statements involve risks and uncertainties. Words such as "believe," "anticipate," "estimate," "expect," "intend," "plan," "will," "may," "might," "could," "continue" and other similar expressions identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of several factors more fully described in "Risk Factors" and elsewhere in this Form 10-K. The forward-looking statements made in this Form 10-K relate only to events as of the date on which the statements are made. We undertake no obligation to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

**Background and Overview**

We incorporated under the laws of the state of New York in August 1981. In 1983, we completed an initial public offering and invested \$406,936 in Otisville BioTech, Inc., which also completed an initial public offering later that year. In 1984, Charles E. Harris purchased a controlling interest in us which also made him the control person of Otisville. We then divested our other assets and became a financial services company, with the investment in Otisville as the initial focus of our business activity.

In 1992, we registered as an investment company under the 1940 Act, commencing operations as a closed-end, non-diversified investment company. In 1995, we elected to become a business development company subject to the provisions of Sections 55 through 65 of the 1940 Act.

Throughout our corporate history, we have made early stage venture capital investments in a variety of industries. We define venture capital investments as investments in start-up firms and small businesses with exceptional growth potential. We have invested a substantial portion of our assets in venture capital investments of private, development stage or start-up companies. These private businesses tend to be thinly capitalized, unproven, small companies that lack management depth, have little or no history of operations and are developing unproven technologies. At December 31, 2007, \$78,110,384, or 56.5 percent, of our net assets at fair value consisted of private venture capital investments, net of unrealized depreciation of \$4,567,144. At December 31, 2006, \$53,667,831, or 47.1 percent, of our net assets at fair value consisted of private venture capital investments, net of unrealized depreciation of \$8,450,969.

Since our investment in Otisville in 1983 through December 31, 2007, we have made a total of 80 venture capital investments, including four private placement investments in securities of publicly traded companies. We have sold 45 of these 80 investments, realizing total proceeds of \$143,737,906 on our invested capital of \$51,229,202. As measured from first dollar in to last dollar out, the average and median holding periods for these 45 investments were 3.69 years and 3.11 years, respectively. As measured by the 150 separate rounds of investment within these 45 investments, the average and median holding periods for the 150 separate rounds of investment were 2.87 years and 2.49 years, respectively.

In 1994, we made our first tiny technology investment. From August 2001 through December 31, 2007, all 38 of our initial investments have been in tiny technology. From August 2001 through December 31, 2007, we have invested a total (before any subsequent write-ups, write-downs or dispositions) of \$86,635,250 in tiny technology.

We currently have 30 active tiny technology companies in our portfolio, including one tiny technology investment made prior to 2001. At December 31, 2007, from first dollar in, the average and median holding periods for these 30 active tiny technology investments were 3.01 years and 2.82 years, respectively.

The following is a summary of our initial and follow-on investments in tiny technology from 2001 to the present. We consider a "round led" to be a round where we were the new investor or the leader of a set of new investors in an investee company. Typically, but not always, the lead investor negotiates the price and terms of a deal with the investee company.

	2001	2002	2003	2004	2005	2006	2007
Total Incremental Investments	\$ 489,999	\$ 6,240,118	\$ 3,812,600	\$ 14,837,846	\$ 16,251,339	\$ 24,408,187	\$ 20,595,161
No. of New Investments	1	7	5	8	4	6	7
No. of Follow-On Investment Rounds	0	1	5	21	13	14	20
No. of Rounds Led	0	1	0	2	0	7	3
Average Dollar Amount – Initial	\$ 489,999	\$ 784,303	\$ 437,156	\$ 911,625	\$ 1,575,000	\$ 2,383,424	\$ 1,086,441
Average Dollar Amount – Follow- On	N/A	\$ 750,000	\$ 325,364	\$ 359,278	\$ 765,488	\$ 721,974	\$ 649,504

We value our private venture capital investments each quarter as determined in good faith by our Valuation Committee, a committee of independent directors, within guidelines established by our Board of Directors in accordance with the 1940 Act. (See "Footnote to Consolidated Schedule of Investments" contained in "Item 8. Consolidated Financial Statements and Supplementary Data.")

In the years 2001 through 2007, the Company recorded the following gross write-ups in privately held securities as a percentage of net assets at the beginning of the year ("BOY"), gross write-downs in privately held securities as a percentage of net assets at the beginning of the year, and net write-ups/(write-downs) in privately held securities as a percentage of net assets at the beginning of the year.



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	2001	2002	2003	2004	2005	2006	2007
Net Asset Value, BOY	\$ 31,833,475	\$ 24,334,770	\$ 27,256,046	\$ 40,682,738	\$ 74,744,799	\$ 117,987,742	\$ 113,987,742
Gross Write-Downs During Year	\$ (2,532,730)	\$ (5,400,005)	\$ (1,256,102)	\$ (5,711,229)	\$ (3,450,236)	\$ (4,211,323)	\$ (7,811,323)
Gross Write-Ups During Year	\$ 1,528,866	\$ 285	\$ 847,578	\$ 6,288,397	\$ 23,485,176	\$ 279,363	\$ 11,685,176
Gross Write-Downs as a Percentage of Net Asset Value, BOY	-7.96%	-22.19%	-4.61%	-14.04%	-4.62%	-3.57%	-6.86%
Gross Write-Ups as a Percentage of Net Asset Value, BOY	4.80%	0%	3.11%	15.46%	31.42%	0.24%	13.03%
Net Write-Downs/Write-Ups as a Percentage of Net Asset Value, BOY	-3.15%	-22.19%	-1.49%	1.42%	26.8%	-3.33%	6.17%

We have discretion in the investment of our capital. However, we invest primarily in illiquid equity securities of private companies. Generally, these investments take the form of preferred stock, are subject to restrictions on resale and have no established trading market. Our principal objective is to achieve long-term capital appreciation. Therefore, a significant portion of our investment portfolio provides little or no income in the form of dividends or interest. We earn interest income from fixed-income securities, including U.S. government and agency securities. The amount of interest income we earn varies with the average balance of our fixed-income portfolio and the average yield on this portfolio. Interest income is secondary to capital gains and losses in our results of operations.

We present the financial results of our operations utilizing accounting principles generally accepted in the United States for investment companies. On this basis, the principal measure of our financial performance during any period is the net increase/(decrease) in our net assets resulting from our operating activities, which is the sum of the following three elements:

Net Operating Income / (Loss) - the difference between our income from interest, dividends, and fees and our operating expenses.

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Net Realized Income / (Loss) on Investments - the difference between the net proceeds of sales of portfolio securities and their stated cost, plus income from interests in limited liability companies.

Net Increase / (Decrease) in Unrealized Appreciation or Depreciation on Investments - the net unrealized change in the value of our investment portfolio.

Owing to the structure and objectives of our business, we generally expect to experience net operating losses and seek to generate increases in our net assets from operations through the long term appreciation of our venture capital investments. We have relied, and continue to rely, on proceeds from sales of investments, rather than on investment income, to defray a significant portion of our operating expenses. Because such sales are unpredictable, we attempt to maintain adequate working capital to provide for fiscal periods when there are no such sales.

## **Results of Operations**

### ***Years Ended December 31, 2007, 2006, and 2005***

During the years ended December 31, 2007, 2006, and 2005, we had net (decreases) increases in net assets resulting from operations of \$(6,716,445), \$(11,773,112), and \$6,716,376, respectively.

### **Investment Income and Expenses:**

During the years ended December 31, 2007, 2006, and 2005, we had net operating losses of \$11,827,543, \$7,612,935, and \$5,465,761, respectively. The variation in these results is primarily owing to the changes in investment income and operating expenses, including non-cash expense of \$8,050,807 in 2007 and \$5,038,956 in 2006 associated with the granting of stock options. During the years ended December 31, 2007, 2006, and 2005, total investment income was \$2,705,636, \$3,028,761, and \$1,540,862, respectively. During the years ended December 31, 2007, 2006, and 2005, total operating expenses were \$14,533,179, \$10,641,696, and \$7,006,623, respectively.

During 2007, as compared with 2006, investment income decreased from \$3,028,761 to \$2,705,636, reflecting a decrease in our average holdings of U.S. government and agency securities throughout the period. During the twelve months ended December 31, 2007, our average holdings of such securities were \$62,184,565, as compared with \$69,506,136 at December 31, 2006.

Operating expenses, including non-cash, stock-based compensation expenses, were \$14,533,179 and \$10,641,696 for the twelve months ended December 31, 2007, and December 31, 2006, respectively. The increase in operating expenses for the twelve months ended December 31, 2007, as compared to the twelve months ended December 31, 2006, was primarily owing to increases in salaries, benefits and stock-based compensation expenses and to increases in administration and operations expense, professional fees and directors' fees and expenses. Salaries, benefits and non-cash, stock-based compensation expense increased by \$3,502,053, or 44.1 percent, through December 31, 2007, as compared to December 31, 2006, primarily as a result of an increase in non-cash expense of \$3,011,851 through December 31, 2007, associated with the Harris & Harris Group, Inc. 2006 Equity Incentive Plan (the "Stock Plan"). While the non-cash, stock-based, compensation expense for the Stock Plan increased our operating expenses by \$8,050,807, this increase was offset by a corresponding increase to our additional paid-in capital, resulting in no net impact to our net asset value. The non-cash, stock-based, compensation expense and corresponding increase to our additional paid-in capital may increase in future quarters. Salaries and benefits also increased for the twelve months ended December 31, 2007, owing to an increase in our headcount as compared with that of the same period in 2006. At December 31, 2007, we had 13 full-time employees, as compared with 10 full-time employees and one part-time employee at December 31, 2006. Administration and operations expense increased by \$182,573, or 14.6 percent, for the twelve months ended December 31, 2007, as compared with the same period in 2006, owing to an increase in Nasdaq Global Market fees related to the increase in our number of outstanding shares and increased office-related and travel expenses related to the increase in headcount. Professional fees increased by \$165,083, or 22.4 percent, primarily as a result of an increase in legal fees, an increase in audit fees and corporate consulting costs for the audit of our compliance program. Directors' fees and expenses increased by \$94,310, or 27.7 percent, primarily as a result of additional meetings held in the period ended December 31, 2007, as compared with the period ended December 31, 2006, as well as an increase in the monthly retainers paid to committee chairs and to the Lead Independent Director.

During 2006, investment income increased, reflecting an increase in our average holdings of U.S. government and agency securities, as our average holdings increased from \$50,620,881 at December 31, 2005, to \$69,506,136 at December 31, 2006, and as a result of an increase in interest rates during the year. During 2005, investment income increased, reflecting an increase in our income on U.S. government and agency securities, as our holdings increased from \$44,622,722 at December 31, 2004 to \$96,250,864 at December 31, 2005, and as a result of an increase in interest rates during the year.

The increase in operating expenses for the year ended December 31, 2006, was primarily owing to increases in salaries, benefits and stock-based compensation expense, and directors' fees and expenses, offset by decreases in administrative and operations expenses, profit-sharing expense and professional fees. Salaries, benefits and stock-based compensation expense increased by \$5,474,243, or 222.6 percent, for the year ended December 31, 2006, as compared with December 31, 2005, primarily as a result of non-cash expense of \$5,038,956 associated with the Stock Plan adopted during the second quarter of 2006 and secondarily as a result of an increase in the number of full-time employees. The increase in salaries, benefits and stock-based compensation expense reflects expenses associated with ten full-time employees and one part-time employee during the year ended December 31, 2006, as compared with an average of nine full-time employees during the year ended December 31, 2005. Salaries, benefits and stock-based compensation include \$5,038,956 of non-cash expense associated with the Stock Plan, versus no such charge in 2005. Directors' fees and expenses increased by \$31,876, or 10.3 percent, as a result of additional meetings held in 2006 related to the adoption of the Stock Plan. Administrative and operations expense decreased by \$69,274, or 5.3 percent, primarily as a result of a decrease in our directors' and officers' liability insurance expense and decreases in the cost of proxy-related expenses. Profit-sharing expense for the year ended December 31, 2006, was \$50,875, as compared with \$1,796,264 for December 31, 2005, owing to the termination of the profit-sharing plan effective May 4, 2006. We recorded \$50,875 of profit-sharing expense toward the remainder of the 2005 profit-sharing payment in the year ended December 31, 2006, because of updated estimates of our ultimate tax liability for 2005. Professional fees decreased by \$92,234, or 11.1 percent, for the year ended December 31, 2006, as compared with December 31, 2005. Professional fees were lower for the year ended December 31, 2006, as compared with December 31, 2005, primarily as a result of the elimination of consulting costs incurred for a temporary Senior

Controller in 2005 and the reduction of some of our Sarbanes-Oxley-related compliance costs incurred in 2005.

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The increase in operating expenses during 2005 was primarily owing to increases in the profit-sharing provision, salaries and benefits, professional fees, administration and operations, rent expense and Directors' fees and expenses. Profit-sharing expense for 2005 was \$1,796,264, an increase of \$1,484,670 as compared with 2004. Profit-sharing expense increased primarily as a result of the gains realized on the sale of NeuroMetrix, Inc., offset by the taxes payable by the Company on the deemed dividend and taxes payable on Built-In Gains. The profit-sharing expense was also impacted by the Company's decision to retain its net realized long-term capital gains for reinvestment for growth, rather than distribute them as a cash dividend. When the Company chooses to retain its net realized long-term capital gains, it declares a deemed dividend and pays taxes on behalf of shareholders. Conversely, when the Company distributes its net realized long-term capital gains as a cash dividend, the shareholders pay all of the taxes. The taxes payable by the Company on behalf of shareholders reduce the amount of profit against which the profit-sharing payable to employees is calculated. Had the Company chosen to distribute its net realized long-term capital gains as a cash dividend, the provision for employee profit sharing would have been \$3,420,737 for 2005, rather than the actual provision for employee profit sharing of \$1,796,264 for 2005.

For the year ended December 31, 2005, as compared with 2004, salaries and benefits increased by \$530,945, or 27.5 percent, primarily as a result of the addition of three employees. Professional fees increased by \$162,751, or 24.4 percent, reflecting in part the expenses associated with ongoing compliance with the Sarbanes-Oxley Act of 2002. Administration and operations increased by \$600,824, or 83.6 percent, primarily as the result of increases in travel expenses associated with additional investments in portfolio companies, increases in expenses related to the preparation and distribution of the annual and quarterly reports and proxy statement owing to the increased number of shareholders, and an increase in the premium expense for director and officer liability insurance. The premium expense for director and officer liability insurance increased by \$339,810 to \$512,038 in 2005, and the premium expense for 2006 is estimated to be \$514,650. Rent expense increased by \$60,148 or 39.7 percent, owing primarily to the leasing of additional office space in California and New York. Directors' fees and expenses in 2005 increased by \$99,664 or 47.6 percent as a result of an increase in the fees paid to the directors for monthly retainer and meeting attendance.

Realized Income and Losses on Investments:

During the years ended December 31, 2007, 2006, and 2005, we had net realized income from investments of \$30,162, \$258,693, and \$14,208,789, respectively. The variation in these results is primarily owing to variations in gross realized income from investments and income taxes in each of the three years. For the years ended December 31, 2007, 2006, and 2005, realized income from investments, before taxes, was \$118,137, \$31,338, and \$23,862,037, respectively. Income tax expense (benefit) for the years ended December 31, 2007, 2006, and 2005 was \$87,975, \$(227,355), and \$9,653,248, respectively.

During the year ended December 31, 2007, we realized net gains of \$118,137, consisting primarily of proceeds received from the sale of our interest in AlphaSimplex Group, LLC, and income from our investment in Exponential Business Development Company. During the year ended December 31, 2007, we recognized tax expense of \$87,975, consisting of \$74,454 of interest and penalties related to our 2005 tax returns and \$13,521 in current year expense.

During the year ended December 31, 2006, we realized net gains of \$31,338, consisting primarily of proceeds received from the liquidation of Optiva, Inc., proceeds received from Exponential Business Development Company, and net losses realized on our investment in AlphaSimplex Group, LLC. During 2005, we deemed the securities we held in Optiva, Inc., worthless and recorded the proceeds received and due to us on the liquidation of our bridge notes, realizing a loss of \$1,619,245. At December 31, 2005, we recorded a \$75,000 receivable for estimated proceeds from the final payment on the Optiva, Inc., bridge notes. During the first quarter of 2006, we received payment of \$95,688 from these bridge notes, resulting in the realized gain of \$20,688 on Optiva, Inc. During the year ended December 31, 2006, we realized tax benefits of \$227,355 for 2005 taxes that had been refunded.

During the year ended December 31, 2005, our realized income from investments before taxes of \$23,862,037 consisted primarily of a realized gain of \$30,179,762 from the sale of our investment in NeuroMetrix, Inc., offset by realized losses of \$1,358,286, \$2,093,968, \$1,091,209, and \$1,619,245, from the sale of our shares in Agile Materials & Technologies, Inc., Experion Systems, Inc., Nanotechnologies, Inc., and Optiva, Inc., respectively. Realized losses on U.S. government and agency securities totaled \$422,383 for 2005. For the year ended December 31, 2005, our income tax expense on realized gains was \$9,653,248, which includes \$8,122,367 of taxes payable by the Company on behalf of shareholders in connection with the deemed dividend and \$1,364,470 of taxes on Built-In Gains.

Net Unrealized Appreciation and Depreciation on Investments:

During the year ended December 31, 2007, net unrealized depreciation on total investments decreased by \$5,080,936.

During the years ended December 31, 2006, and 2005, net unrealized depreciation on total investments increased by \$4,418,870 and \$2,026,652, respectively.

During the year ended December 31, 2007, net unrealized depreciation on our venture capital investments decreased by \$3,883,825, or 46.0 percent, from \$8,450,969 to \$4,567,144, owing primarily to increases in the valuations of our investments in BridgeLux, Inc., of \$3,699,529, Crystal IS, Inc., of \$13,819, CSwitch, Inc., of \$48,935, D-Wave Systems, Inc., of \$202,408, Exponential Business Development Company of \$2,026, Innovalight, Inc., of \$3,218,216, Kovio, Inc., of \$125,000, Mersana Therapeutics, Inc., of \$118,378, NanoGram Corporation of \$2,437,136, NeoPhotonics Corporation of \$2,160, SiOnyx, Inc., of \$899,566, Solazyme, Inc., of \$612,291 and Zia Laser, Inc., of \$6,329, offset by decreases in the valuations of our investments in Ancora Pharmaceuticals, Inc., of \$100,561, Chlorogen, Inc., of \$1,326,073, Evolved Nanomaterial Sciences, Inc., of \$2,800,000, Kereos, Inc., of \$1,340,257, Nanomix, Inc., of \$459,772, NanoOpto Corporation of \$1,369,885, Polatis, Inc., of \$9,534 and Questech Corporation of \$404,712. We also had an increase owing to foreign currency translation of \$307,636 on our investment in D-Wave Systems, Inc. Unrealized depreciation on our U.S. government and agency securities portfolio decreased from \$556,451 at December 31, 2006, to unrealized appreciation of \$640,660 at December 31, 2007.

The net increase in unrealized depreciation on our venture capital investments in 2006 was owing primarily to decreases in the valuations of our investments in Nanomix, Inc., of \$1,710,000, NanoOpto Corporation of \$1,211,259, NeoPhotonics Corporation of \$254,238, Polatis, Inc., of \$145,228, SiOnyx, Inc., of \$679,950 and Zia Laser, Inc., of \$172,500, and to increases in the valuations of our investments in Crystal IS of \$19,735 and Questech Corporation of \$259,628. We also had a decrease, owing to foreign currency translation, of \$34,103 on our investment in D-Wave Systems, Inc. Unrealized depreciation on our U.S. government and agency securities portfolio increased from \$69,541 at December 31, 2005, to \$556,451 at December 31, 2006.

The net increase in unrealized depreciation on our venture capital investments in 2005 was the result of the appreciation in value of \$19,790,298 on investments held, offset by depreciation of \$23,181,420 related to investments sold. The change in unrealized depreciation on investments held was owing to appreciation in our investment in NeuroMetrix, Inc., prior to the sale of our interest in it as well as to increases in the valuations of NanoGram Corporation, Nanosys, Inc., and Nantero, Inc., of \$313,534, \$870,113 and \$813,771, respectively. These increases were offset by decreases in the valuations of AlphaSimplex Group LLC, CSwitch, Inc., Mersana Therapeutics, Inc., NanoOpto, Inc., Polatis, Inc., and Zia Laser, Inc., of \$109,464, \$500,000, \$563,097, \$529,997, \$169,827, and \$1,312,500 respectively. The change in unrealized depreciation on investments sold is owing to the realization of the gain on our investment in NeuroMetrix, Inc., offset by realizations of losses on our investments in Agile Materials and Technologies, Inc., Experion Systems, Inc., Nanotechnologies, Inc., and Optiva, Inc.

## **Financial Condition**

### ***December 31, 2007***

At December 31, 2007, our total assets and net assets were \$142,893,332 and \$138,363,344, respectively. Our net asset value ("NAV") per share at that date was \$5.93, and our shares outstanding increased to 23,314,573 at December 31, 2007.

During the twelve months ended December 31, 2007, significant developments included an increase in the value of our venture capital investments of \$24,442,553 and an increase in the value of our investment in U.S. government and agency obligations of \$1,537,446. The increase in the value of our venture capital investments, from \$53,667,831 at December 31, 2006, to \$78,110,384 at December 31, 2007, resulted primarily from seven new and 20 follow-on investments and by a net increase of \$3,883,825 in the net value of our venture capital investments. The increase in the value of our U.S. government and agency obligations, from \$58,656,147 at December 31, 2006, to \$60,193,593 at December 31, 2007, is primarily owing to the use of net proceeds of \$12,993,168 received through a registered stock offering and proceeds received from stock option exercises of \$10,105,511, offset by a payment of \$80,236 for federal tax and interest and penalties, profit sharing payments of \$261,661, net operating expenses and by new and follow-on venture capital investments totaling \$20,595,161.

For the year ended December 31, 2007, the Company issued 999,556 shares and received proceeds of \$10,105,511 as a result of employee stock option exercises.

The following table is a summary of additions to our portfolio of venture capital investments made during the twelve months ended December 31, 2007:

<u>New Investments</u>	<u>Cost</u>
Adesto Technologies Corporation	\$ 1,147,826
Ancora Pharmaceuticals, Inc.	\$ 800,000
BioVex Group, Inc.	\$ 2,500,000
Ensemble Discovery Corporation	\$ 2,000,000
Lifco, Inc.	\$ 946,528
Phoenix Molecular Corporation	\$ 50,010
Siluria Technologies, Inc.	\$ 160,723
<u>Follow-on Investments</u>	
BridgeLux, Inc.	\$ 350,877
BridgeLux, Inc.	\$ 233,918
BridgeLux, Inc.	\$ 916,928
Cambrios Technologies Corporation	\$ 1,300,000
Chlorogen, Inc.	\$ 7,042
CSwitch, Inc.	\$ 32,624
CSwitch, Inc.	\$ 529,852
Innovalight, Inc.	\$ 1,993,568
Kereos, Inc.	\$ 540,000
Kovio, Inc.	\$ 1,000,000
NanoGram Corporation	\$ 851,393
Mersana Therapeutics, Inc.	\$ 500,000
Nanomix, Inc.	\$ 680,240
NanoOpto Corporation	\$ 268,654
Nextreme Thermal Solutions, Inc.	\$ 750,000
Polatis, Inc.	\$ 17,942
Polatis, Inc.	\$ 13,454
Polatis, Inc.	\$ 58,582
SiOnyx, Inc.	\$ 2,445,000
Solazyme, Inc.	\$ 500,000
<b>Total</b>	<b>\$ 20,595,161</b>

The following tables summarize the fair values of our portfolios of venture capital investments and U.S. government and agency obligations, as compared with their cost, at December 31, 2007, and December 31, 2006:



	<b>December 31,</b>	
	<b>2007</b>	<b>2006</b>
Venture capital investments, at cost	\$ 82,677,528	\$ 62,118,800
Net unrealized depreciation <sup>(1)</sup>	4,567,144	8,450,969
<b>Venture capital investments, at value</b>	<b>\$ 78,110,384</b>	<b>\$ 53,667,831</b>

	<b>December 31,</b>	
	<b>2007</b>	<b>2006</b>
U.S. government and agency obligations, at cost	\$ 59,552,933	\$ 59,212,598
Net unrealized appreciation (depreciation) <sup>(1)</sup>	640,660	(556,451)
<b>U.S. government and agency obligations, at value</b>	<b>\$ 60,193,593</b>	<b>\$ 58,656,147</b>

<sup>(1)</sup>At December 31, 2007, and December 31, 2006, the net accumulated unrealized depreciation on investments was \$3,926,484 and \$9,007,420, respectively.

The following table summarizes the fair value composition of our venture capital investment portfolio at December 31, 2007, and December 31, 2006.

<b>Category</b>	<b>December 31,</b>	
	<b>2007</b>	<b>2006</b>
Tiny Technology	99.9%	99.9%
Other Venture Capital Investments	0.1%	0.1%
<b>Total Venture Capital Investments</b>	<b>100.0%</b>	<b>100.0%</b>

#### ***December 31, 2006***

At December 31, 2006, our total assets and net assets were \$118,328,590 and \$113,930,303, respectively. Our NAV per share at that date was \$5.42, and our shares outstanding increased to 21,015,017 at December 31, 2006.

During the twelve months ended December 31, 2006, significant developments included an increase in the value of our venture capital investments of \$20,480,498 and a decrease in the value of our investment in U.S. government and agency securities of \$37,594,717. The increase in the value of our venture capital investments, from \$33,187,333 at December 31, 2005, to \$53,667,831 at December 31, 2006, resulted primarily from six new and 10 follow-on investments, partially offset by a net decrease of \$3,927,689 in the net value of our previous venture capital investments. The decrease in the value of our U.S. government and agency securities, from \$96,250,864 at December 31, 2005, to \$58,656,147 at December 31, 2006, was primarily owing to the use of funds for investments totaling \$24,408,187, tax payments of \$9,425,922, profit-sharing payments of \$1,897,072, an increase in unrealized losses of \$486,910 and payment of net operating expenses.

During December 2006, the Company also issued stock and received proceeds upon the exercise of employee stock options. Through December 31, 2006, the Company issued 258,672 shares and received proceeds of \$2,615,190 as a result of option exercises.

The Company's liabilities decreased from \$14,950,378 at December 31, 2005, to \$4,398,287 at December 31, 2006, primarily owing to the payment of the tax payable on behalf of shareholders of \$8,122,367 in January 2006, the payment of \$1,897,072 in profit sharing in March 2006 and the reversal of the accrual for federal and state taxes payable of \$1,514,967 recorded at December 31, 2005.

The following table is a summary of additions to our portfolio of venture capital investments made during the twelve months ended December 31, 2006:

<u>New Investments</u>	<u>Cost</u>
D-Wave Systems, Inc.	\$ 1,750,547
Evolved Nanomaterial Sciences, Inc.	2,800,000
Innovalight, Inc.	2,500,000
Metabolon, Inc.	2,500,000
SiOnyx, Inc.	750,000
Xradia, Inc.	4,000,000
<u>Follow-on Investments</u>	
Chlorogen, Inc.	\$ 221,438
Crystal IS, Inc.	1,098,240
CSwitch Corporation	2,850,000
NanoGram Corporation	1,262,764
NanoOpto Corporation	433,138
NeoPhotonics Corporation	2,750,000
Nextreme	500,000
Polatis, Inc.	89,310
Questech Corporation	12,750
SiOnyx, Inc.	890,000
<b>Total</b>	<b>\$ 24,408,187</b>

## **Cash Flow**

### ***Year Ended December 31, 2007***

Net cash used in operating activities for the year ended December 31, 2007, was \$4,142,572, primarily owing to the payment of operating expenses.

Cash used in investing activities for the year ended December 31, 2007, was \$20,697,886, primarily reflecting a net increase in our investment in U.S. government and agency securities of \$235,754 and investments in private placements of \$20,595,161, less proceeds from the sale of venture capital investments of \$174,669.

Cash provided by financing activities for the year ended December 31, 2007, was \$23,098,679, reflecting the issuance of shares in connection with the Stock Plan and the net proceeds from the issuance of 1,300,000 new shares of our common stock on June 25, 2007, in a registered direct follow-on offering.

### ***Year Ended December 31, 2006***

Net cash used in operating activities for the year ended December 31, 2006, was \$14,955,302, primarily owing both to the payment of various federal, state and local taxes, including the tax paid on behalf of shareholders for the deemed dividend, and to the payment of operating expenses.

Cash provided by investing activities for the year ended December 31, 2006, was \$13,198,611, primarily reflecting net proceeds from the sale of U.S. government and agency securities of \$37,593,589, less investments in private placements of \$24,408,187.

Cash provided by financing activities for the year ended December 31, 2006, was \$2,615,190, reflecting the issuance of shares in connection with the Stock Plan.

### ***Year Ended December 31, 2005***

Net cash used in operating activities for the year ended December 31, 2005, was \$2,914,285, primarily owing to an increase in our operating expenses.

Cash used in investing activities for the year ended December 31, 2005, was \$33,049,325, primarily reflecting a net increase in our investment in U.S. government and agency securities of \$52,144,482 and investments in private placements of \$16,251,339, less proceeds from the sale of venture capital investments of \$35,392,200.

Cash provided by financing activities for the year ended December 31, 2005, was \$36,526,567, reflecting net proceeds from the issuance of 3,507,500 new shares of our common stock on September 14, 2005, in an underwritten follow-on offering.

## **Liquidity and Capital Resources**

Our primary sources of liquidity are cash, receivables and freely marketable securities, net of short-term indebtedness. Our secondary sources of liquidity are restricted securities of companies that are publicly traded.

### ***December 31, 2007***

At December 31, 2007, and December 31, 2006, our total net primary liquidity was \$61,183,136 and \$61,323,306, respectively, and our secondary liquidity was \$0 and \$0, respectively.

Our net primary sources of liquidity are more than adequate to cover our gross cash operating expenses over the next 12 months. Our gross cash operating expenses for 2007 and 2006 totaled \$6,263,510 and \$5,285,448, respectively.

The increase in our primary liquidity from December 31, 2006, to December 31, 2007, is primarily owing to the proceeds received through a registered direct stock offering from a shelf registration statement and proceeds received from stock option exercises, offset by the use of funds for investments and payment of net operating expenses. In the future, we may sell additional shares registered pursuant to our shelf registration statement.

On November 29, 2006, we filed a shelf registration statement with the SEC on Form N-2 to register 4,000,000 shares of our common stock. On December 11, 2006, and on April 23, 2007, we filed amended registration statements with the SEC. On May 11, 2007, the SEC declared the registration statement effective. The common stock may be sold at prices and on terms to be set forth in one or more supplements to the prospectus from time to time.

On June 25, 2007, we completed the sale of 1,300,000 shares of our common stock from our shelf registration statement for gross proceeds of \$14,027,000; net proceeds of this offering, after placement agent fees and offering costs of \$1,033,832, were \$12,993,168. We intend to use, and have been using, the net proceeds of this offering to make new investments in tiny technology, as well as for follow-on investments in our existing venture capital investments and for working capital. Through December 31, 2007, we have used \$9,475,687 of the net proceeds from this offering for these purposes.

On April 17, 2003, we signed a seven-year sublease for office space at 111 West 57<sup>th</sup> Street in New York City. On December 17, 2004, we signed a sublease for additional office space at our current location. The subleases expire on April 29, 2010. Total rent expense for our office space in New York City was \$178,167 in 2007, \$174,625 in 2006 and \$171,171 in 2005. Future minimum sublease payments in each of the following years are: 2008 -- \$193,083; 2009 -- \$197,700; and thereafter, for the remaining term -- \$65,969.

***December 31, 2006***

At December 31, 2006, and December 31, 2005, our total net primary liquidity was \$61,323,306 and \$97,797,219, respectively, and our secondary liquidity was \$0 and \$0, respectively.

Our net primary sources of liquidity were more than adequate to cover our gross cash operating expenses over the next 12 months. Our gross cash operating expenses for 2006 and 2005 totaled \$5,285,448 and \$5,021,066, respectively.

The decrease in our primary liquidity from December 31, 2005, to December 31, 2006, was primarily owing to the use of funds for investments, profit-sharing and tax payments, as well as net operating expenses.

**Critical Accounting Policies**

The Company's significant accounting policies are described in Note 2 to the Consolidated Financial Statements and in the Footnote to the Consolidated Schedule of Investments. Critical accounting policies are those that are both important to the presentation of our financial condition and results of operations and those that require management's most difficult, complex or subjective judgments. The Company considers the following accounting policies and related estimates to be critical:

**Stock-Based Compensation**

Determining the appropriate fair-value model and calculating the fair value of share-based awards at the date of grant requires judgment. We use the Black-Scholes option pricing model to estimate the fair value of employee stock options, consistent with the provisions of SFAS No. 123(R). Management uses the Black-Scholes option pricing model because of the lack of the historical option data that is required for use in other, more complex models. Other models may yield fair values that are significantly different from those calculated by the Black-Scholes option pricing model.

Option pricing models, including the Black-Scholes model, require the use of subjective input assumptions, including expected volatility, expected life, expected dividend rate, and expected risk-free rate of return. In the Black-Scholes model, variations in the expected volatility or expected term assumptions have a significant impact on fair value. As the volatility or expected term assumptions increase, the fair value of the stock option increases. In the Black-Scholes model, the expected dividend rate and expected risk-free rate of return are not as significant to the calculation of fair value. A higher assumed dividend rate yields a lower fair value, whereas higher assumed interest rates yield higher fair values for stock options.

We use the simplified calculation of expected life described in the SEC's Staff Accounting Bulletin 107 because of the lack of historical information about option exercise patterns. Future exercise behavior could be materially different than that which is assumed by the model.

Expected volatility is based on the historical fluctuations in the Company's stock. The Company's stock has historically been volatile, which increases the fair value.

SFAS No. 123(R) requires us to develop an estimate of the number of share-based awards that will be forfeited owing to employee turnover. Quarterly changes in the estimated forfeiture rate can have a significant effect on reported share-based compensation, as the effect of adjusting the rate for all expense amortization after the grant date is recognized in the period the forfeiture estimate is changed. If the actual forfeiture rate proves to be higher than the estimated forfeiture rate, then an adjustment will be made to increase the estimated forfeiture rate, which would result in a decrease to the expense recognized in the financial statements. If the actual forfeiture rate proves to be lower than the estimated forfeiture rate, then an adjustment will be made to decrease the estimated forfeiture rate, which would result in an increase to the expense recognized in the financial statements. Such adjustments would affect our operating expenses and additional paid-in capital, but would have no effect on our net asset value.

#### Valuation of Portfolio Investments

As a business development company, we invest in illiquid securities including debt and equity securities of private companies. These investments are generally subject to restrictions on resale and generally have no established trading market. We value substantially all of our equity investments at fair value as determined in good faith by our Valuation Committee on a quarterly basis. The Valuation Committee, comprised of all of our non-interested Board members, reviews and approves the valuation of our investments within the valuation procedures established by the Board of Directors. Fair value is generally defined as the amount that an investment could be sold for in an orderly disposition over a reasonable time. Generally, to increase objectivity in valuing our assets, external measures of value, such as public markets or third-party transactions, are utilized whenever possible. Valuation is not based on long-term work-out value, nor immediate liquidation value, nor incremental value for potential changes that may take place in the future. Upon sale of investments, the values that are ultimately realized may be different from what is presently estimated. This difference could be material.

#### Pension and Post-Retirement Benefit Plan Assumptions

The Company provides a Retiree Medical Benefit Plan for employees who meet certain eligibility requirements. Several statistical and other factors that attempt to anticipate future events are used in calculating the expense and liability values related to our post-retirement benefit plans. These factors include assumptions we make about the discount rate, the rate of increase in healthcare costs, and mortality, among others.

The discount rate reflects the current rate at which the post-retirement benefit liabilities could be effectively settled considering the timing of expected payments for plan participants. In estimating this rate, we consider rates of return on high quality fixed-income investments included in published bond indexes. We consider the Moody's Aa Corporate Bond Index and the Citigroup Pension Liability Index in the determination of the appropriate discount rate assumptions. The weighted average rate we utilized to measure our post retirement benefit obligation as of December 31, 2007, and to calculate our 2008 expense was 6.55 percent, which is an increase from the 5.75 percent rate used in determining the 2007 expense.

### **Recent Developments — Portfolio Companies**

Two of our portfolio companies have been considering with their advisors the possibility of filing for initial public offerings (IPOs) in 2008. There can be no assurance that either of them will file for an IPO in 2008, and a variety of factors, including stock market and general business conditions, could lead either or both of them to terminate such considerations.

On January 16, 2008, we made a \$736,019 follow-on investment that has not yet been announced in a privately held tiny technology portfolio company.

On January 31, 2008, we made a \$377,580 follow-on investment that has not yet been announced in a privately held tiny technology portfolio company.

On February 1, 2008, we made a \$25,000 follow-on investment that has not yet been announced in a privately held tiny technology portfolio company.

On February 8, 2008, we made a \$244,500 new investment in PolyRemedy, Inc.

On February 21, 2008, we made a \$1,052,174 follow-on investment that has not yet been announced in a privately held tiny technology portfolio company.

On February 25, 2008, we made a \$1,000,001 follow-on investment that has not yet been announced in a privately held tiny technology portfolio company.

On March 7, 2008, we made a \$2,000,000 follow-on investment that has not yet been announced in a privately held tiny technology portfolio company.

### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

Our business activities contain elements of risk. We consider the principal types of market risk to be valuation risk and the risk associated with fluctuations in interest rates. Although we are risk-seeking rather than risk-averse in our investments, we consider the management of risk to be essential to our business.

Value, as defined in Section 2(a)(41) of the 1940 Act, is (i) the market price for those securities for which market quotations are readily available and (ii) fair value as determined in good faith by, or under the direction of, the Board of Directors for all other assets. (See the "Valuation Procedures" in the "Footnote to Consolidated Schedule of Investments" contained in "Item 8. Consolidated Financial Statements and Supplementary Data.")

Neither our investments nor an investment in us is intended to constitute a balanced investment program.

We have invested a substantial portion of our assets in private development stage or start-up companies. These private businesses tend to be based on new technology and to be thinly capitalized, unproven, small companies that lack management depth and have not attained profitability or have no history of operations. Because of the speculative nature and the lack of a public market for these investments, there is significantly greater risk of loss than is the case with traditional investment securities. We expect that some of our venture capital investments will be a complete loss or will be unprofitable and that some will appear to be likely to become successful but never realize their potential. Even when our private equity investments complete initial public offerings (IPOs), we are normally subject to lock-up agreements for a period of time, and thereafter, the market for the unseasoned publicly traded securities may be relatively illiquid.

Because there is typically no public market for our interests in the small privately held companies in which we invest, the valuation of the equity interests in that portion of our portfolio is determined in good faith by our Valuation Committee, comprised of the independent members of our Board of Directors, in accordance with our Valuation Procedures. In the absence of a readily ascertainable market value, the determined value of our portfolio of equity interests may differ significantly from the values that would be placed on the portfolio if a ready market for the equity interests existed. Any changes in valuation are recorded in our consolidated statements of operations as "Net increase (decrease) in unrealized appreciation on investments." Changes in valuation of any of our investments in privately held companies from one period to another may be volatile.

We also invest in short-term money market instruments, and both short and long-term U.S. government and agency securities. To the extent that we invest in short and long-term U.S. government and agency securities, changes in interest rates result in changes in the value of these obligations which result in an increase or decrease of our net asset value. The level of interest rate risk exposure at any given point in time depends on the market environment, the expectations of future price and market movements, and the quantity and duration of both the short and long-term U.S. government and agency securities held by the Company, and it will vary from period to period. If the average interest rate on U.S. government and agency securities at December 31, 2007, were to increase by 25, 75 and 150 basis points, the weighted average value of these securities held by us at December 31, 2007, would decrease by approximately \$144,380, \$433,139 and \$866,278, respectively, and our net asset value would decrease correspondingly.

Most of our investments are denominated in U.S. dollars. We currently have one investment denominated in Canadian dollars. We are exposed to foreign currency risk related to potential changes in foreign currency exchange rates. The potential loss in fair value on this investment resulting from a 10 percent adverse change in quoted foreign currency exchange rates is \$202,408 at December 31, 2007.

In addition, in the future, we may from time to time opt to borrow money to make investments. Our net investment income will be dependent upon the difference between the rate at which we borrow funds and the rate at which we invest such funds. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income in the event we choose to borrow funds for investing purposes.



**Item 8. Consolidated Financial Statements and Supplementary Data.**

**HARRIS & HARRIS GROUP, INC.**  
**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULES**

The following reports and consolidated financial schedules of Harris & Harris Group, Inc. are filed herewith and included in response to Item 8.

Documents	Page
Management's Report on Internal Control Over Financial Reporting	52
Report of Independent Registered Public Accounting Firm	53
<u>Consolidated Financial Statements</u>	
Consolidated Statements of Assets and Liabilities as of December 31, 2007, and 2006	55
Consolidated Statements of Operations for the years ended December 31, 2007, 2006, 2005	56
Consolidated Statements of Cash Flows for the years ended December 31, 2007, 2006, and 2005	57
Consolidated Statements of Changes in Net Assets for the years ended December 31, 2007, 2006, and 2005	58
Consolidated Schedule of Investments as of December 31, 2007	59-69
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Financial Highlights for the years ended December 31, 2007, 2006 and 2005	103

Schedules other than those listed above have been omitted because they are not applicable or the required information is presented in the consolidated financial statements and/or related notes.

### **Management's Report on Internal Control Over Financial Reporting**

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's Board of Directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the Company; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness of internal control over financial reporting to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has assessed the effectiveness of our internal control over financial reporting as of December 31, 2007. In making its assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on the results of this assessment, management (including our Chief Executive Officer and Chief Financial Officer) has concluded that, as of December 31, 2007, the Company's internal control over financial reporting was effective.

The effectiveness of the Company's internal control over financial reporting has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears on page 53 of this Annual Report on Form 10-K.

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders of Harris & Harris Group, Inc.:

In our opinion, the accompanying consolidated statements of assets and liabilities including the consolidated schedules of investments, and the related consolidated statements of operations, changes in net assets, cash flows, and the financial highlights present fairly, in all material respects, the financial position of Harris & Harris Group, Inc. and its subsidiaries ("the Company") at December 31, 2007 and December 31, 2006, and the results of their operations, their cash flows, the changes in their net assets, and the financial highlights for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing on page 52 of the 2007 Annual Report to Shareholders. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As more fully disclosed in Note 2 of the Notes to Consolidated Financial Statements, the financial statements include investments valued at \$78,110,384 (56.5% of net assets) at December 31, 2007, the fair values of which have been estimated by the Board of Directors in the absence of readily ascertainable market values. These estimated values may differ significantly from the values that would have been used had a ready market for the investments existed, and the differences could be material.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

New York, New York  
March 12, 2008

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<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES</b>
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December 31, 2007    December 31, 2006

**ASSETS**

Investments, at value (Cost: \$142,230,461 at 12/31/07, \$121,331,398 at 12/31/06)	\$	138,303,977	\$	112,323,978
Cash and cash equivalents		330,009		2,071,788
Restricted funds (Note 7)		2,667,020		2,149,785
Receivable from portfolio company		524		0
Receivable from broker (Note 4)		0		819,905
Interest receivable		647,337		625,372
Prepaid expenses		488,667		10,945
Other assets		455,798		326,817
<b>Total assets</b>	<b>\$</b>	<b>142,893,332</b>	<b>\$</b>	<b>118,328,590</b>

**LIABILITIES & NET ASSETS**

Accounts payable and accrued liabilities (Note 7)	\$	4,515,463	\$	4,115,300
Accrued profit sharing (Note 5)		0		261,661
Deferred rent		14,525		21,326
<b>Total liabilities</b>		<b>4,529,988</b>		<b>4,398,287</b>
<b>Net assets</b>	<b>\$</b>	<b>138,363,344</b>	<b>\$</b>	<b>113,930,303</b>
<b>Net assets are comprised of:</b>				
Preferred stock, \$0.10 par value, 2,000,000 shares authorized; none issued	\$	0	\$	0
Common stock, \$0.01 par value, 45,000,000 shares authorized at 12/31/07 and 12/31/06; 25,143,313 issued at 12/31/07 and 22,843,757 issued at 12/31/06		251,434		228,438
Additional paid in capital (Note 10)		160,927,691		129,801,201
Accumulated net realized loss		(15,483,766)		(3,686,385)
Accumulated unrealized depreciation of investments		(3,926,484)		(9,007,420)
Treasury stock, at cost (1,828,740 shares at 12/31/07 and 12/31/06)		(3,405,531)		(3,405,531)
<b>Net assets</b>	<b>\$</b>	<b>138,363,344</b>	<b>\$</b>	<b>113,930,303</b>
<b>Shares outstanding</b>		<b>23,314,573</b>		<b>21,015,017</b>
<b>Net asset value per outstanding share</b>	<b>\$</b>	<b>5.93</b>	<b>\$</b>	<b>5.42</b>

The accompanying notes are an integral part of these consolidated financial statements.

<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED STATEMENTS OF OPERATIONS</b>
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	Year Ended December 31, 2007	Year Ended December 31, 2006	Year Ended December 31, 2005
<b>Investment income:</b>			
Interest from:			
Fixed-income securities	\$ 2,705,597	\$ 2,991,261	\$ 1,409,273
Portfolio companies	0	0	65,620
Miscellaneous income	39	37,500	65,969
<b>Total investment income</b>	<b>2,705,636</b>	<b>3,028,761</b>	<b>1,540,862</b>
<b>Expenses:</b>			
Salaries, benefits and stock-based compensation (Note 4)	11,435,329	7,933,276	2,459,033
Administration and operations	1,432,653	1,250,080	1,319,354
Profit-sharing provision (Note 5)	0	50,875	1,796,264
Professional fees	902,911	737,828	830,062
Rent	235,998	239,846	211,582
Directors' fees and expenses	435,060	340,750	308,874
Depreciation	63,113	64,916	64,713
Custodian fees	28,115	24,125	16,741
<b>Total expenses</b>	<b>14,533,179</b>	<b>10,641,696</b>	<b>7,006,623</b>
<b>Net operating loss</b>	<b>(11,827,543)</b>	<b>(7,612,935)</b>	<b>(5,465,761)</b>
<b>Net realized gain from investments:</b>			
Realized gain from investments	118,137	31,338	23,862,037
Income tax expense (benefit) (Note 8)	87,975	(227,355)	9,653,248
<b>Net realized gain from investments</b>	<b>30,162</b>	<b>258,693</b>	<b>14,208,789</b>
<b>Net decrease (increase) in unrealized depreciation on investments:</b>			
Change as a result of investment sales	0	0	(23,181,420)
Change on investments held	5,080,936	(4,418,870)	19,790,298
Change in unrealized depreciation on investments	5,080,936	(4,418,870)	(3,391,122)
Income tax (benefit) (Note 8)	0	0	(1,364,470)
<b>Net decrease (increase) in unrealized depreciation on investments</b>	<b>5,080,936</b>	<b>(4,418,870)</b>	<b>(2,026,652)</b>
<b>Net (decrease) increase in net assets resulting from operations:</b>			
<b>Total</b>	<b>\$ (6,716,445)</b>	<b>\$ (11,773,112)</b>	<b>\$ 6,716,376</b>
<b>Per average basic and diluted outstanding share</b>	<b>\$ (0.30)</b>	<b>\$ (0.57)</b>	<b>\$ 0.36</b>
<b>Average outstanding shares</b>	<b>22,393,030</b>	<b>20,759,547</b>	<b>18,471,770</b>

The accompanying notes are an integral part of these consolidated financial statements.



<b>HARRIS &amp; HARRIS GROUP, INC.</b>
<b>CONSOLIDATED STATEMENTS OF CASH FLOWS</b>

	Year Ended December 31, 2007	Year Ended December 31, 2006	Year Ended December 31, 2005
<b>Cash flows used in operating activities:</b>			
Net (decrease) increase in net assets resulting from operations	\$ (6,716,445)	\$ (11,773,112)	\$ 6,716,376
Adjustments to reconcile net increase (decrease) in net assets resulting from operations to net cash used in operating activities:			
Net realized and unrealized (gain) loss on investments	(5,199,073)	4,420,619	(20,470,915)
Deferred income taxes	0	0	(1,364,470)
Depreciation and amortization	(60,009)	(426,168)	346,019
Taxes payable on behalf of shareholders on deemed dividend	0	0	8,122,367
Stock-based compensation expense	8,050,807	5,038,956	0
Changes in assets and liabilities:			
Restricted funds	(517,235)	(419,351)	(138,463)
Receivable from portfolio company	(524)	75,000	(65,000)
Interest receivable	(21,965)	(376,808)	(189,603)
Income tax receivable	0	0	(7,023)
Prepaid expenses	(477,722)	(7,951)	539,496
Other receivables	819,905	(819,905)	0
Other assets	(152,012)	(176,325)	11,599
Accounts payable and accrued liabilities	400,163	1,002,643	268,525
Accrued profit sharing	(261,661)	(1,846,197)	1,796,264
Deferred rent	(6,801)	(9,677)	(3,927)
Current income tax liability	0	(9,637,026)	1,524,470
<b>Net cash used in operating activities</b>	<b>(4,142,572)</b>	<b>(14,955,302)</b>	<b>(2,914,285)</b>
<b>Cash flows from investing activities:</b>			
Net (purchase) sale of short-term investments and marketable securities	(235,754)	37,593,589	(52,144,482)
Investment in private placements and loans	(20,595,161)	(24,408,187)	(16,251,339)
Proceeds from sale of investments	174,669	28,295	35,392,200
Purchase of fixed assets	(41,640)	(15,086)	(45,704)
<b>Net cash (used in) provided by investing activities</b>	<b>(20,697,886)</b>	<b>13,198,611</b>	<b>(33,049,325)</b>
<b>Cash flows from financing activities:</b>			
Proceeds from public offering, net (Note 10)	12,993,168	0	36,526,567
Proceeds from stock option exercises (Note 4)	10,105,511	2,615,190	0
<b>Net cash provided by financing activities</b>	<b>23,098,679</b>	<b>2,615,190</b>	<b>36,526,567</b>
<b>Net (decrease) increase in cash and cash</b>			



**equivalents:**

Cash and cash equivalents at beginning of the year	2,071,788	1,213,289	650,332
Cash and cash equivalents at end of the year	330,009	2,071,788	1,213,289

**Net (decrease) increase in cash and cash equivalents**

\$	(1,741,779)	\$	858,499	\$	562,957
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**Supplemental disclosures of cash flow information:**

Income taxes paid	\$	80,236	\$	9,425,922	\$	0
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The accompanying notes are an integral part of these consolidated financial statements.

<b>HARRIS &amp; HARRIS GROUP, INC.</b>
<b>CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS</b>

	<b>Year Ended</b>	<b>Year Ended</b>	<b>Year Ended</b>
	<b>December 31, 2007</b>	<b>December 31, 2006</b>	<b>December 31, 2005</b>

**Changes in net assets from operations:**

Net operating loss	\$ (11,827,543)	\$ (7,612,935)	\$ (5,465,761)
Net realized gain on investments	30,162	258,693	14,208,789
Net (increase) in unrealized depreciation on investments as a result of sales	0	0	(23,181,420)
Net decrease (increase) in unrealized depreciation on investments held	5,080,936	(4,418,870)	19,790,298
Net change in deferred taxes	0	0	1,364,470

**Net (decrease) increase in net assets resulting from operations**

	(6,716,445)	(11,773,112)	6,716,376
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**Changes in net assets from capital stock transactions:**

Issuance of common stock upon the exercise of stock options	9,996	2,587	0
Issuance of common stock on offering	13,000	0	35,075
Additional paid in capital on common stock issued	23,075,683	2,612,603	36,491,492
Stock-based compensation expense	8,050,807	5,038,956	0

**Net increase in net assets resulting from capital stock transactions**

	31,149,486	7,654,146	36,526,567
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**Changes in net assets from adoption of SFAS No. 158**

	0	61,527	0
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**Net increase (decrease) in net assets**

	24,433,041	(4,057,439)	43,242,943
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**Net Assets:**

Beginning of the year	113,930,303	117,987,742	74,744,799
End of the year	\$ 138,363,344	\$ 113,930,303	\$ 117,987,742

The accompanying notes are an integral part of these consolidated financial statements.

<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007</b>
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	Method of Valuation (1)	Shares/ Principal	Value
<b>Investments in Unaffiliated Companies (2)(3) – 15.25% of net assets at value</b>			
<b>Private Placement Portfolio (Illiquid) – 15.25% of net assets at value</b>			
BioVex Group, Inc. (4)(5)(6)(7)(8) – Developing novel biologics for treatment of cancer and infectious disease Series			
E Convertible Preferred Stock	(B)	2,799,552 \$	2,500,000
Exponential Business Development Company (4)(5) — Venture capital partnership focused on early stage companies			
Limited Partnership Interest	(B)	1	2,026
Molecular Imprints, Inc. (4)(5) — Manufacturing nanoimprint lithography capital equipment			
Series B Convertible Preferred Stock	(B)	1,333,333	2,000,000
Series C Convertible Preferred Stock	(B)	1,250,000	2,389,250
Warrants at \$2.00 expiring 12/31/11	(B)	125,000	110,750
			4,500,000
Nanosys, Inc. (4)(5)(7) — Developing zero and one-dimensional inorganic nanometer-scale materials and devices			
Series C Convertible Preferred Stock	(B)	803,428	2,370,113
Series D Convertible Preferred Stock	(B)	1,016,950	3,000,003
			5,370,116
Nantero, Inc. (4)(5)(7) — Developing a high-density, nonvolatile, random access memory chip, enabled by carbon nanotubes			
Series A Convertible Preferred Stock	(B)	345,070	1,046,908
Series B Convertible Preferred Stock	(B)	207,051	628,172
Series C Convertible Preferred Stock	(B)	188,315	571,329
			2,246,409

The accompanying notes are an integral part of these consolidated financial statements.

<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007</b>
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	Method of Valuation (1)	Shares/ Principal	Value
<b>Investments in Unaffiliated Companies (2)(3) – 15.25% of net assets at value (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 15.25% of net assets at value (cont.)</b>			
NeoPhotonics Corporation (4)(5) — Developing and manufacturing optical devices and components			
Common Stock	(B)	716,195 \$	133,141
Series 1 Convertible Preferred Stock	(B)	1,831,256	1,831,256
Series 2 Convertible Preferred Stock	(B)	741,898	741,898
Series 3 Convertible Preferred Stock	(B)	2,750,000	2,750,000
Warrants at \$0.15 expiring 01/26/10	(B)	16,364	1,325
Warrants at \$0.15 expiring 12/05/10	(B)	14,063	1,139
			5,458,759
Polatis, Inc. (4)(5)(7)(9) — Developing MEMS-based optical networking components			
Series A-1 Convertible Preferred Stock	(B)	16,775	0
Series A-2 Convertible Preferred Stock	(B)	71,611	132,653
Series A-4 Convertible Preferred Stock	(B)	4,774	8,768
Series A-5 Convertible Preferred Stock	(B)	16,438	135,105
			276,526
Starfire Systems, Inc. (4)(5)(7) — Producing ceramic-forming polymers			
Common Stock	(B)	375,000	150,000
Series A-1 Convertible Preferred Stock	(B)	600,000	600,000
			750,000
<b>Total Unaffiliated Private Placement Portfolio (cost: \$21,435,392)</b>			<b>\$ 21,103,836</b>
<b>Total Investments in Unaffiliated Companies (cost: \$21,435,392)</b>			<b>\$ 21,103,836</b>

The accompanying notes are an integral part of these consolidated financial statements.

<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007</b>
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	Method of Valuation (1)	Shares/ Principal	Value
<b>Investments in Non-Controlled Affiliated Companies</b>			
<b>(2)(10) – 38.06% of net assets at value</b>			
<b>Private Placement Portfolio (Illiquid) – 38.06% of net assets at value</b>			
Adesto Technologies Corporation (4)(5)(6)(7) — Developing semiconductor-related products enabled at the nanoscale			
Series A Convertible Preferred Stock	(B)	3,416,149 \$	1,147,826
Ancora Pharmaceuticals Inc. (4)(5)(6)(7) – Developing synthetic carbohydrates for pharmaceutical markets and for internal drug development programs			
Series B Convertible Preferred Stock	(B)	909,091	639,062
Warrants at \$1.06 expiring 05/01/08	(B)	754,717	60,377
			699,439
BridgeLux, Inc. (4)(5)(11) — Manufacturing high-power light emitting diodes			
Series B Convertible Preferred Stock	(B)	1,861,504	2,792,256
Series C Convertible Preferred Stock	(B)	2,130,699	3,196,050
Warrants at \$0.7136 expiring 02/02/2017	(B)	98,340	138,856
Warrants at \$0.7136 expiring 04/26/2017	(B)	65,560	92,833
			6,219,995
Cambrios Technologies Corporation (4)(5)(7) — Developing nanowire-enabled electronic materials for the display industry			
Series B Convertible Preferred Stock	(B)	1,294,025	1,294,025
Series C Convertible Preferred Stock	(B)	1,300,000	1,300,000
			2,594,025
Chlorogen, Inc. (4)(5)(12) — Developed patented chloroplast technology to produce plant-made proteins			
Series A Convertible Preferred Stock	(B)	4,478,038	0
Series B Convertible Preferred Stock	(B)	2,077,930	0
Secured Convertible Bridge Note (including interest)	(B)	\$ 176,811	0
			0

The accompanying notes are an integral part of these consolidated financial statements.



<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007</b>
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	Method of Valuation (1)	Shares/ Principal	Value
<b>Investments in Non-Controlled Affiliated Companies</b>			
<b>(2)(10) – 38.06% of net assets at value (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 38.06% of net assets at value (cont.)</b>			
Crystal IS, Inc. (4)(5)(7) — Developing single-crystal aluminum nitride substrates for optoelectronic devices			
Series A Convertible Preferred Stock	(B)	391,571 \$	305,425
Series A-1 Convertible Preferred Stock	(B)	1,300,376	1,014,294
Warrants at \$0.78 expiring 05/05/2013	(B)	15,231	9,550
Warrants at \$0.78 expiring 05/12/2013	(B)	2,350	1,473
Warrants at \$0.78 expiring 08/08/2013	(B)	4,396	2,796
			1,333,538
CSwitch, Inc. (4)(5)(7)(13) — Developing next-generation, system-on- a-chip solutions for communications-based platforms			
Series A-1 Convertible Preferred Stock	(B)	6,863,118	3,431,559
Secured Convertible Bridge Note (including interest)	(B)	\$ 529,852	541,581
			3,973,140
D-Wave Systems, Inc. (4)(5)(7)(14) — Developing high-performance quantum computing systems			
Series B Convertible Preferred Stock	(B)	2,000,000	2,226,488
Ensemble Discovery Corporation (4)(5)(6)(7) – Developing DNA Programmed Chemistry for the discovery of new classes of therapeutics and bioassays			
Series B Convertible Preferred Stock	(B)	1,449,275	2,000,000
Innovalight, Inc. (4)(5)(7) – Developing renewable energy products enabled by silicon-based nanomaterials			
Series B Convertible Preferred Stock	(B)	16,666,666	5,718,216
Series C Convertible Preferred Stock	(B)	5,810,577	1,993,568
			7,711,784

The accompanying notes are an integral part of these consolidated financial statements.

<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007</b>
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	Method of Valuation (1)	Shares/ Principal	Value
<b>Investments in Non-Controlled Affiliated Companies</b>			
<b>(2)(10) – 38.06% of net assets at value (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 38.06% of net assets at value (cont.)</b>			
Kereos, Inc. (4)(5)(7) — Developing emulsion-based imaging agents and targeted therapeutics to image and treat cancer and cardiovascular disease			
Series B Convertible Preferred Stock	(B)	545,456 \$	159,743
Kovio, Inc. (4)(5)(7) — Developing semiconductor products using printed electronics and thin-film technologies			
Series C Convertible Preferred Stock	(B)	2,500,000	3,125,000
Series D Convertible Preferred Stock	(B)	800,000	1,000,000
			4,125,000
Lifco, Inc. (4)(5)(6)(7)(15) — Developing energy solutions using nanostructured materials			
Series A Convertible Preferred Stock	(B)	1,208,262	946,528
Mersana Therapeutics, Inc. (4)(5)(7)(16) — Developing advanced polymers for drug delivery			
Series A Convertible Preferred Stock	(B)	68,451	136,902
Series B Convertible Preferred Stock	(B)	866,500	1,733,000
Warrants at \$2.00 expiring 10/21/10	(B)	91,625	118,380
			1,988,282
Metabolon, Inc. (4)(5)(7) – Discovering biomarkers through the use of metabolomics			
Series B Convertible Preferred Stock	(B)	2,173,913	2,500,000

The accompanying notes are an integral part of these consolidated financial statements.



<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007</b>
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	Method of Valuation (1)	Shares/ Principal	Value
<b>Investments in Non-Controlled Affiliated Companies</b>			
<b>(2)(10) – 38.06% of net assets at value (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 38.06% of net assets at value (cont.)</b>			
NanoGram Corporation (4)(5)(7) — Developing a broad suite of intellectual property utilizing nanoscale materials			
Series I Convertible Preferred Stock	(B)	63,210 \$	124,524
Series II Convertible Preferred Stock	(B)	1,250,904	2,464,281
Series III Convertible Preferred Stock	(B)	1,242,144	2,447,024
Series IV Convertible Preferred Stock	(B)	432,179	851,393
			5,887,222
Nanomix, Inc. (4)(5)(7) — Producing nanoelectronic sensors that integrate carbon nanotube electronics with silicon microstructures			
Series C Convertible Preferred Stock	(B)	977,917	330,228
Series D Convertible Preferred Stock	(B)	6,802,397	680,240
			1,010,468
NanoOpto Corporation (4)(5)(17) — Manufactured discrete and integrated optical communications sub-components on a chip by utilizing nano manufacturing and nano coating technology			
Series A-1 Convertible Preferred Stock	(B)	267,857	0
Series B Convertible Preferred Stock	(B)	3,819,935	0
Series C Convertible Preferred Stock	(B)	1,932,789	0
Series D Convertible Preferred Stock	(B)	1,397,218	0
Warrants at \$0.4359 expiring 03/15/10	(B)	193,279	0
Secured Convertible Bridge Note (including interest)	(B)	\$ 268,654	105,714
			105,714
Nextreme Thermal Solutions, Inc. (4)(5)(7) — Developing thin-film thermoelectric devices for cooling and energy conversion			
Series A Convertible Preferred Stock	(B)	1,750,000	1,750,000

The accompanying notes are an integral part of these consolidated financial statements.

<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007</b>
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	Method of Valuation (1)	Shares/ Principal	Value
<b>Investments in Non-Controlled Affiliated Companies</b>			
<b>(2)(10) – 38.06% of net assets at value (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 38.06% of net assets at value (cont.)</b>			
Questech Corporation (4)(5) — Manufacturing and marketing proprietary metal and stone decorative tiles			
Common Stock	(B)	655,454 \$	589,259
Warrants at \$1.50 expiring 11/19/08	(B)	5,000	1,085
Warrants at \$1.50 expiring 11/19/09	(B)	5,000	1,910
			592,254
Siluria Technologies, Inc. (4)(5)(6)(7) – Developing new-generation nanomaterials			
Series S-2 Convertible Preferred Stock	(B)	482,218	160,723
Solazyme, Inc. (4)(5)(7) — Developing energy-harvesting machinery of photosynthetic microbes to produce industrial and pharmaceutical molecules			
Series A Convertible Preferred Stock	(B)	988,204	997,691
Series B Convertible Preferred Stock	(B)	495,246	500,000
			1,497,691
Xradia, Inc. (4)(5) – Designing, manufacturing and selling ultra high resolution 3D x-ray microscopes and fluorescence imaging systems			
Series D Convertible Preferred Stock	(B)	3,121,099	4,000,000
Zia Laser, Inc. (4)(5)(18) — Developed quantum dot semiconductor lasers			
Series C Convertible Preferred Stock	(B)	1,500,000	21,329
<b>Total Non-Controlled Private Placement Portfolio (cost: \$54,306,393)</b>			<b>\$ 52,651,189</b>
<b>Total Investments in Non-Controlled Affiliated Companies (cost: \$54,306,393)</b>			<b>\$ 52,651,189</b>

The accompanying notes are an integral part of these consolidated financial statements.

<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007</b>
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	Method of Valuation (1)	Shares/ Principal	Value
<b>Investments in Controlled Affiliated Companies</b>			
<b>(2)(19) – 3.15% of net assets at value</b>			
<b>Private Placement Portfolio (Illiquid) – 3.15% of net assets at value</b>			
Evolved Nanomaterial Sciences, Inc. (4)(5)(20) — Developed nanoscale-enhanced approaches for the resolution of chiral molecules			
Series A Convertible Preferred Stock	(B)	5,870,021 \$	0
Phoenix Molecular Corporation (4)(5)(6)(7) – Developing technology to enable the separation of difficult-to-separate materials.			
Common Stock	(B)	1,000	10
Unsecured Convertible Bridge Note (including interest)	(B)	\$ 50,000	50,733
			50,743
SiOnyx, Inc. (4)(5)(7) — Developing silicon-based optoelectronic products enabled by its proprietary "Black Silicon"			
Series A Convertible Preferred Stock	(B)	233,499	135,686
Series A-1 Convertible Preferred Stock	(B)	2,966,667	1,723,930
Series A-2 Convertible Preferred Stock	(B)	4,207,537	2,445,000
			4,304,616
<b>Total Controlled Private Placement Portfolio (cost: \$6,935,743)</b>		<b>\$</b>	<b>4,355,359</b>
<b>Total Investments in Controlled Affiliated Companies (cost: \$6,935,743)</b>		<b>\$</b>	<b>4,355,359</b>
<b>Total Private Placement Portfolio (cost: \$82,677,528)</b>		<b>\$</b>	<b>78,110,384</b>

The accompanying notes are an integral part of these consolidated financial statements.

<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007</b>
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**U.S. Government and Agency Securities —43.50% of net assets  
at value**

U.S. Treasury Bill — due date 02/21/08	(J)	\$ 2,750,000	\$ 2,738,725
U.S. Treasury Notes — due date 02/15/08, coupon 3.375%	(H)	15,005,000	15,006,200
U.S. Treasury Notes — due date 05/15/08, coupon 3.75%	(H)	9,000,000	9,010,530
U.S. Treasury Notes — due date 09/15/08, coupon 3.125%	(H)	5,000,000	4,991,800
U.S. Treasury Notes — due date 01/15/09, coupon 3.25%	(H)	3,000,000	3,005,160
U.S. Treasury Notes — due date 02/15/09, coupon 4.50%	(H)	5,100,000	5,176,908
U.S. Treasury Notes — due date 04/15/09, coupon 3.125%	(H)	3,000,000	3,001,410
U.S. Treasury Notes — due date 07/15/09, coupon 3.625%	(H)	3,000,000	3,023,910
U.S. Treasury Notes — due date 10/15/09, coupon 3.375%	(H)	3,000,000	3,018,510
U.S. Treasury Notes — due date 01/15/10, coupon 3.625%	(H)	3,000,000	3,034,680
U.S. Treasury Notes — due date 04/15/10, coupon 4.00%	(H)	3,000,000	3,060,930
U.S. Treasury Notes — due date 07/15/10, coupon 3.875%	(H)	3,000,000	3,060,930
U.S. Treasury Notes — due date 10/15/10, coupon 4.25%	(H)	2,000,000	2,063,900

<b>Total Investments in U.S. Government and Agency Securities (cost: \$59,552,933)</b>	<b>\$ 60,193,593</b>
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<b>Total Investments (cost: \$142,230,461)</b>	<b>\$ 138,303,977</b>
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The accompanying notes are an integral part of these consolidated financial statements.

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007**

Notes to Consolidated Schedule of Investments

- (1) See Footnote to Consolidated Schedule of Investments on page 78 for a description of the Valuation Procedures.
- (2) Investments in unaffiliated companies consist of investments in which we own less than five percent of the voting shares of the portfolio company. Investments in non-controlled affiliated companies consist of investments in which we own five percent or more, but less than 25 percent, of the voting shares of the portfolio company, or where we hold one or more seats on the portfolio company's Board of Directors but do not control the company. Investments in controlled affiliated companies consist of investments in which we own 25 percent or more of the voting shares of the portfolio company or otherwise control the company.
- (3) The aggregate cost for federal income tax purposes of investments in unaffiliated companies is \$21,435,392. The gross unrealized appreciation based on the tax cost for these securities is \$1,732,194. The gross unrealized depreciation based on the tax cost for these securities is \$2,063,750.
- (4) Legal restrictions on sale of investment.
- (5) Represents a non-income producing security. Equity investments that have not paid dividends within the last 12 months are considered to be non-income producing.
- (6) Initial investment was made during 2007.
- (7) These investments are development stage companies. A development stage company is defined as a company that is devoting substantially all of its efforts to establishing a new business, and either it has not yet commenced its planned principal operations, or it has commenced such operations but has not realized significant revenue from them.
- (8) With our purchase of Series E Convertible Preferred Stock of BioVex, we received a warrant to purchase a number of shares of common stock of BioVex as determined by dividing 624,999.99 by the price per share at which the common stock is offered and sold to the public in connection with the initial public offering. The ability to exercise this warrant is therefore contingent on BioVex completing successfully an initial public offering before the expiration date of the warrant of September 27, 2012. The exercise price of this warrant shall be 110 percent of the initial public offering price.
- (9) Continuum Photonics, Inc., merged with Polatis, Ltd., to form Polatis, Inc.

The accompanying notes are an integral part of these consolidated financial statements.

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2007**

- (10) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated companies is \$54,306,393. The gross unrealized appreciation based on the tax cost for these securities is \$10,915,201. The gross unrealized depreciation based on the tax cost for these securities is \$12,570,405.
- (11) BridgeLux, Inc., was previously named eLite Optoelectronics, Inc.
- (12) On November 30, 2007, Chlorogen filed a Certificate of Dissolution with the state of Delaware.
- (13) With our investment in a secured convertible bridge note issued by CSwitch, we received a warrant to purchase a number of shares of the class of stock sold in the next financing of CSwitch equal to \$529,322.36, the principal of the note, divided by the lowest price per share of the class of stock sold in the next financing of CSwitch. The ability to exercise this warrant is therefore contingent on CSwitch completing successfully a subsequent round of financing. The warrant will expire five years from the date of the close of the next round of financing. The cost basis of this warrant is \$529.32.
- (14) D-Wave Systems, Inc., is located and is doing business primarily in Canada. We invested in D-Wave Systems, Inc., through D-Wave USA, a Delaware company. Our investment is denominated in Canadian dollars and is subject to foreign currency translation. See "Note 2. Summary of Significant Accounting Policies."
- (15) On February 28, 2008, Lifco, Inc., merged with CFX Battery, Inc., to form CFX Battery, Inc.
- (16) Mersana Therapeutics, Inc., was previously named Nanopharma Corp.
- (17) On July 19, 2007, NanoOpto Corporation sold its assets to API Nanotronics, Inc.
- (18) On November 30, 2006, the assets of Zia Laser, Inc., were acquired by Innolume, Inc.
- (19) The aggregate cost for federal income tax purposes of investments in controlled affiliated companies is \$6,935,743. The gross unrealized appreciation based on the tax cost for these securities is \$219,616. The gross unrealized depreciation based on the tax cost for these securities is \$2,800,000.
- (20) On September 30, 2007, Evolved Nanomaterial Sciences, Inc., filed for Chapter 7 bankruptcy.

The accompanying notes are an integral part of this consolidated schedule.

<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2006</b>
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	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Unaffiliated Companies (6)(7) – 15.61% of net assets</b>			
<b>Private Placement Portfolio (Illiquid) – 15.61% of net assets</b>			
AlphaSimplex Group, LLC (2) — Investment management company headed by Dr. Andrew W. Lo, holder of the Harris & Harris Group Chair at MIT			
Limited Liability Company Interest	(B)	—\$	10,521
Exponential Business Development Company (1)(2) — Venture capital partnership focused on early stage companies			
Limited Partnership Interest	(B)	—	0
Molecular Imprints, Inc. (1)(2) — Manufacturing nanoimprint lithography capital equipment			
Series B Convertible Preferred Stock	(A)	1,333,333	2,000,000
Series C Convertible Preferred Stock	(A)	1,250,000	2,500,000
Warrants at \$2.00 expiring 12/31/11	(B)	125,000	0
			4,500,000
Nanosys, Inc. (1)(2)(5) — Developing zero and one-dimensional inorganic nanometer-scale materials for use in nanotechnology-enabled systems			
Series C Convertible Preferred Stock	(C)	803,428	2,370,113
Series D Convertible Preferred Stock	(C)	1,016,950	3,000,003
			5,370,116
Nantero, Inc. (1)(2)(5) — Developing a high-density, nonvolatile, random access memory chip, enabled by carbon nanotubes			
Series A Convertible Preferred Stock	(C)	345,070	1,046,908
Series B Convertible Preferred Stock	(C)	207,051	628,172
Series C Convertible Preferred Stock	(C)	188,315	571,329
			2,246,409

The accompanying notes are an integral part of these consolidated financial statements.

<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2006</b>
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	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Unaffiliated Companies (6)(7) – 15.61% of net assets (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 15.61% of net assets (cont.)</b>			
NeoPhotonics Corporation (1)(2) — Developing and manufacturing planar optical devices and components			
Common Stock	(C)	716,195	\$ 133,141
Series 1 Convertible Preferred Stock	(C)	1,831,256	1,831,256
Series 2 Convertible Preferred Stock	(C)	741,898	741,898
Series 3 Convertible Preferred Stock	(C)	2,750,000	2,750,000
Warrants at \$0.15 expiring 01/26/10	(C)	16,364	164
Warrants at \$0.15 expiring 12/05/10	(C)	14,063	140
			5,456,599
Polatis, Inc. (1)(2)(5)(10) — Developing optical networking components by merging materials, MEMS and electronics technologies			
Series A-1 Convertible Preferred Stock	(B)	16,775	0
Series A-2 Convertible Preferred Stock	(B)	71,611	141,520
Series A-4 Convertible Preferred Stock	(B)	4,774	9,435
Series A-5 Convertible Preferred Stock	(B)	5,491	45,127
			196,082
<b>Total Unaffiliated Private Placement Portfolio (cost: \$18,107,124)</b>			<b>\$ 17,779,727</b>
<b>Total Investments in Unaffiliated Companies (cost: \$18,107,124)</b>			<b>\$ 17,779,727</b>

The accompanying notes are an integral part of these consolidated financial statements.



<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2006</b>
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	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Non-Controlled Affiliated Companies</b>			
<b>(6)(8) – 28.20% of net assets</b>			
<b>Private Placement Portfolio (Illiquid) – 28.20% of net assets</b>			
BridgeLux, Inc. (1)(2)(11) — Manufacturing high-power light emitting diodes			
Series B Convertible Preferred Stock	(A)	1,861,504	\$ 1,000,000
Cambrios Technologies Corporation (1)(2)(5) — Developing nanowire- enabled electronic materials for the display industry			
Series B Convertible Preferred Stock	(A)	1,294,025	1,294,025
Chlorogen, Inc. (1)(2)(5) — Developing patented chloroplast technology to produce plant-made proteins			
Series A Convertible Preferred Stock	(C)	4,478,038	785,000
Series B Convertible Preferred Stock	(C)	2,077,930	364,261
Secured Convertible Bridge Note (including interest)	(A)	\$ 221,438	225,697
			1,374,958
Crystal IS, Inc. (1)(2)(5) — Developing single-crystal aluminum nitride substrates for optoelectronic devices			
Series A Convertible Preferred Stock	(C)	391,571	305,425
Series A-1 Convertible Preferred Stock	(C)	1,300,376	1,014,294
Warrants at \$0.78 expiring 05/05/2013	(B)	15,231	0
Warrants at \$0.78 expiring 05/12/2013	(B)	2,350	0
Warrants at \$0.78 expiring 08/08/2013	(B)	4,396	0
			1,319,719
CSwitch, Inc. (1)(2)(5) — Developing next-generation, system-on-a-chip solutions for communications-based platforms			
Series A-1 Convertible Preferred Stock	(C)	6,700,000	3,350,000

The accompanying notes are an integral part of these consolidated financial statements.

<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2006</b>
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	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Non-Controlled Affiliated Companies</b>			
<b>(6)(8) – 28.20% of net assets (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 28.20% of net assets (cont.)</b>			
D-Wave Systems, Inc. (1)(2)(4)(5)(13) — Developing high-performance quantum computing systems			
Series B Convertible Preferred Stock	(A)	2,000,000	\$ 1,716,444
Warrants at \$0.85 expiring 10/19/07	(B)	1,800,000	0
			1,716,444
Innovalight, Inc. (1)(2)(4)(5) - Developing renewable energy products enabled by silicon-based nanomaterials			
Series B Convertible Preferred Stock	(A)	16,666,666	2,500,000
Kereos, Inc. (1)(2)(5) — Developing emulsion-based imaging agents and targeted therapeutics to image and treat cancer and cardiovascular disease			
Series B Convertible Preferred Stock	(A)	349,092	960,000
Kovio, Inc. (1)(2)(5) — Developing semiconductor products using printed electronics and thin-film technologies			
Series C Convertible Preferred Stock	(A)	2,500,000	3,000,000
Mersana Therapeutics, Inc. (1)(2)(5)(12) — Developing advanced polymers for drug delivery			
Series A Convertible Preferred Stock	(C)	68,452	136,904
Series B Convertible Preferred Stock	(C)	616,500	1,233,000
Warrants at \$2.00 expiring 10/21/10	(B)	91,625	0
			1,369,904
Metabolon, Inc. (1)(2)(4)(5) - Discovering biomarkers through the use of metabolomics			
Series B Convertible Preferred Stock	(A)	2,173,913	2,500,000

The accompanying notes are an integral part of these consolidated financial statements.

<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2006</b>
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	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Non-Controlled Affiliated Companies</b>			
<b>(6)(8) – 28.20% of net assets (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 28.20% of net assets (cont.)</b>			
NanoGram Corporation (1)(2)(5) — Developing a broad suite of intellectual property utilizing nanotechnology			
Series I Convertible Preferred Stock	(C)	63,210 \$	64,259
Series II Convertible Preferred Stock	(C)	1,250,904	1,271,670
Series III Convertible Preferred Stock	(C)	1,242,144	1,262,764
			2,598,693
Nanomix, Inc. (1)(2)(5) — Producing nanoelectronic sensors that integrate carbon nanotube electronics with silicon microstructures			
Series C Convertible Preferred Stock	(B)	9,779,181	790,000
NanoOpto Corporation (1)(2)(5) — Manufacturing discrete and integrated optical communications sub-components on a chip by utilizing nano manufacturing and nano coating technology			
Series A-1 Convertible Preferred Stock	(B)	267,857	16,400
Series B Convertible Preferred Stock	(B)	3,819,935	560,328
Series C Convertible Preferred Stock	(B)	1,932,789	425,266
Series D Convertible Preferred Stock	(B)	1,397,218	204,951
Warrants at \$0.4359 expiring 03/15/10	(B)	193,279	0
			1,206,945
Nextreme Thermal Solutions, Inc. (1)(2)(5) — Developing thin-film thermoelectric devices			
Series A Convertible Preferred Stock	(A)	1,000,000	1,000,000
Questech Corporation (1)(2) — Manufacturing and marketing proprietary metal and stone decorative tiles			
Common Stock	(B)	655,454	996,683
Warrants at \$1.50 expiring 11/21/07	(B)	3,750	77
Warrants at \$1.50 expiring 11/19/08	(B)	5,000	103
Warrants at \$1.50 expiring 11/19/09	(B)	5,000	103
			996,966

The accompanying notes are an integral part of these consolidated financial statements.



<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2006</b>
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	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Non-Controlled Affiliated Companies</b>			
<b>(6)(8) – 28.20% of net assets (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) – 28.20% of net assets (cont.)</b>			
Solazyme, Inc. (1)(2)(5) — Developing energy-harvesting machinery of photosynthetic microbes to produce industrial and pharmaceutical molecules			
Series A Convertible Preferred Stock	(C)	988,204	\$ 385,400
Starfire Systems, Inc. (1)(2)(5) —Producing ceramic-forming polymers			
Common Stock	(A)	375,000	150,000
Series A-1 Convertible Preferred Stock	(C)	600,000	600,000
			750,000
Xradia, Inc. (1)(2)(4) - Designing, manufacturing and selling ultra high resolution 3D x-ray microscopes and fluorescence imaging systems.			
Series D Convertible Preferred Stock	(A)	3,121,099	4,000,000
Zia Laser, Inc. (1)(2)(5) — Developing quantum dot semiconductor lasers			
Series C Convertible Preferred Stock	(C)	1,500,000	15,000
<b>Total Non-Controlled Private Placement Portfolio</b>			
<b>(cost: \$39,571,676)</b>			<b>\$ 32,128,054</b>
<b>Total Investments in Non-Controlled Affiliated Companies (cost: \$39,571,676)</b>			<b>\$ 32,128,054</b>

The accompanying notes are an integral part of these consolidated financial statements.

<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2006</b>
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	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Controlled Affiliated Companies (6)(9) – 3.30% of net assets</b>			
<b>Private Placement Portfolio (Illiquid) – 3.30% of net assets</b>			
Evolved Nanomaterial Sciences, Inc. (1)(2)(4)(5) — Developing nanotechnology-enhanced approaches for the resolution of chiral molecules			
Series A Convertible Preferred Stock	(A)	5,870,021	\$ 2,800,000
SiOnyx, Inc. (1)(2)(4)(5) — Developing silicon-based optoelectronic products enabled by its proprietary, "Black Silicon"			
Series A Convertible Preferred Stock	(C)	233,499	70,050
Series A-1 Convertible Preferred Stock	(C)	2,966,667	890,000
			960,050
<b>Total Controlled Private Placement Portfolio (cost: \$4,440,000)</b>			<b>\$ 3,760,050</b>
<b>Total Investments in Controlled Affiliated Companies (cost: \$4,440,000)</b>			<b>\$ 3,760,050</b>
<b>U.S. Government and Agency Securities – 51.48% of net assets</b>			
U.S. Treasury Bill — due date 1/18/07	(J)	2,217,000	2,212,677
U.S. Treasury Notes — due date 11/30/07, coupon 4.25%	(H)	6,500,000	6,455,345
U.S. Treasury Notes — due date 02/15/08, coupon 3.375%	(H)	9,000,000	8,842,860
U.S. Treasury Notes — due date 05/15/08, coupon 3.75%	(H)	9,000,000	8,862,210
U.S. Treasury Notes — due date 09/15/08, coupon 3.125%	(H)	5,000,000	4,861,350
U.S. Treasury Notes — due date 01/15/09, coupon 3.25%	(H)	3,000,000	2,910,930
U.S. Treasury Notes — due date 02/15/09, coupon 4.50%	(H)	5,100,000	5,069,145
U.S. Treasury Notes — due date 04/15/09, coupon 3.125%	(H)	3,000,000	2,893,830
U.S. Treasury Notes — due date 07/15/09, coupon 3.625%	(H)	3,000,000	2,920,890
U.S. Treasury Notes — due date 10/15/09, coupon 3.375%	(H)	3,000,000	2,894,310
U.S. Treasury Notes — due date 01/15/10, coupon 3.625%	(H)	3,000,000	2,907,420
U.S. Treasury Notes — due date 04/15/10, coupon 4.00%	(H)	3,000,000	2,935,560
U.S. Treasury Notes — due date 07/15/10, coupon 3.875%	(H)	3,000,000	2,920,560
U.S. Treasury Notes — due date 10/15/10, coupon 4.25%	(H)	2,000,000	1,969,060
<b>Total Investments in U.S. Government and Agency</b>			<b>\$ 58,656,147</b>

**Securities (cost: \$59,212,598)**

**Total Investments (cost: \$121,331,398) \$ 112,323,978**

The accompanying notes are an integral part of these consolidated financial statements.

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**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2006**

Notes to Consolidated Schedule of Investments

- (1) Represents a non-income producing security. Equity investments that have not paid dividends within the last 12 months are considered to be non-income producing.
- (2) Legal restrictions on sale of investment.
- (3) See Footnote to Schedule of Investments for a description of the Valuation Procedures.
- (4) Initial investment was made during 2006.
- (5) These investments are development stage companies. A development stage company is defined as a company that is devoting substantially all of its efforts to establishing a new business, and either it has not yet commenced its planned principal operations, or it has commenced such operations but has not realized significant revenue from them.
- (6) Investments in unaffiliated companies consist of investments in which we own less than five percent of the voting shares of the portfolio company. Investments in non-controlled affiliated companies consist of investments in which we own five percent or more, but less than 25 percent, of the voting shares of the portfolio company or where we hold one or more seats on the portfolio company's Board of Directors. Investments in controlled affiliated companies consist of investments in which we own 25 percent or more of the voting shares of the portfolio company.
- (7) The aggregate cost for federal income tax purposes of investments in unaffiliated companies is \$18,107,124. The gross unrealized appreciation based on the tax cost for these securities is \$1,732,194. The gross unrealized depreciation based on the tax cost for these securities is \$2,059,591.
- (8) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated companies is \$39,571,676. The gross unrealized appreciation based on the tax cost for these securities is \$333,269. The gross unrealized depreciation based on the tax cost for these securities is \$7,776,891.
- (9) The aggregate cost for federal income tax purposes of investments in controlled affiliated companies is \$4,400,000. The gross unrealized appreciation based on the tax cost for these securities is \$0. The gross unrealized depreciation based on the tax cost for these securities is \$679,950.
- (10) Continuum Photonics, Inc., merged with Polatis, Ltd., to form Polatis, Inc.
- (11) BridgeLux, Inc., was previously named eLite Optoelectronics, Inc.
- (12) Mersana Therapeutics, Inc., was previously named Nanopharma Corp.
- (13) D-Wave Systems, Inc., is located and is doing business primarily in Canada. We invested in D-Wave Systems, Inc., through D-Wave USA, a Delaware company. Our investment is denominated in Canadian dollars and is subject to foreign currency translation. Refer to "Note 2. Summary of Significant Accounting Policies."

The accompanying notes are an integral part of this consolidated schedule.





**HARRIS & HARRIS GROUP, INC.**  
**FOOTNOTE TO CONSOLIDATED SCHEDULE OF INVESTMENTS**

**VALUATION PROCEDURES**

Our investments can be classified into five broad categories for valuation purposes:

Equity-Related Securities;

Investments in Intellectual Property or Patents or Research and Development in Technology or Product Development;

Long-Term Fixed-Income Securities;

Short-Term Fixed-Income Securities; and

All Other Securities.

The 1940 Act requires periodic valuation of each investment in our portfolio to determine net asset value. Under the 1940 Act, unrestricted securities with readily available market quotations are to be valued at the current market value; all other assets must be valued at "fair value" as determined in good faith by or under the direction of the Board of Directors.

Our Board of Directors is responsible for (1) determining overall valuation guidelines and (2) ensuring the valuation of investments within the prescribed guidelines.

Our Valuation Committee, comprised of all of our independent Board members, is responsible for reviewing and approving the valuation of our assets within the guidelines established by the Board of Directors.

Fair value is generally defined as the amount that an investment could be sold for in an orderly disposition over a reasonable time. Generally, to increase objectivity in valuing our assets, external measures of value, such as public markets or third-party transactions, are utilized whenever possible. Valuation is not based on long-term work-out value, nor immediate liquidation value, nor incremental value for potential changes that may take place in the future.

The values assigned to these investments are based on available information and do not necessarily represent amounts that might ultimately be realized, as these amounts depend on future circumstances and cannot reasonably be determined until the individual investments are actually liquidated or become marketable.

Our valuation policy with respect to the five broad investment categories is as follows:

## Equity-Related Securities

Equity-related securities, including warrants, are valued using one or more of the following basic methods of valuation:

**A. Cost.** This method may be used in the early stages of a company's development until significant positive or negative events occur subsequent to the date of the original investment that dictate a change to another valuation method.

**B. Analytical Method.** The analytical method is generally used to value an investment position when there is no established public or private market in the company's securities. This valuation method is inherently imprecise and ultimately the result of reconciling the judgments of our Valuation Committee members, based on the data available to them. The resulting valuation, although stated as a precise number, is necessarily within a range of values that vary depending upon the significance attributed to the various factors being considered.

The analytical method considers the following factors:

- The cost of the Company's investment;
- Transactions in a company's securities or unconditional firm offers by responsible parties as a factor in determining valuation;
- The financial condition and operating results of the company;
- The long-term potential of the business and technology of the company;
- The values of similar securities issued by companies in similar businesses;
- Multiples to revenue, net income or EBITDA that similar securities issued by companies in similar businesses receive;
- The proportion of the company's securities we own and the nature of any rights to require the company to register restricted securities under applicable securities laws; and
- The rights and preferences of the class of securities we own as compared to other classes of securities the portfolio company has issued.

When the analytical method is used to value warrants, the Company utilizes the Black-Scholes model.

**C. Private Market.** The private market method uses actual, executed, historical transactions in a company's securities by responsible third parties as a basis for valuation. The private market method may also use, where applicable, unconditional firm offers by responsible third parties as a basis for valuation.

**D. Public Market.** The public market method is used when there is an established public market for the class of the company's securities held by us or into which our securities are convertible. We discount market value for securities that are subject to significant legal and contractual restrictions. Other securities, for which market quotations are readily available, are carried at market value as of the time of valuation. Market value for securities traded on securities exchanges or on the Nasdaq Global Market is the last reported sales price on the day of valuation. For other securities traded in the over-the-counter market and listed securities for which no sale was reported on that day, market value is the mean of the closing bid price and asked price on that day. This method is the preferred method of valuation when there is an established public market for a company's securities, as that market provides the most objective basis for valuation. If for any reason, the Valuation Committee determines that market quotations are not reliable, such securities shall be fair valued by the Valuation Committee in accordance with these Valuation Procedures.

### **Investments in Intellectual Property or Patents or Research and Development in Technology or Product Development**

These investments are carried at fair value using the following basic methods of valuation:

**E. Cost.** This method may be used in the early stages of commercializing or developing intellectual property or patents or research and development in technology or product development until significant positive or adverse events occur subsequent to the date of the original investment that dictate a change to another valuation method.

**F. Analytical Method.** The analytical method is used to value an investment after analysis of the best available outside information where the factual information available to us dictates that an investment should no longer be valued under either the cost or private market method. This valuation method is inherently imprecise and ultimately the result of reconciling the judgments of our Valuation Committee members. The resulting valuation, although stated as a precise number, is necessarily within a range of values that vary depending upon the significance attributed to the various factors being considered. Some of the factors considered may include the results of research and development, product development progress, commercial prospects, term of patent and projected markets.

The analytical method considers the following factors:

- The cost of the investment;
- Investments in the same or substantially similar intellectual property or patents or research and development in technology or product development or offers by responsible third parties;
- The results of research and development;
- Product development progress;
- Commercial prospects;
- Term of patent;
- Projected markets; and
- Other subjective factors.

**G. Private Market.** The private market method uses actual third-party investments in intellectual property or patents or research and development in technology or product development as a basis for valuation, using actual executed historical transactions by responsible third parties. The private market method may also use, where applicable, unconditional firm offers by responsible third parties as a basis for valuation.

As of December 31, 2007, and December 31, 2006, we do not have any investments in intellectual property or patents or research and development in technologies or products.

#### **Long-Term Fixed-Income Securities**

**H. Readily Marketable.** Long-term, fixed-income securities for which market quotations are readily available are carried at market value as of the time of valuation using the most recent bid quotations when available.

**I. Not Readily Marketable.** Long-term, fixed-income securities for which market quotations are not readily available are carried at fair value as determined in good faith by the Valuation Committee on the basis of available data, which may include credit quality and interest rate analysis, as well as quotations from dealers and brokers. Where such quotations are not available, fair value is determined using prices from independent pricing services that the Board believes are reasonably reliable and based on reasonable price discovery procedures and data from other sources.

### **Short-Term Fixed-Income Securities**

**J. Short-Term Fixed-Income Securities** are valued in the same manner as long-term fixed-income securities until the remaining maturity is 60 days or less, after which time such securities may be valued at amortized cost if there is no concern over payment at maturity.

### **All Other Securities**

**K. All Other Securities** are reported at fair value as determined in good faith by the Valuation Committee. As of December 31, 2007, and December 31, 2006, we did not have any of these investments.

For all other securities, the reported values shall reflect the Valuation Committee's judgment of fair values as of the valuation date using the outlined basic methods of valuation or any other method of valuation within the prescribed guidelines that the Valuation Committee determines after review and analysis is more appropriate for the particular kind of investment. They do not necessarily represent an amount of money that would be realized if we had to sell such assets in an immediate liquidation. Thus, valuations as of any particular date are not necessarily indicative of amounts that we may ultimately realize as a result of future sales or other dispositions of investments we hold.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1. THE COMPANY**

Harris & Harris Group, Inc. (the "Company," "us," "our" and "we"), is a venture capital company operating as a business development company ("BDC") under the Investment Company Act of 1940 ("1940 Act"). We operate as an internally managed company whereby our officers and employees, under the general supervision of our Board of Directors, conduct our operations.

We elected to become a BDC on July 26, 1995, after receiving the necessary shareholder approvals. From September 30, 1992, until the election of BDC status, we operated as a closed-end, non-diversified investment company under the 1940 Act. Upon commencement of operations as an investment company, we revalued all of our assets and liabilities in accordance with the 1940 Act. Prior to September 30, 1992, we were registered and filed under the reporting requirements of the Securities Exchange Act of 1934 (the "1934 Act") as an operating company and, while an operating company, operated directly and through subsidiaries.

Harris & Harris Enterprises, Inc.,<sup>SM</sup> is a 100 percent wholly owned subsidiary of the Company. Harris & Harris Enterprises, Inc., is a partner in Harris Partners I, L.P.,<sup>SM</sup> and is taxed under Subchapter C of the Code (a "C Corporation"). Harris Partners I, L.P., is a limited partnership and owned our interest in AlphaSimplex Group, LLC. The partners of Harris Partners I, L.P., are Harris & Harris Enterprises, Inc., (sole general partner) and Harris & Harris Group, Inc., (sole limited partner). Harris & Harris Enterprises, Inc., pays taxes on any non-passive investment income generated by Harris Partners I, L.P. The Company consolidates the results of its subsidiaries for financial reporting purposes.

**NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The following is a summary of significant accounting policies followed in the preparation of the consolidated financial statements:

Principles of Consolidation. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for investment companies and include the accounts of the Company and its wholly owned subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation.

Use of Estimates. The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and contingent assets and liabilities as of December 31, 2007, and December 31, 2006, and the reported amounts of revenues and expenses for the twelve months ended December 31, 2007, 2006, and 2005. Actual results could differ from these estimates, and the differences could be material. The most significant estimates relate to the fair valuations of certain of our investments. At December 31, 2007, and 2006, 54.6 percent and 45.4 percent, respectively, of the Company's total assets represented portfolio investments whose fair values have been determined by the Board of Directors in good faith in the absence of readily available market values.

Cash and Cash Equivalents. Cash and cash equivalents includes demand deposits and money market instruments with maturities of less than three months. Cash and cash equivalents are carried at cost which approximates fair value.

Portfolio Investment Valuations. Investments are stated at "value" as defined in the 1940 Act and in the applicable regulations of the SEC. Value, as defined in Section 2(a)(41) of the 1940 Act, is (i) the market price for those securities for which a market quotation is readily available and (ii) the fair value as determined in good faith by, or under the direction of, the Board of Directors for all other assets. (See "Valuation Procedures" in the "Footnote to Consolidated Schedule of Investments.") At December 31, 2007, and 2006, our financial statements include private venture capital investments valued at \$78,110,384 and \$53,667,831, respectively, the fair values of which were determined in good faith by, or under the direction, of the Board of Directors. Upon sale of investments, the values that are ultimately realized may be different from what is presently estimated. The difference could be material.

Foreign Currency Translation. The accounting records of the Company are maintained in U.S. dollars. All assets and liabilities denominated in foreign currencies are translated into U.S. dollars based on the rate of exchange of such currencies against U.S. dollars on the date of valuation. For the year ended December 31, 2007, included in the net decrease in unrealized depreciation on investments was a \$307,636 gain resulting from foreign currency translation.

Securities Transactions. Securities transactions are accounted for on the date the securities are purchased or sold (trade date).

Interest Income Recognition. Interest income, adjusted for amortization of premium and accretion of discount, is recorded on accrual basis. The Company ceases accruing interest when securities are determined to be non-income producing and writes off any previously accrued interest.

Realized Gain or Loss and Unrealized Appreciation or Depreciation of Portfolio Investments. Realized gain or loss is recognized when an investment is disposed of and is computed as the difference between the Company's cost basis in the investment at the disposition date and the net proceeds received from such disposition. Realized gains and losses on investment transactions are determined by specific identification. Unrealized appreciation or depreciation is computed as the difference between the fair value of the investment and the cost basis of such investment.

Stock-Based Compensation. The Company has a stock-based employee compensation plan. The Company accounts for the plan in accordance with the provisions of Statement of Financial Accounting Standards ("SFAS") No. 123(R), "Share-Based Payment." See "Note 4. Stock-Based Compensation" for further discussion.



Income Taxes. As we intend to qualify as a RIC under Subchapter M of the Internal Revenue Code, the Company does not provide for income taxes. Our taxes are accounted for in accordance with SFAS No. 109, "Accounting for Income Taxes."

However, we pay federal, state and local income taxes on behalf of our wholly owned subsidiary, Harris & Harris Enterprises, Inc., which is a C corporation. See "Note 8. Income Taxes."

In June 2006, the FASB issued Interpretation 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), an interpretation of SFAS No. 109. FIN 48 clarifies the accounting and reporting for income taxes where interpretation of the law is uncertain. FIN 48 prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of income tax uncertainties with respect to positions taken or expected to be taken in income tax returns. The Company adopted FIN 48 on January 1, 2007, which had no effect on the Company's financial statements. The Company recognizes interest and penalties in income tax expense. See "Note 8. Income Taxes" for further discussion.

Restricted Funds. The Company maintains a rabbi trust for the purposes of accumulating funds to satisfy the obligations incurred by us for the Supplemental Executive Retirement Plan ("SERP") under the employment agreement with Charles E. Harris.

Property and Equipment. Property and equipment are included in "Other Assets" and are carried at cost, less accumulated depreciation of \$336,877. Depreciation is provided using the straight-line method over the estimated useful lives of the premises and equipment.

Concentration of Credit Risk. The Company places its cash and cash equivalents with financial institutions and, at times, cash held in checking accounts may exceed the Federal Deposit Insurance Corporation insured limit.

Recent Accounting Pronouncements. In September 2006, FASB issued SFAS No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 is effective for us on January 1, 2008. The adoption of SFAS No. 157 will not have a material impact on our consolidated financial statements.

In February 2007, the FASB issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"). SFAS No. 159 would allow the Company an irrevocable election to measure certain financial assets and liabilities at fair value, with unrealized gains and losses on the elected items recognized in earnings at each reporting period. The fair value option may only be elected at the time of initial recognition of a financial asset or financial liability or upon the occurrence of certain specified events. The election is applied on an instrument-by-instrument basis, with a few exceptions, and is applied only to entire instruments and not to portions of instruments. SFAS No. 159 also provides expanded disclosure requirements regarding the effects of electing the fair value option on the financial statements. SFAS No. 159 is effective prospectively for fiscal years beginning after November 15, 2007. The Company is currently evaluating this Statement. However, as investments are carried at fair value, the Company does not anticipate that this Statement will have a significant impact on the consolidated financial statements.

**NOTE 3. INVESTMENTS**

The private placement portfolio at fair value consisted of the following geographic regions at December 31, 2007, and 2006:

**December 31, 2007**

<b>Geographic Region</b>	<b>Fair Value</b>	<b>Percentage of Total Private Placement Portfolio</b>	<b>Percentage of Net Assets</b>
West	\$ 50,124,606	64.2%	36.2%
Northeast	\$ 16,849,547	21.6%	12.2%
Midwest	\$ 4,659,743	6.0%	3.4%
Southeast	\$ 4,250,000	5.4%	3.1%
Outside U.S.	\$ 2,226,488	2.8%	1.6%
	<b>\$ 78,110,384</b>	<b>100.0%</b>	

**December 31, 2006**

<b>Geographic Region</b>	<b>Fair Value</b>	<b>Percentage of Total Private Placement Portfolio</b>	<b>Percentage of Net Assets</b>
West	\$ 29,759,833	55.5%	26.1%
Northeast	\$ 11,856,596	22.1%	10.4%
Midwest	\$ 6,834,958	12.7%	6.0%
Southeast	\$ 3,500,000	6.5%	3.1%
Outside U.S.	\$ 1,716,444	3.2%	1.5%
	<b>\$ 53,667,831</b>	<b>100.0%</b>	

**NOTE 4. STOCK-BASED COMPENSATION**

On March 23, 2006, the Board of Directors of the Company voted to terminate the Employee Profit-Sharing Plan and to establish the Stock Plan, subject to shareholder approval. This proposal was approved at the May 4, 2006, Annual Meeting of Shareholders. The Stock Plan provides for the grant of equity-based awards of stock options to our officers, employees and directors (subject to receipt of an exemptive order described below) and restricted stock (subject to receipt of an exemptive order described below) to our officers and employees who are selected by our Compensation Committee for participation in the plan and subject to compliance with the 1940 Act.

On July 11, 2006, the Company filed an application with the SEC regarding certain provisions of the Stock Plan, and on June 29, 2007, the Company responded to comments from the SEC on the application. In the event that the SEC provides the exemptive relief requested by the application, and we receive any additional stockholder approval required by the SEC, the Compensation Committee may, in the future, authorize awards of stock options under the Stock Plan to non-employee directors of the Company and authorize grants of restricted stock to employees.

A maximum of 20 percent of our total shares of our common stock issued and outstanding are available for awards under the Stock Plan. Under the Stock Plan, no more than 25 percent of the shares of stock reserved for the grant of the awards under the Stock Plan may be restricted stock awards at any time during the term of the Stock Plan. If any shares of restricted stock are awarded, such awards will reduce on a percentage basis the total number of shares of stock for which options may be awarded. If the Company does not receive exemptive relief from the SEC to issue restricted stock, all shares granted under the Stock Plan may be subject to stock options. No more than 1,000,000 shares of our common stock may be made subject to awards under the Stock Plan to any individual in any year.

On June 26, 2006, the Compensation Committee of the Board of Directors of the Company approved individual stock option awards for certain officers and employees of the Company. Both non-qualified stock options ("NQSOs") and incentive stock options ("ISOs"), subject to the limitations of Section 422 of the Internal Revenue Code, were awarded under the Stock Plan. The terms and conditions of the stock options granted were determined by the Compensation Committee and set forth in award agreements between the Company and each award recipient. Options to purchase a total of 3,958,283 shares of stock were granted with vesting periods ranging from December 2006 to June 2014 and with an exercise price of \$10.11. Upon exercise, the shares will be issued from our previously authorized shares. The full Board of Directors ratified and approved the grants on August 3, 2006, on which date the Company's common stock price fluctuated between \$9.76 and \$10.00.

On June 27, 2007, the Compensation Committee of the Board of Directors and the full Board of Directors of the Company approved a new grant of individual NQSO awards for certain officers and employees of the Company. The terms and conditions of the stock options granted were set forth in award agreements between the Company and each award recipient entered into on that date. Options to purchase a total of 1,700,609 shares of stock were granted with vesting periods ranging from December 2007 to June 2014 and with an exercise price of \$11.11, which was the closing volume weighted average price of our shares of common stock on June 27, 2007. Upon exercise, the shares would be issued from our previously authorized but unissued shares.

The Company accounts for the Stock Plan in accordance with the provisions of SFAS No. 123(R), "Share-Based Payment," which requires that we determine the fair value of all share-based payments to employees, including the fair value of grants of employee stock options, and record these amounts as an expense in the Statement of Operations over the vesting period with a corresponding increase to our additional paid-in capital. At December 31, 2007, the increase to our operating expenses was offset by the increase to our additional paid-in capital, resulting in no net impact to our net asset value. Additionally, the Company does not record the tax benefits associated with the expensing of stock options, because the Company currently intends to qualify as a RIC under Subchapter M of the Code.

An option's expected term is the estimated period between the grant date and the exercise date of the option. As the expected term period increases, the fair value of the option and the non-cash compensation cost will also increase. The expected term assumption is generally calculated using historical stock option exercise data. The Company does not have historical exercise data to develop such an assumption. In cases where companies do not have historical data and where the options meet certain criteria, SEC Staff Accounting Bulletin 107 ("SAB 107") provides the use of a simplified expected term calculation. Accordingly, the Company calculated the expected terms using the SAB 107 simplified method.

Expected volatility is the measure of how the stock's price is expected to fluctuate over a period of time. An increase in the expected volatility assumption yields a higher fair value of the stock option. Expected volatility factors for the stock options were based on the historical fluctuations in the Company's stock price over a period commensurate with the expected term of the option, adjusted for stock splits and dividends.

The expected dividend yield assumption is traditionally calculated based on a company's historical dividend yield. An increase to the expected dividend yield results in a decrease in the fair value of option and resulting compensation cost. Although the Company has declared deemed dividends in previous years, most recently in 2005, the amounts and timing of any future dividends cannot be reasonably estimated. Therefore, for purposes of calculating fair value, the Company has assumed an expected dividend yield of 0 percent.

The risk-free interest rate assumptions are based on the annual yield on the measurement date of a zero-coupon U.S Treasury bond the maturity of which equals the option's expected term. Higher assumed interest rates yield higher fair values.

The amount of non-cash, stock-based compensation expense recognized in the Consolidated Statements of Operations is based on the fair value of the awards the Company expects to vest, recognized over the vesting period on a straight-line basis for each award, and adjusted for actual forfeitures that occur before vesting. The forfeiture rate is estimated at the time of grant and revised, if necessary, in subsequent periods if the actual forfeiture rate differs from the estimated rate and is accounted for in the current period and prospectively.

The fair value of each stock option award is estimated on the date of grant using the Black-Scholes option pricing model as permitted by SFAS No. 123(R). The stock options granted on June 26, 2006, were awarded in five different grant types, each with different contractual terms. The assumptions used in the calculation of fair value of the stock options granted on June 26, 2006, using the Black-Scholes model for each contract term were as follows:

Type of Award	Term	Number of Options Granted	Expected Term in Yrs	Expected Volatility Factor	Expected Dividend Yield	Risk-free Interest Rates	Weighted Average Fair Value Per Share
Non-qualified stock options	1 Year	1,001,017	0.75	37.4%	0%	5.16%	\$ 1.48
Non-qualified stock options	2 Years	815,000	1.625	45.2%	0%	5.12%	\$ 2.63
Non-qualified stock options	3 Years	659,460	2.42	55.7%	0%	5.09%	\$ 3.81
Non-qualified stock options	10 Years	690,000	5.75	75.6%	0%	5.08%	\$ 6.94
Incentive stock options	10 Years	792,806	7.03	75.6%	0%	5.08%	\$ 7.46
<b>Total</b>		<b>3,958,283</b>					<b>\$ 4.25</b>

The stock options granted on June 27, 2007, were awarded in four different grant types, each with different contractual terms. The assumptions used in the calculation of fair value of the stock options granted on June 27, 2007, using the Black-Scholes model for each contract term were as follows:

Type of Award	Contractual Term	Number of Options Granted	Expected Term in Yrs	Expected Volatility Factor	Expected Dividend Yield	Risk-free Interest Rates	Fair Value Per Share
Non-qualified stock options	1.5 Years	380,000	1	42.6%	0%	4.93%	\$ 2.11
Non-qualified stock options	2.5 Years	600,540	2	40.1%	0%	4.91%	\$ 2.92
Non-qualified stock options	3.5 Years	338,403	3	44.7%	0%	4.93%	\$ 3.94
Non-qualified stock options	9 Years	381,666	Ranging from 4.75-6.28	Ranging from 57.8% to 59.9%	0%	Ranging from 4.97% to 5.01%	Ranging from \$5.92 to \$6.85
<b>Total</b>		<b>1,700,609</b>					

For the years ended December 31, 2007, and December 31, 2006, the Company recognized \$8,050,807 and \$5,038,956 of compensation expense in the Consolidated Statements of Operations, respectively. As of December 31, 2007, there was approximately \$7,810,508 of unrecognized compensation cost related to unvested stock option awards. This cost is expected to be recognized over a weighted-average period of approximately 1.7 years.

For the year ended December 31, 2007, a total of 999,556 options were exercised for total proceeds to the Company of \$10,105,511. For the year ended December 31, 2006, a total of 258,672 shares were exercised for total proceeds to the Company of \$2,615,190. At December 31, 2006, the Company had a broker receivable totaling \$819,905 for proceeds from stock option exercises transacted on December 29, 2006. The Company received these proceeds on January 3, 2007.

The grant date fair value of options vested during the years ended December 31, 2007, and December 31, 2006, was \$6,851,874 and \$3,781,681, respectively.

For the years ended December 31, 2007, and December 31, 2006, the calculation of the net decrease in net assets resulting from operations per share excludes the stock options because such options were anti-dilutive. The options may be dilutive in future periods in which there is a net increase in net assets resulting from operations, in the event that there is a significant increase in the average stock price in the stock market or significant decreases in the amount of unrecognized compensation cost.

A summary of the changes in outstanding stock options is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term (Yrs)	Aggregate Intrinsic Value
Options Outstanding at December 31, 2006	3,699,611	\$ 10.11	\$ 4.43		
Granted	1,700,609	\$ 11.11	\$ 3.68	3.43	
Exercised	(999,556)	\$ 10.11	\$ 1.97		
Forfeited or Expired	(432,920)		\$ 3.99		
Options Outstanding at December 31, 2007	3,967,744	\$ 10.54	\$ 4.77	4.58	\$ 0
Options Exercisable at December 31, 2007	1,717,125	\$ 10.43	\$ 4.45	4.18	\$ 0
Options Exercisable and Expected to be Exercisable at December 31, 2007	3,858,226	\$ 10.55	\$ 4.70	4.47	\$ 0

The aggregate intrinsic value in the table above with respect to options outstanding, exercisable and expected to be exercisable, is calculated as the difference between the Company's closing stock price of \$8.79 on the last trading day of 2007 and the exercise price, multiplied by the number of in-the-money options. This calculation represents the total pre-tax intrinsic value that would have been received by the option holders had all options been fully vested and all option holders exercised their awards on December 31, 2007.

For the twelve months ended December 31, 2007, the aggregate intrinsic value of the 999,556 options exercised was \$1,700,552. For the twelve months ended December 31, 2006, the aggregate intrinsic value for the 258,672 options exercised was \$512,171.

Unless earlier terminated by our Board of Directors, the Stock Plan will expire on May 4, 2016. The expiration of the Stock Plan will not by itself adversely affect the rights of plan participants under awards that are outstanding at the time the Stock Plan expires. Our Board of Directors may terminate, modify or suspend the plan at any time, provided that no modification of the plan will be effective unless and until any required shareholder approval has been obtained. The Compensation Committee may terminate, modify or amend any outstanding award under the Stock Plan at any time, provided that in such event, the award holder may exercise any vested options prior to such termination of the Stock Plan or award.

#### **NOTE 5. EMPLOYEE PROFIT-SHARING PLAN**

Prior to the adoption of the Stock Plan, the Company operated the Amended and Restated Harris & Harris Group, Inc. Employee Profit-Sharing Plan (the "2002 Plan"). Effective May 4, 2006, the 2002 Plan was terminated.

The 2002 Plan (and its predecessor) provided for profit sharing by our officers and employees equal to 20 percent of our "qualifying income" for that plan year.

As soon as practicable following the year-end, the Compensation Committee determined whether, and if so how much, qualifying income existed for a plan year. Approximately 90 percent of the amount determined by the Compensation Committee was then paid out to plan participants pursuant to the distribution percentages set forth in the 2002 Plan. The remaining payment was paid out after we finalized our tax returns for that plan year.

At December 31, 2006, we accrued \$261,661 for profit sharing related to the 2005 plan year. On March 1, 2006, the Company paid \$1,897,072 to plan participants (employees and former employees), which represented approximately 90 percent of the total estimated profit-sharing payment for 2005. The balance of \$261,661 related to the 2005 plan year was paid on January 31, 2007, upon finalization of our tax returns.

**NOTE 6. DISTRIBUTABLE EARNINGS**

As of December 31, 2007, December 31, 2006, and December 31, 2005, there were no distributable earnings. The difference between the book basis and tax basis components of distributable earnings is primarily nondeductible deferred compensation and net operating losses.

On December 20, 2005, the Company declared a designated undistributed capital gain dividend ("deemed dividend") for shareholders of record as of December 31, 2005. The deemed dividend for 2005 was \$23,206,763. See "Note 8. Income Taxes." The Company did not declare dividends for the years ended December 31, 2007, or December 31, 2006.

**NOTE 7. EMPLOYEE BENEFITS**

**Employment Agreement with CEO**

Pursuant to his employment agreement, as most recently amended as of August 2, 2007 (the "Employment Agreement"), during the period of employment, Charles E. Harris is to receive compensation in the form of base salary, with automatic yearly adjustments to reflect inflation, which amounted to a minimum required base salary of \$246,651 for 2006. In addition, the Board may increase such salary, and subsequently decrease it, but not below the level provided for by the automatic adjustments described above. Mr. Harris's base salary for 2006 was increased to \$300,000 (thereby also increasing his SERP benefit as described below) in part in recognition of a 74 percent decrease in Mr. Harris's profit-sharing allocation in recent years in order to provide additional profit sharing to other employees. This was the first salary increase for Mr. Harris, other than cost-of-living adjustments, since 1994. Mr. Harris's base salary for 2007 and 2008 was increased to \$306,187 and \$314,623, respectively, based on cost-of-living adjustments.

Under his employment agreement, Mr. Harris is entitled to participate in all compensation and employee benefit plans or programs, and to receive all benefits, perquisites, and emoluments for which salaried employees are eligible. Under the Employment Agreement, we furnish Mr. Harris with certain perquisites, which include a company car, health-club membership, membership in certain social or country clubs, a reimbursement for an annual physical examination and up to a \$5,000 annual reimbursement, adjusted for inflation, over the period of the agreement, for personal financial or tax advice.

The Employment Agreement also provides Mr. Harris with life insurance for the benefit of his designated beneficiary in the amount of at least \$2,000,000; provides reimbursement for uninsured medical expenses, not to exceed \$10,000 per annum, adjusted for inflation, over the period of the agreement; provides Mr. Harris and his spouse with long-term care insurance; and provides Mr. Harris with disability insurance providing for continuation of 100 percent of his base salary for a specified period. These benefits are for the term of the Employment Agreement. The Employment Agreement provides that the term of Mr. Harris's employment may not be extended beyond December 31, 2008, unless a committee of the Board consisting of non-interested Directors extends the date by one year pursuant to the Executive Mandatory Retirement Benefit Plan, and Mr. Harris agrees to serve beyond December 31, 2008.



Mr. Harris's Employment Agreement also provides for a supplemental executive retirement plan (the "SERP") and a severance compensation agreement for his benefit as discussed below.

In the event of termination without cause or by constructive discharge, Mr. Harris's Employment Agreement provides for the continuation of certain benefits over specified periods, as well as severance pay, payable to Mr. Harris (or to his estate if he dies before all payments are made), equal to two times his base salary distributed over a period of two years.

Other than Mr. Harris, our Chairman and Chief Executive Officer, none of our executive officers has a change in control agreement. None of our executive officers is entitled to any special payments solely upon a change in control.

In addition, Mr. Harris is entitled to receive severance pay pursuant to the severance compensation agreement that he entered into with us, effective August 15, 1990, and amended and restated effective as of January 1, 2005. The severance compensation agreement provides that if, following a change in our control, as defined in the agreement, Mr. Harris's employment is terminated by us without cause or by him within one year of such change in control, he shall be entitled to receive compensation in a lump sum payment equal to 2.99 times his average base salary plus other amounts included in Mr. Harris's income as compensation from the Company (but excluding bonus, incentive, profit sharing plan and equity compensation) as in effect over the most recent five years preceding the year in which the change in control occurred. Under the severance compensation agreement, Mr. Harris is also entitled to receive a lump sum payment equal to any amounts forfeited on account of his termination, under any employee pension benefit plan, including benefits under the Company's executive mandatory retirement benefit plan. In addition, he is entitled to receive medical and health insurance coverage under the Company's retiree medical benefit plan and all other benefits he would be eligible to receive in the event of termination without cause or by constructive discharge, although no duplicate benefits will be provided. In the event that Mr. Harris is entitled to receive 2.99 times his base salary under the severance compensation agreement, he shall not also be paid two times his base salary under the employment agreement.

### **SERP**

The Employment Agreement provides that we adopt a supplemental executive retirement plan (the "SERP") for the benefit of Mr. Harris. Under the SERP, we will cause an amount equal to one-twelfth of Mr. Harris's current annual salary to be credited each month to a special account maintained on our books for the benefit of Mr. Harris, provided that Mr. Harris is employed by us on the last business day of such month. The amounts credited to the SERP Account are deemed invested or reinvested in such investments as are requested by Mr. Harris and agreed to by the Company. The SERP Account is credited and debited to reflect the deemed investment returns, losses and expenses attributed to such deemed investments and reinvestments in accordance with the terms of the SERP. Mr. Harris's benefit under the SERP equals the balance in the SERP Account and such benefit will always be 100 percent vested (i.e., not forfeitable).

In 2005, Mr. Harris received a \$125,000 distribution from the SERP Account. The balance of the SERP Account will be paid in a lump sum on May 30, 2008, and any subsequent balance will be paid on July 31, 2009.

If Mr. Harris dies before the entire benefit under the SERP Account has been paid to him, the amount remaining in the SERP Account will be distributed to his beneficiary in a lump-sum payment on the 90<sup>th</sup> day after the date of his death.

We have established a rabbi trust for the purpose of accumulating funds to satisfy the obligations incurred by us under the SERP, which amounted to \$2,667,020 and \$2,149,785 at December 31, 2007, and 2006, respectively, and is included in accounts payable and accrued liabilities. The restricted funds for the SERP Account totaled \$2,667,020 and \$2,149,785 at December 31, 2007, and 2006, respectively. Mr. Harris's rights to benefits pursuant to this SERP will be no greater than those of a general creditor of us.

#### **401(k) Plan**

We adopted a 401(k) Plan covering substantially all of our employees. Matching contributions to the plan are at the discretion of the Compensation Committee. For the year ended December 31, 2007, the Compensation Committee approved a 100 percent match which amounted to \$176,873. The 401(k) Company match for the years ended December 31, 2006 and 2005 was \$155,000 and \$119,360, respectively.

#### **Medical Benefit Retirement Plan**

On June 30, 1994, we adopted a plan to provide medical and dental insurance for retirees, their spouses and dependents who, at the time of their retirement, have ten years of service with us and have attained 50 years of age or have attained 45 years of age and have 15 years of service with us. On February 10, 1997, we amended this plan to include employees who have seven full years of service and have attained 58 years of age. On November 3, 2005, we amended this plan to reverse the 1997 amendment for future retirees and to remove dependents other than spouses from the plan. The coverage is secondary to any government or subsequent employer provided health insurance plans. The annual premium cost to us with respect to the entitled retiree shall not exceed \$12,000, subject to an index for inflation. On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") was signed into law. The Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. The Act, which went into effect January 1, 2006, provides a 28 percent subsidy for post-65 prescription drug benefits. Our liability assumes our plan is actuarially equivalent under the Act.

The stock options of retirees who qualify for the Medical Benefit Retirement Plan will remain exercisable (to the extent exercisable at the time of the optionee's termination) post retirement, if such retiree executes a post-termination non-solicitation agreement in a form reasonably acceptable to the Company, until the expiration of its term.

The plan is unfunded and has no assets. The following disclosures about changes in the benefit obligation under our plan to provide medical and dental insurance for retirees are as of the measurement date of December 31:

	2007	2006
Accumulated Postretirement Benefit Obligation at Beginning of Year	\$ 696,827	\$ 675,334
Service Cost	102,676	79,381
Interest Cost	33,935	33,786
Actuarial (Gain)/Loss	(196,248)	(84,879)
Benefits Paid	(8,445)	(6,795)
<b>Accumulated Postretirement Benefit Obligation at End of Year</b>	<b>\$ 628,745</b>	<b>\$ 696,827</b>

In accounting for the plan, the assumption made for the discount rate was 6.55 percent and 5.75 percent for the years ended December 31, 2007, and 2006, respectively. The assumed health care cost trend rates in 2007 were 9 percent grading to 6 percent over three years for medical and 5 percent per year for dental. The assumed health care cost trend rates in 2006 were 9 percent grading to 6 percent over three years for medical and 3 percent per year for dental. The effect on disclosure information of a one percentage point change in the assumed health care cost trend rate for each future year is shown below.

	1% Decrease in Rates	Assumed Rates	1% Increase in Rates
Aggregated Service and Interest Cost	\$ 105,317	\$ 136,611	\$ 179,692
Accumulated Postretirement Benefit Obligation	\$ 606,717	\$ 628,745	\$ 883,758

The net periodic postretirement benefit cost for the year is determined as the sum of service cost for the year, interest on the accumulated postretirement benefit obligation and amortization of the transition obligation (asset) less previously accrued expenses over the average remaining service period of employees expected to receive plan benefits. The following is the net periodic postretirement benefit cost for the years ended December 31, 2007, 2006, and 2005:

	2007	2006	2005
Service Cost	\$ 102,676	\$ 79,381	\$ 49,990
Interest Cost on Accumulated Postretirement Benefit Obligation	33,935	33,786	32,573
Amortization of Transition Obligation	0	0	0
Amortization of Net (Gain)/Loss	(6,234)	0	0
<b>Net Periodic Post Retirement Benefit Cost</b>	<b>\$ 130,377</b>	<b>\$ 113,167</b>	<b>\$ 82,563</b>

The Company estimates the following benefits to be paid in each of the following years:

2008	\$ 18,489
2009	\$ 23,639
2010	\$ 25,584
2011	\$ 20,213
2012	\$ 21,663
2013 through 2017	\$ 135,078

The contribution payable for 2008 is estimated to be \$18,489.

On December 31, 2006, the Company adopted the recognition and disclosure provisions of SFAS No. 158. SFAS No. 158 required the Company to recognize the funded status of its retirement benefit plans in the December 31, 2006 statement of assets and liabilities with a corresponding adjustment to net assets. The adjustment to net assets at adoption of \$61,527 represents the net unrecognized actuarial gains of \$95,145 applicable to the healthcare benefit plan net of \$33,618 of unrecognized actuarial losses applicable to the Executive Mandatory Retirement Benefit Plan. Such amounts previously were reflected as a net increase of the plan's funded status in the Company's statement of assets and liabilities pursuant to the provisions of SFAS Nos. 106 and 187. These amounts will be subsequently recognized as net periodic benefit cost pursuant to the Company's historical accounting policy for amortizing such amounts. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic benefit cost in the same periods will be recognized as a component of net assets. Those amounts will be subsequently recognized as a component of net periodic benefit cost on the same basis as the amounts recognized at adoption of SFAS No. 158.

For the year ended December 31, 2007, net unrecognized actuarial gains, which resulted from the increase in the discount rate referred to above, increased by \$190,014, which represents \$196,248 of actuarial gains arising during the year, net of a \$6,234 reclassification adjustment which reduced the net periodic benefit cost for the year.

**Executive Mandatory Retirement Benefit Plan**

On March 20, 2003, in order to begin planning for eventual management succession, the Board of Directors voted to establish the Executive Mandatory Retirement Benefit Plan for individuals who are employed by us in a bona fide executive or high policy-making position. The plan was amended and restated effective January 1, 2005, to comply with certain provisions of the Internal Revenue Code. There are currently four individuals that qualify under the plan: Charles E. Harris, the Chairman and Chief Executive Officer, Douglas W. Jamison, the President and Chief Operating Officer, Daniel B. Wolfe, the Chief Financial Officer, and Mel P. Melsheimer, the former President, Chief Operating Officer and Chief Financial Officer. Under this plan, mandatory retirement takes place effective December 31 of the year in which the eligible individuals attain the age of 65. On an annual basis beginning in the year in which the designated individual attains the age of 65, a committee of the Board consisting of non-interested directors may determine for our benefit to postpone the mandatory retirement date for that individual for one additional year.

Under applicable law prohibiting discrimination in employment on the basis of age, we can impose a mandatory retirement age of 65 for our executives or employees in high policy-making positions only if each employee subject to the mandatory retirement age is entitled to an immediate retirement benefit at retirement age of at least \$44,000 per year. The benefits payable at retirement to Mr. Harris and Mr. Melsheimer under our existing 401(k) plan do not equal this threshold. The plan was established to provide the difference between the benefit required under the age discrimination laws and that provided under our existing plans. For individuals retiring after 2007, the benefit under the plan is paid to the qualifying individual in the form of a lump sum, and is paid six months and one day after the individual's separation from service with the Company, pursuant to certain exceptions.

At December 31, 2007, and 2006, we had accrued \$382,932 and \$347,075, respectively, for benefits under this plan. At December 31, 2007, \$235,630 was accrued for Mr. Melsheimer and \$147,302 was accrued for Mr. Harris. Currently, there is no accrual for Mr. Jamison or Mr. Wolfe. This benefit will be unfunded, and the expense as it relates to Mr. Melsheimer and Mr. Harris is being amortized over the fiscal periods through the years ended December 31, 2004, and 2008, respectively. On December 31, 2004, Mr. Melsheimer retired pursuant to the Executive Mandatory Retirement Benefit Plan. His annual benefit under the plan is \$22,915. Mr. Harris's projected mandatory benefit will be approximately \$147,302 and paid as a lump sum six months and one day after his retirement.

**NOTE 8. INCOME TAXES**

We filed for the 1999 tax year to elect treatment as a regulated investment company ("RIC") under Subchapter M of the Internal Revenue Code of 1986 (the "Code") and qualified for the same treatment for the years 2000 through 2007. However, there can be no assurance that we will qualify as a RIC for 2008 or subsequent years.

In the case of a RIC, which furnishes capital to development corporations, there is an exception to the rule relating to the diversification of investments required to qualify for RIC treatment. This exception is available only to registered management investment companies which the SEC determines to be principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available ("SEC Certification"). We have received SEC Certification since 1999, including for 2006, but it is possible that we may not receive SEC Certification in future years.

In addition, under certain circumstances, even if we qualified for Subchapter M treatment for a given year, we might take action in a subsequent year to ensure that we would be taxed in that subsequent year as a C Corporation, rather than as a RIC. As a RIC, we must, among other things, distribute at least 90 percent of our investment company taxable income and may either distribute or retain our realized net capital gains on investments.

Provided that a proper election is made, a corporation taxable under Subchapter C of the Code or a C Corporation that elects to qualify as a RIC continues to be taxable as a C Corporation on any gains realized within 10 years of its qualification as a RIC (the "Inclusion Period") from sales of assets that were held by the corporation on the effective date of the RIC election ("C Corporation Assets"), to the extent of any gain built into the assets on such date ("Built-In Gain"). If the corporation fails to make a proper election, it is taxable on its Built-In Gain as of the effective date of its RIC election. We had Built-In Gains at the time of our qualification as a RIC and made the election to be taxed on any Built-In Gain realized during the Inclusion Period.

To the extent that we retain capital gains and declare a deemed dividend to shareholders, the dividend is taxable to the shareholders. We would pay tax on behalf of shareholders, at the corporate rate, on the distribution, and the shareholders would receive a tax credit equal to their proportionate share of the tax paid. We took advantage of this rule for 2005. Included in net realized income from investments for the year ended December 31, 2005, were net realized gains before taxes of \$23,862,037, which consisted primarily of a net realized long term capital gain on the sale of our investment in Neurometrix, Inc., offset by realized net long term capital losses on the sales of Agile Materials & Technologies, Inc., Experion Systems, Inc., Nanotechnologies, Inc., and Optiva, Inc. We applied \$140,751 of our capital loss carryforwards and \$501,640 of our pre-1999 loss carryforwards on Built-In Gains to these gains.

In December 2005, we declared a deemed dividend on net taxable realized long-term capital gains of \$23,206,763. The Company recorded a tax payable on its Consolidated Statements of Assets and Liabilities of \$8,122,367 for taxes payable on behalf of its shareholders. This distribution of \$8,122,367 was also recorded as an income tax expense on the Consolidated Statements of Operations for the year ended December 31, 2005. Shareholders of record at December 31, 2005, received a tax credit of \$0.39131971 per share. The balance of \$15,084,396 was retained by the Company. The Company paid \$8,122,367 of taxes on behalf of its shareholders on January 30, 2006. At December 31, 2005, we had \$1,514,967 accrued for federal and state income taxes payable upon filing of our 2005 tax returns.

For federal tax purposes, the Company's 2004 through 2007 tax years remain open for examination by the tax authorities under the normal three year statute of limitations. Generally, for state tax purposes, the Company's 2004 through 2007 tax years remain open for examination by the tax authorities under a four year statute of limitations.

For the twelve months ended December 31, 2007, we paid \$74,454 in interest and penalties related to the federal income tax on Built-In Gains recognized in the Company's 2005 tax year, which is included in income tax expense. During 2007, we paid \$10,290 in federal, state and local income taxes. At December 31, 2007, we had \$0 accrued for federal, state and local taxes payable by the Company.

We pay federal, state and local taxes on behalf of our wholly owned subsidiary, Harris & Harris Enterprises, Inc., which is taxed as a C Corporation. For the years ended December 31, 2007, 2006, and 2005, our income tax expense (benefit) for Harris & Harris Enterprises, Inc., was \$3,231, \$9,475 and (\$6,411), respectively.

For the years ended December 31, 2007, 2006, and 2005, the Company's income tax (benefit) expense was allocated as follows:

	2007		2006		2005
Investment operations	\$ 0	\$	0	\$	0
Realized income on investments	87,975		(227,355)		1,530,881
Taxes paid on behalf of shareholders	0		0		8,122,367
Increase (decrease) in unrealized appreciation on investments	0		(0)		(1,364,470)
Total income tax (benefit) expense	\$ 87,975	\$	(227,355)	\$	8,288,778

The above tax expense consists of the following:

	2007		2006		2005
Current	\$ 87,975	\$	(227,355)	\$	9,653,248
Deferred — Federal	0		0		(1,364,470)
Total income tax (benefit) expense	\$ 87,975	\$	(227,355)	\$	8,288,778

Continued qualification as a RIC requires us to satisfy certain investment asset diversification requirements in future years. Our ability to satisfy those requirements may not be controllable by us. There can be no assurance that we will qualify as a RIC in subsequent years.

**NOTE 9. COMMITMENTS & GUARANTEES**

On April 17, 2003, we signed a seven-year sublease for office space at 111 West 57<sup>th</sup> Street in New York City. On December 17, 2004, we signed a sublease for additional office space at our current location. The subleases expire on April 29, 2010. Total rent expense for our office space in New York City was \$178,167 in 2007, \$174,625 in 2006 and \$171,171 in 2005. Future minimum sublease payments in each of the following years are: 2008 — \$193,083; 2009 — \$197,700; and thereafter, for the remaining term — \$65,969.

In the ordinary course of business, we indemnify our officers and directors, subject to certain regulatory limitations, for loss or liability related to their service on behalf of the Company, including serving on the Boards of Directors or as officers of portfolio companies. At December 31, 2007, and 2006, we believe our estimated exposure is minimal, and accordingly we have no liability recorded.

**NOTE 10. CAPITAL TRANSACTIONS**

On November 29, 2006, we filed a registration statement with the SEC on Form N-2 to register 4,000,000 shares of our common stock. On December 11, 2006, and on April 23, 2007, we filed amended registration statements with the SEC. On May 11, 2007, the SEC declared the registration statement effective. The common stock may be sold at prices and on terms to be set forth in one or more supplements to the prospectus from time to time.

On June 25, 2007, we completed the sale of 1,300,000 shares of our common stock for gross proceeds of \$14,027,000; net proceeds of this offering, after placement agent fees and offering costs of \$1,033,832, were \$12,993,168.

**NOTE 11. CHANGE IN NET ASSETS PER SHARE**

The following table sets forth the computation of basic and diluted per share net increases in net assets resulting from operations for the twelve months ended December 31, 2007, 2006, and 2005.

	2007	2006	2005
Numerator for (decrease) increase in net assets per share	\$ (6,716,445)	\$ (11,773,112)	\$ 6,716,376
Denominator for basic and diluted weighted average shares	22,393,030	20,759,547	18,471,770
Basic and diluted net (decrease) increase in net assets per share resulting from operations	\$ (0.30)	\$ (0.57)	\$ 0.36



**NOTE 12. SUBSEQUENT EVENTS**

On January 16, 2008, we made a \$736,019 follow-on investment that has not yet been announced in a privately held tiny technology portfolio company.

On January 31, 2008, we made a \$377,580 follow-on investment that has not yet been announced in a privately held tiny technology portfolio company.

On February 1, 2008, we made a \$25,000 follow-on investment that has not yet been announced in a privately held tiny technology portfolio company.

On February 8, 2008, we made a \$244,500 new investment in PolyRemedy, Inc.

On February 21, 2008, we made a \$1,052,174 follow-on investment that has not yet been announced in a privately held tiny technology portfolio company.

On February 25, 2008, we made a \$1,000,001 follow-on investment that has not yet been announced in a privately held tiny technology portfolio company.

On March 7, 2008, we made a \$2,000,000 follow-on investment that has not yet been announced in a privately held tiny technology portfolio company.

**NOTE 13. SELECTED QUARTERLY DATA (UNAUDITED)**

	<b>2007</b>			
	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
Total investment income	\$ 652,498	\$ 637,701	\$ 743,414	\$ 672,023
Net operating loss	\$ (2,667,118)	\$ (2,891,667)	\$ (3,117,595)	\$ (3,151,163)
Net increase (decrease) in net assets resulting from operations	\$ (6,390,160)	\$ (4,093,644)	\$ 604,237	\$ 3,163,122
Net (decrease) increase in net assets resulting from operations per average outstanding share	\$ (0.30)	\$ (0.19)	\$ 0.03	\$ 0.16
	<b>2006</b>			
	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
Total investment income	\$ 804,862	\$ 785,265	\$ 719,619	\$ 719,015
Net operating loss	\$ (767,743)	\$ (693,887)	\$ (2,988,790)	\$ (3,162,515)
Net increase (decrease) in net assets resulting from operations	\$ (1,653,990)	\$ (1,282,997)	\$ (2,588,092)	\$ (6,248,033)
Net (decrease) increase in net assets resulting from operations per average outstanding share	\$ (0.08)	\$ (0.06)	\$ (0.12)	\$ (0.31)

<b>HARRIS &amp; HARRIS GROUP, INC.</b> <b>FINANCIAL HIGHLIGHTS</b>
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	Year Ended December 31, 2007	Year Ended December 31, 2006	Year Ended December 31, 2005
<b>Per Share Operating Performance</b>			
Net asset value per share, beginning of year	\$ 5.42	\$ 5.68	\$ 4.33
Net operating (loss) income*	(0.53)	(0.37)	(0.30)
Net realized income on investments*	0.00	0.01	0.77
Net increase (decrease) in unrealized appreciation (depreciation) as a result of sales*	0.00	0.00	(1.18)
Net increase (decrease) in unrealized appreciation (depreciation) on investments held*	0.23	(0.21)	1.07
Total from investment operations*	(0.30)	(0.57)	0.36
Net increase as a result of stock- based compensation expense*	0.36	0.24	0.00
Net increase as a result of proceeds from exercise of options	0.19	0.07	0.00
Net increase as a result of stock offering	0.26	0.00	0.99
Total increase from capital stock transactions	0.81	0.31	0.99
Net asset value per share, end of year	\$ 5.93	\$ 5.42	\$ 5.68
Stock price per share, end of year	\$ 8.79	\$ 12.09	\$ 13.90
Total return based on stock price	(27.3)%	(13.0)%	(15.1)%
<b>Supplemental Data:</b>			
Net assets, end of year	\$ 138,363,344	\$ 113,930,303	\$ 117,987,742
Ratio of expenses to average net assets	11.6%	9.2%	7.5%
Ratio of net operating loss to average net assets	(9.5)%	(6.6)%	(5.8)%
Cash dividends paid per share	\$ 0.00	\$ 0.00	\$ 0.00
Taxes payable on behalf of shareholders on the deemed dividend per share	\$ 0.00	\$ 0.00	\$ 0.39
Number of shares outstanding, end of year	23,314,573	21,015,017	20,756,345

\*Based on average shares outstanding.

The accompanying notes are an integral part of this schedule.



**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.**

None.

**Item 9A. Controls and Procedures.**

Disclosure Controls and Procedures

As of the end of the period covered by this report, the Company's management, under the supervision and with the participation of our chief executive officer and chief financial officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as required by Rules 13a-15 of the Securities Exchange Act of 1934 (the "1934 Act")). Disclosure controls and procedures means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the 1934 Act is recorded, processed, summarized and reported, within time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the issuer's management, as appropriate, to allow timely decisions regarding required disclosures. As of December 31, 2007, based upon this evaluation of our disclosure controls and procedures, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective.

Internal Control Over Financial Reporting

Management's Report on Internal Control Over Financial Reporting and the Report of Independent Registered Public Accounting Firm, on the Company's internal control over financial reporting, is included in Item 8 of this Annual Report on Form 10-K.

Changes in Internal Control Over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fourth quarter of 2007 to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 9B. Other Information.**

None.

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### **PART III**

#### **Item 10. Directors and Executive Officers of the Registrant.**

The information set forth under the captions "Nominees," "Executive Officers," "Section 16(a) Beneficial Ownership Reporting Compliance" and "Audit Committee" in our Proxy Statement for the Annual Meeting of Shareholders to be held May 1, 2008, to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934 (the "2008 Proxy Statement"), is herein incorporated by reference.

We have adopted a Code of Conduct for Directors and Employees, which also applies to our Chief Executive Officer, Chief Financial Officer, Treasurer and Controller and is posted on our website at [http://www.tinytechvc.com/shareholder\\_information/Code\\_of\\_Conduct.html](http://www.tinytechvc.com/shareholder_information/Code_of_Conduct.html). You may obtain a copy of the Code of Conduct, free of charge, by calling 1-877-TINY-TECH.

The Board of Directors has determined that Dugald A. Fletcher, James E. Roberts and Richard P. Shanley are all "Audit Committee Financial Experts" serving on our Audit Committee. Messrs. Fletcher, Roberts and Shanley are independent as defined under Section 2(a)(19) of the Investment Company Act of 1940 and under the rules of the NASD.

#### **Item 11. Executive Compensation.**

The information set forth under the captions "Executive Compensation," "Compensation Committee Interlocks and Insider Participation" and "Compensation Committee Report on Executive Compensation" in the 2008 Proxy Statement is herein incorporated by reference.

#### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

The information set forth under the caption "Principal Shareholders and Ownership by Directors and Executive Officers" in the 2008 Proxy Statement is herein incorporated by reference. The "Equity Compensation Plan Information" chart is set forth under Item 5.

#### **Item 13. Certain Relationships and Related Transactions, and Director Independence.**

The information set forth under the captions "Board Committees," "Nominees" and "Related Party Transactions" in the 2008 Proxy Statement is herein incorporated by reference.

**Item 14. Principal Accountant Fees and Services.**

The information set forth under the captions "Audit Committee's Pre-Approval Policies" and "Fees Paid to PwC for 2007 and 2006" in the 2008 Proxy Statement is herein incorporated by reference.

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**PART IV**

**Item 15. Exhibits and Financial Statements Schedules.**

(a) The following documents are filed as a part of this report:

(1) Listed below are the financial statements which are filed as part of this report:

- Consolidated Statements of Assets and Liabilities as of December 31, 2007, and 2006;
- Consolidated Statements of Operations for the years ended December 31, 2007, 2006, and 2005;
- Consolidated Statements of Cash Flows for the years ended December 31, 2007, 2006, and 2005;
- Consolidated Statements of Changes in Net Assets for the years ended December 31, 2007, 2006, and 2005;
- Consolidated Schedule of Investments as of December 31, 2007;
- Consolidated Schedule of Investments as of December 31, 2006;
- Footnote to Consolidated Schedule of Investments;
- Notes to Consolidated Financial Statements; and
- Financial Highlights for the years ended December 31, 2007, 2006, and 2005.

(2) No financial statement schedules are required to be filed herewith because (i) such schedules are not required or (ii) the information has been presented in the above financial statements.

(3) The following exhibits are filed with this report or are incorporated herein by reference to a prior filing, in accordance with Rule 12b-32 under the Securities Exchange Act of 1934.

3.1(a) Restated Certificate of Incorporation of Harris & Harris Group, Inc., dated September 23, 2005, incorporated by reference as Exhibit 99 to Form 8-K (File No. 814-00176) filed on September 27, 2005.

3.1(b) Certificate of Amendment of the Certificate of Incorporation of Harris & Harris Group, Inc., dated May 19, 2006, incorporated by reference as Exhibit 3.1 to the Company's Form 10-Q (File No. 814-00176) filed on August 9, 2006.

3.2 Restated By-laws, incorporated by reference as Exhibit B to Pre-Effective Amendment No.1 to the Company's Registration Statement on Form N-2 (File No. 333-112862) filed on March 22, 2004.



- 4.1 Form of Specimen Certificate of Common Stock, incorporated by reference to Exhibit D to the Company's Registration Statement on Form N-2 (File No. 333-138996) filed November 29, 2006.
- 10.1 Harris & Harris Group, Inc. Custodian Agreement with JP Morgan, incorporated by reference as Exhibit J to Pre-Effective Amendment No. 1 to the Company's Registration Statement on Form N-2 (File No. 333-112862) filed on March 22, 2004.
- 10.2 Form of Indemnification Agreement which has been established with all directors and executive officers of the Company, incorporated by reference as Exhibit I(7) to Pre-Effective Amendment No. 1 to the Company's Registration Statement on Form N-2 (File No. 333-112862) filed on March 22, 2004.
- 10.3 Deferred Compensation Agreement, incorporated by reference as Exhibit 10.5 to the Company's Form 10-K for the year ended December 31, 2004 (File No. 814-00176) filed on March 16, 2005.
- 10.4 Amendment No. 4 to Deferred Compensation Agreement, incorporated by reference as Exhibit 10 to the Company's Form 10-Q (File No. 814-00176) filed on August 9, 2006.
- 10.5 Amendment No. 2 to Deferred Compensation Agreement, incorporated by reference as Exhibit 10.1 to the Company's Form 8-K (File No. 814-00176) filed on October 15, 2004.
- 10.6 Amendment No. 1 to Deferred Compensation Agreement, incorporated by reference as Exhibit 10.2 to the Company's Form 10-Q (File No. 811-07074) filed on May 14, 2003.
- 10.7 Trust Under Harris & Harris Group, Inc., Deferred Compensation Agreement, incorporated by reference as Exhibit I(12) to the Company's Registration Statement on Form N-2 (File No. 333-138996) filed on November 29, 2006.
- 10.8\* Harris & Harris Group, Inc. Amended and Restated Employee Profit-Sharing Plan.
- 10.9 Harris & Harris Group, Inc. 2006 Equity Incentive Plan, incorporated by reference as Appendix B to the Company's Proxy Statement for the 2006 Annual Meeting of Shareholders filed on April 3, 2006.
- 10.10 Form of Incentive Stock Option Agreement incorporated by reference as Exhibit 10.1 to the Company's Form 8-K (File No. 814-00176) filed on June 26, 2006.
- 10.11 Form of Non-Qualified Stock Option Agreement, incorporated by reference as Exhibit 10.2 to the Company's Form 8-K (File No. 814-00176) filed on June 26, 2006.

- 10.12 Harris & Harris Group, Inc. Directors Stock Purchase Plan 2001, incorporated by reference as Exhibit I(6) to the Company's Registration Statement on Form N-2 (File No. 333-138996) filed on November 29, 2006.
- 10.13 Amended and Restated Employment Agreement between Harris & Harris Group, Inc. and Charles E. Harris, dated August 2, 2007, incorporated by reference as Exhibit 10.1 to the Company's Form 8-K (File No. 814-00176) filed on August 3, 2007.
- 10.14 Amended and Restated Severance Compensation Agreement, dated August 2, 2007, incorporated by reference as Exhibit 10.2 to the Company's Form 8-K (File No. 814-00176) filed on August 3, 2007.
- 10.15 Amended and Restated Supplemental Executive Retirement Plan, dated August 2, 2007, incorporated by reference as Exhibit 10.3 to the Company's Form 8-K (File No. 814-00176) filed on August 3, 2007.
- 10.16 Amended and Restated Harris & Harris Group, Inc. Executive Mandatory Retirement Benefit Plan, dated August 2, 2007, incorporated by reference as Exhibit 10.4 to the Company's Form 8-K (File No. 814-00176) filed on August 3, 2007.
- 10.17\* Agreement of Sub-Sublease, dated April 18, 2003, by and between Prominent USA, Inc. and Harris & Harris Group, Inc.
- 10.18\* Amendment to Agreement of Sub-Sublease, dated May 9, 2003, by and between Prominent USA, Inc., and Harris & Harris Group, Inc.
- 10.19\* Assignment and Assumption, Modification and Extension of Sublease Agreement, dated December 17, 2004, by and among the Economist Newspaper Group, Inc., National Academy of Television Arts & Sciences, and Harris & Harris Group, Inc.
- 14.1 Code of Conduct for Directors and Employees of Harris & Harris Group, Inc. incorporated by reference as Exhibit 14 to the Company's Form 8-K (File No. 814-00176) filed on October 5, 2004.
- 14.2 Code of Ethics Pursuant to Rule 17j-1, incorporated by reference as Exhibit 14 to the Company's Form 8-K (File No. 814-00176) filed on March 7, 2008.
- 31.01\* Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.02\* Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.01\* Certification of CEO and CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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\*Filed herewith

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HARRIS & HARRIS GROUP, INC.

Date: March 12, 2008

By:

/s/ Charles E. Harris  
Charles E. Harris  
Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated.

Signatures	Title	Date
/s/ Charles E. Harris Charles E. Harris	Chairman of the Board and Chief Executive Officer	March 12, 2008
/s/ Daniel B. Wolfe Daniel B. Wolfe	Chief Financial Officer	March 12, 2008
/s/ Patricia N. Egan Patricia N. Egan	Chief Accounting Officer and Senior Controller	March 12, 2008
/s/ W. Dillaway Ayres, Jr. W. Dillaway Ayres, Jr.	Director	March 12, 2008
/s/ C. Wayne Bardin C. Wayne Bardin	Director	March 12, 2008

/s/ Phillip A. Bauman Phillip A. Bauman	Director	March 12, 2008
/s/ G. Morgan Browne G. Morgan Browne	Director	March 12, 2008
/s/ Dugald A. Fletcher Dugald A. Fletcher	Director	March 12, 2008
/s/ Douglas W. Jamison Douglas W. Jamison	Director	March 12, 2008
/s/ Kelly S. Kirkpatrick Kelly S. Kirkpatrick	Director	March 12, 2008
/s/ Lori D. Pressman Lori D. Pressman	Director	March 12, 2008
/s/ Charles E. Ramsey Charles E. Ramsey	Director	March 12, 2008
/s/ James E. Roberts James E. Roberts	Director	March 12, 2008
/s/ Richard P. Shanley Richard P. Shanley	Director	March 12, 2008

**EXHIBIT INDEX**

The following exhibits are filed with this report in accordance with Rule 12b-32 under the Securities Exchange Act of 1934.

Exhibit No.	Description
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