

HARRIS & HARRIS GROUP INC /NY/  
Form 10-K  
March 16, 2009

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

Form 10-K

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

For the fiscal year ended December 31, 2008

or

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"  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, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

<input type="checkbox"/> Large accelerated filer	<input checked="" type="checkbox"/> Accelerated filer
<input type="checkbox"/> Non-accelerated filer	<input type="checkbox"/> Smaller reporting company

(Do not check if a smaller reporting company)

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 30, 2008 was \$147,195,678 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, 2009, the registrant had 25,859,573 shares of common stock, par value \$.01 per share, outstanding.

DOCUMENTS INCORPORATED BY  
REFERENCE

INCORPORATED AT

Harris & Harris Group, Inc. Proxy Statement for the  
2009 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.® (the "Company," "us," "our," and "we"), is an internally managed venture capital company specializing in nanotechnology and microsystems 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 primarily 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, many of 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 companies commercializing or integrating products enabled by nanotechnology or microsystems. Nanotechnology is measured in nanometers, which are units of measurement in billionths of a meter. Microsystems are measured in micrometers, which are units of measurement in millionths of a meter. We use "tiny technology" to describe both of these disciplines. We consider a company to fit our investment thesis 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, 2008, our venture capital portfolio comprised 51 percent of our total assets, our U.S. Treasury obligations and cash and cash equivalents comprised 48 percent of our total assets, and other assets comprised the remaining one percent of our total assets. We had no debt outstanding. At December 31, 2008, 99.9 percent of our venture capital portfolio was invested in companies commercializing or integrating products enabled by nanotechnology or microsystems. 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.

Nanotechnology is multidisciplinary and widely applicable, and it incorporates technology that was not previously in widespread use. Products enabled by nanotechnology 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, biofuels 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, 2008, 11 of our 33 active portfolio companies are focused on the commercialization of alternative energy-related products. These companies represent 39.6 percent of our venture capital portfolio based on value as of December 31, 2008.

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 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 companies commercializing products enabled by nanotechnology and microsystems, 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 five professional, full-time members of management, four of whom are designated as Managing Directors: Douglas W. Jamison, Alexei A. Andreev, Michael A. Janse and Daniel B. Wolfe, and a Vice President, Misti Ushio. 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 was our Chairman and Chief Executive Officer through December 31, 2008. On December 31, 2008, Mr. Harris retired pursuant to the Company's mandatory retirement policy for senior executives. On January 1, 2009, Douglas W. Jamison became the Chairman and Chief Executive Officer.

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 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. In May 2008, the Securities and Exchange Commission ("SEC") amended a rule to expand the definition of eligible portfolio companies in which BDCs can invest to include publicly traded securities of companies with a market capitalization of less than \$250 million. We believe this action greatly increases our opportunity to invest in public companies involved in nanotechnology. As of December 31, 2008, approximately 51 percent of companies listed on a major U.S. stock exchange had market capitalizations of less than \$250 million. We intend to adjust our investment focus as needed to comply with and/or take advantage of the new rule, as well as other regulatory, legislative, administrative or judicial actions in this area.

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.

Most of our current portfolio company investments are in the equity securities of private companies. Investments in equity securities of private companies often 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 privately held start-up firms and privately held and publicly traded small businesses with exceptional growth potential. These businesses can range in stage from pre-revenue to cash flow positive. 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 unprofitable or complete losses, 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, 2008, the debt obligations held in our portfolio consisted of convertible bridge notes and U.S. Treasury securities. The convertible bridge notes generally do not generate income, nor are they held for that purpose.

Our investments in debt obligations may 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 non-qualifying assets, including the securities 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 (including preferred stock but excluding temporary borrowings of up to five percent of our assets), if after giving effect to the borrowing or issuance, the value of our total assets less liabilities not constituting senior securities would be less than 200 percent of our senior securities. We may pledge assets to secure any borrowings. We currently have no debt and have no current intention to issue preferred stock.

Although not currently employed in the operation of our business, a primary purpose of our borrowing power should we decide to use it 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 nanotechnology and microsystems, 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 during a year as well as from year to 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 nanotechnology. 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. 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 companies that satisfy certain additional criteria described below 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) has a market capitalization of less than \$250 million and has a class of equity securities listed on a national securities exchange, (ii) does not have a class of securities listed on a national securities exchange, or (iii) 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) and has a representative on the Board of Directors of such 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; (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, U.S. 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 during the 12-month period after (i) 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 (ii) the holders of a majority of our outstanding voting securities and the holders of a majority of our voting securities held by persons who are not affiliated persons of ours approve such issuances. 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 so 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 us.

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 (Current Tax Structure Employed): 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 1999-2007, there can be no assurance that we will receive such certification for subsequent years (to the extent we need additional certifications as a result of changes in our portfolio). In 2008, we qualified for RIC treatment even without certification. 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.

#### Subsidiaries

Harris & Harris Enterprises, Inc.<sup>sm</sup> ("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.<sup>sm</sup>, 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 11 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.

The recent financial crisis could increase the non-performance risk for our portfolio companies.

The global financial markets are in turmoil, and the economies of the U.S. and many other countries are in recession, which may be severe and prolonged. This status results in severely diminished opportunities for liquidity and credit availability, declines in consumer confidence, declines in economic growth, increases in unemployment rates, and uncertainty about overall economic stability, and there can be no assurance against further decline. These conditions adversely affect the availability of capital to meet the funding needs of our portfolio companies as the majority of our portfolio companies, and venture-backed companies in general, have negative cash flows, and thus require follow-on financings to continue operations. A substantial decrease in the availability of this necessary capital would dramatically increase the risk of these companies. We define non-performance as the risk that a portfolio company will be unable to raise additional capital. In these circumstances, the portfolio company could be recapitalized at a valuation significantly lower than the post-money valuation implied by our valuation method, sold at a loss to our investment or shut down.

A continuing lack of initial public offering opportunities and a decrease in merger and acquisition transactions 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 2008, according to the National Venture Capital Association, there were only six venture capital-backed companies that completed IPOs, the fewest annual venture-backed offerings since 1977. There were no venture-backed IPOs in the fourth quarter of 2008. In 2008, according to Dow Jones VentureSource, the venture capital-backed companies that completed IPOs had a median age of about 8.3 years. Also according to Dow Jones VentureSource, the market for mergers and acquisitions ("M&A") during 2008 experienced a drop in the number of transactions by 28.8 percent and in median transaction price by 50 percent.

Now that some of our companies are becoming more mature, a continuing lack of IPO opportunities and decrease in the number and size of M&A transactions for venture capital-backed companies could lead to companies staying longer in our portfolio as private entities that may require additional 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 financings or are not able to access additional capital at all. A continuing lack of IPO opportunities and the decrease in the number and size of M&A transactions for venture capital-backed companies are also causing some venture capital firms to change their strategies. Accordingly, some venture capital firms are reducing funding of their portfolio companies, making it more difficult for such companies to access capital and to fulfill their potential. In some cases this leads 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. Companies commercializing products enabled by nanotechnology or microsystems 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. It is sets of enabling technologies that are applicable to a diverse set of industries. As such, nanotechnology-enabled products must compete against existing products or enable a completely new product in a given industry. There are as of yet relatively few nanotechnology-enabled products commercially available. The timing of additional future commercially available nanotechnology-enabled products and the industries on which nanotechnology will have the most significant impact 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 nanotechnology-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 nanotechnology to these products.

Our portfolio companies working with nanotechnology and microsystems may be particularly susceptible to intellectual property litigation.

Research and commercialization efforts in nanotechnology and microsystems are being undertaken by a wide variety of government, academic and private corporate entities. As additional commercially viable applications of nanotechnology 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.

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. Nanotechnology in particular is currently the subject of health and environmental impact research. If health or environmental concerns about nanotechnology or microsystems 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 Nanotech for Cleantech™ portfolio is currently the largest and fastest growing portion of our venture capital portfolio, and, therefore, fluctuations in its value may adversely affect our net asset value per share to a greater degree than other sectors of our portfolio.

The fastest growing portion of our portfolio is our Nanotech for Cleantech™ portfolio, which consists of companies commercializing nanotechnology-enabled products targeted at cleantech-related markets. There are risks in investing in companies that target cleantech-related markets, including the rapid and sometimes dramatic price fluctuations of commodities, particularly oil and public equities, the reliance on the capital and debt markets to finance large capital outlays and the dependence on government subsidies to be cost-competitive with non-cleantech solutions. For example, the attractiveness of alternative methods for the production of biobutanol and biodiesel can be adversely affected by a decrease in the demand or price of oil. The demand for solar cells is driven primarily by government subsidies and the availability of credit to finance the purchase and installation of the system. Adverse developments in any of these sectors may significantly affect the value of our Nanotech for Cleantech portfolio, and thus our venture capital portfolio as a whole. Additionally, companies with alternative energy (cleantech) platforms are currently in favor with the media and investors. Cleantech companies in general may have a harder time accessing capital in the future if this level of interest subsides.

Our portfolio companies may generate revenues from the sale of products that are not enabled by nanotechnology.

We consider a company to be enabled by nanotechnology or microsystems 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 nanotechnology-enabled products, and, therefore, their success or failure may not be dependent upon the nanotechnology aspects of their business. In addition to developing products that we consider nanotechnology, some of these companies may also develop products that we do not consider enabled by nanotechnology. Some of these companies will generate revenues from the sale of non-nanotechnology-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-nanotechnology-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 regulatory changes could impair our ability to engage in liquidity events.

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.

Our business may be adversely affected by the recent financial crisis and our ability to access the capital markets.

The global financial markets are in turmoil, and the economies of the U.S. and many other countries are in recession, which may be severe and prolonged. This status results in severely diminished opportunities for liquidity and credit availability, declines in consumer confidence, declines in economic growth, increases in unemployment rates, and uncertainty about overall economic stability, and there can be no assurance against further decline. We are unable to predict the likely duration and severity of this global financial turmoil, and if the current uncertainty continues or economic conditions further deteriorate, our business and the business of our portfolio companies could be materially and adversely affected.



Our business and results of operations could be impacted adversely by a number of follow-on effects of the financial crisis, including the inability of our portfolio companies to obtain sufficient financing to continue to operate as a going concern, an increase in our funding costs or the limitation on our access to the capital markets. A prolonged period of market illiquidity may have an adverse effect on our business, financial condition, and results of operations. Our nonperforming assets are likely to increase, and the value of our portfolio is likely to decrease during these periods. These events could limit our investment activity, limit our ability to grow and negatively impact our operating results.

The financial crisis and changes in regulations of the financial industry have adversely affected coverage of us by financial analysts. A number of analysts that have covered us in the past are no longer able to continue to do so owing to changes in employment, to restrictions on the size of companies they are allowed to cover and/or their firms have shut down operations. An inability to attract analyst coverage may adversely affect our ability to raise capital from investors, particularly institutional investors. Our inability to access the capital markets on favorable terms, or at all, may adversely affect our future financial performance. The inability to obtain adequate financing capital sources could force us to seek debt financing, self-fund strategic initiatives or even forgo certain opportunities, which in turn could potentially harm our current and future performance.

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 private 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. 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 a security has 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-Merton option pricing model to determine the fair value of warrants held in our portfolio. Option pricing models, including the Black-Scholes-Merton 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-Merton 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 nanotechnology 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 generally valued only at quarterly intervals by our Valuation Committee, a committee made up of all of the 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. Information pertinent to our portfolio companies is not always known immediately by us, and, therefore, its availability for use in determining value may not always coincide with the timeframe of our valuations required by the federal securities laws.

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 nanotechnology has increased from year to year and continues to increase, the average size of our write-downs may also increase.

Because we do not choose investments based on a strategy of diversification, nor do we rebalance the portfolio should one or more investments increase in value substantially relative to the rest of the portfolio, the value of our portfolio 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. We also do not rebalance the portfolio should one of our portfolio companies increase in value substantially relative to the rest of the portfolio. Therefore, the value of our portfolio 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, particularly on Douglas W. Jamison, our Chairman and Chief Executive Officer and a Managing Director, who was designated by our Board of Directors as the successor to Mr. Harris upon his retirement in his positions of Chairman and Chief Executive Officer as of January 1, 2009; on Daniel B. Wolfe, our President, Chief Operating Officer, 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 nanotechnology 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 nanotechnology 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 2009 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 2009 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 BDC. 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 Stock Market rules, are creating additional expense and uncertainty for publicly held companies in general, and for BDCs 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 has required the commitment of significant financial and managerial resources.

Moreover, even though BDCs 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 or cleantech-related fields in general;
- environmental and health concerns regarding nanotechnology, whether real or perceptual;

• announcements regarding government funding and initiatives related to the development of nanotechnology or cleantech-related products;

- 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 BDC, 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 nanotechnology and in the semi-conductor and information technology, life sciences, materials science and other high technology industries, including cleantech, 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 BDCs 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 BDC 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, 2008, our stock closed at \$3.95 per share, a discount of \$0.29 to our net asset value per share of \$4.24 as of December 31, 2008.

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 Board of Directors 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 57th 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.")

On July 1, 2008, we signed a five-year lease for approximately 2,290 square feet of office space at 420 Florence Street, Suite 200, Palo Alto, California 94301, commencing on August 1, 2008, and expiring on August 31, 2013.

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.

## 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.

2008 Quarter Ending	Low	High
March 31	\$ 5.76	\$ 8.98
June 30	\$ 6.00	\$ 8.73
September 30	\$ 4.97	\$ 8.50
December 31	\$ 3.10	\$ 6.58
2007 Quarter Ending	Low	High
March 31	\$ 11.00	\$ 13.58
June 30	\$ 11.01	\$ 14.32
September 30	\$ 9.51	\$ 11.79
December 31	\$ 8.00	\$ 11.10

## Shareholders

As of March 12, 2009, there were approximately 149 holders of record of the Company's common stock. As of February 13, 2009, there were approximately 20,066 beneficial owners of the Company's common stock.

## Dividends

We did not pay a cash dividend or declare a deemed dividend for 2008 or 2007. 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, 2008

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in Column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	4,638,213	\$9.30	(1)
Equity compensation plans not approved by security holders	-	-	-
<b>TOTAL</b>	<b>4,638,213</b>	<b>\$9.30</b>	<b>(1)</b>

(1) A maximum of twenty percent (20%) of our total shares of our common stock issued and outstanding 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 the exercise price 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 2008 that were not registered under the Securities Act of 1933.

## Performance Graph

The graph below compares 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, 2003 and tracks it through December 31, 2008.

	12/03	12/04	12/05	12/06	12/07	12/08
Harris & Harris Group, Inc.	100.00	142.06	120.56	104.86	76.24	34.26
NASDAQ Composite	100.00	110.08	112.88	126.51	138.13	80.47
NASDAQ Financial	100.00	113.05	120.15	138.66	125.59	85.29

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:

	2008	2007	2006	2005	2004
Total assets	\$ 111,627,601	\$ 142,893,332	\$ 118,328,590	\$ 132,938,120	\$ 79,361,451
Total liabilities	\$ 2,096,488	\$ 4,529,988	\$ 4,398,287	\$ 14,950,378	\$ 4,616,652
Net assets	\$ 109,531,113	\$ 138,363,344	\$ 113,930,303	\$ 117,987,742	\$ 74,744,799
Net asset value per outstanding share	\$ 4.24	\$ 5.93	\$ 5.42	\$ 5.68	\$ 4.33
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	25,859,573	23,314,573	21,015,017	20,756,345	17,248,845

## Operating Data for Year Ended December 31:

	2008	2007	2006	2005	2004
Total investment income	\$ 1,987,347	\$ 2,705,636	\$ 3,028,761	\$ 1,540,862	\$ 637,562
Total expenses <sup>1</sup>	\$ 12,674,498	\$ 14,533,179	\$ 10,641,696	\$ 7,006,623	\$ 4,046,341
Net operating loss	\$(10,687,151)	\$(11,827,543)	\$(7,612,935)	\$(5,465,761)	\$(3,408,779)
Total tax expense (benefit) <sup>2</sup>	\$ 34,121	\$ 87,975	\$(227,355)	\$ 8,288,778	\$ 650,617
Net realized (loss) income from investments	\$ (8,323,634)	\$ 30,162	\$ 258,693	\$ 14,208,789	\$ 858,503
Net (increase) decrease in unrealized depreciation on investments	\$(30,170,712)	\$ 5,080,936	\$(4,418,870)	\$(2,026,652)	\$ 484,162
Net (decrease) increase in net assets resulting from operations	\$(49,181,497)	\$(6,716,445)	\$(11,773,112)	\$ 6,716,376	\$(2,066,114)

(Decrease) increase in net assets resulting from operations per average outstanding share	\$	(1.99)	\$	(0.30)	\$	(0.57)	\$	0.36	\$	(0.13)
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1 Included in total expenses is non-cash, stock-based, compensation expense of \$5,965,769 in 2008; \$8,050,807 in 2007; and \$5,038,956 in 2006. There was no stock-based compensation expense in 2005 or 2004. Also included in total expenses are the following profit-sharing expenses: \$0 in each of 2008 and 2007; \$50,875 in 2006; \$1,796,264 in 2005; and \$311,594 in 2004.

2 Included in total tax expense are the following taxes paid by the Company on behalf of shareholders: \$0 in each of 2008, 2007 and 2006; \$8,122,367 in 2005; and \$0 in 2004.

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 2008 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. In 1984, we divested all of our assets except Otisville BioTech, Inc., 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.

We have discretion in the investment of our capital. Primarily, we invest in illiquid equity securities. Generally, these investments take the form of preferred stock, are subject to restrictions on resale and have no established trading market. Throughout our corporate history, we have made primarily early stage venture capital investments in a variety of industries. We define venture capital as the money and resources made available to privately held start-up firms and privately held and publicly traded small businesses with exceptional growth potential. These businesses can range in stage from pre-revenue to cash flow positive. These 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, 2008, \$56,965,153, or 52.0 percent, of our net assets at fair value consisted of private venture capital investments, net of unrealized depreciation of \$34,124,848. 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.



Since our investment in Otisville in 1983 through December 31, 2008, we have made a total of 84 venture capital investments, including four private placement investments in securities of publicly traded companies. We have exited 50 of these 84 investments, realizing total proceeds of \$143,923,354 on our invested capital of \$60,549,559. As measured from first dollar in to last dollar out, the average and median holding periods for these 50 investments were 3.68 years and 3.20 years, respectively. As measured by the 173 separate rounds of investment within these 50 investments, the average and median holding periods for the 173 separate rounds of investment were 2.86 years and 2.53 years, respectively.

In 1994, we made our first nanotechnology investment. From August 2001 through December 31, 2008, all 42 of our initial investments have been in companies commercializing or integrating products enabled by nanotechnology or microsystems. We use the term "tiny technology" to describe both of these disciplines. From August 2001 through December 31, 2008, we have invested a total (before any subsequent write-ups, write-downs or dispositions) of \$104,414,712 in these companies.

We currently have 33 active tiny technology companies in our portfolio, including one investment made prior to 2001. At December 31, 2008, from first dollar in, the average and median holding periods for these 33 active tiny technology investments were 3.67 years and 3.62 years, respectively.

Our cumulative dollars invested in nanotechnology and microsystems increased from \$489,999 for the year ended December 31, 2001, to \$104,414,712 through December 31, 2008.

The following is a summary of our initial and follow-on investments in nanotechnology over the past five years. 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.

	2004	2005	2006	2007	2008
Total Incremental Investments	\$ 14,837,846	\$ 16,251,339	\$ 24,408,187	\$ 20,595,161	\$ 17,779,462
No. of New Investments	8	4	6	7	4
No. of Follow-On Investment Rounds	21	13	14	20	25
No. of Rounds Led	2	0	7	3	4
Average Dollar Amount – Initial	\$ 911,625	\$ 1,575,000	\$ 2,383,424	\$ 1,086,441	\$ 683,625
Average Dollar Amount – Follow-On	\$ 359,278	\$ 765,488	\$ 721,974	\$ 649,504	\$ 601,799



We value our private venture capital investments each quarter as determined in good faith by our Valuation Committee, a committee of all our 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 2004 through 2008, 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.

	2004	2005	2006	2007	2008
Net Asset Value, BOY	\$ 40,682,738	\$ 74,744,799	\$ 117,987,742	\$ 113,930,303	\$ 138,363,344
Gross Write-Downs During Year	\$ (5,711,229)	\$ (3,450,236)	\$ (4,211,323)	\$ (7,810,794)	\$ (39,671,588)
Gross Write-Ups During Year	\$ 6,288,397	\$ 23,485,176	\$ 279,363	\$ 11,694,618	\$ 820,559
Gross Write-Downs as a Percentage of Net Asset Value, BOY	-14.04%	-4.62%	-3.57%	-6.86%	-28.67%
Gross Write-Ups as a Percentage of Net Asset Value, BOY	15.46%	31.42%	0.24%	10.26%	0.59%
Net Write-Downs/Write-Ups as a Percentage of Net Asset Value, BOY	1.42 %	26.8 %	-3.33 %	3.40 %	-28.08 %

During the year ended December 31, 2008, we recorded gross write-downs of \$39,671,588. These write-downs primarily reflect the non-performance risk associated with our portfolio companies in the current business environment. This non-performance risk accounted for approximately 60 percent of the \$39,671,588 in gross write-downs and applied to approximately 50 percent of our portfolio companies. The remaining 40 percent of write-downs reflected adjustments of valuations relating to specific fundamental developments unique to particular portfolio companies. We define non-performance risk as the risk that a portfolio company will be: (a) unable to raise capital, will need to be shut down and will not return our invested capital; or (b) able to raise capital, but at a valuation significantly lower than the implied post-money valuation. Our best estimate of the non-performance risk of our portfolio companies has been quantified and included in the valuation of the companies as of December 31, 2008.

The increase or decrease in the value of our venture capital investments does not affect the day-to-day operations of the Company, as we have no debt and fund our venture capital investments and daily operating expenses from interest earned and proceeds from the sales of our investments in U.S. government and agency obligations, which is where we hold our cash. As of December 31, 2008, we held \$52,983,940 in U.S. government obligations.



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.

#### Current Business Environment

We continually examine our approach to investing activities based on the market conditions at the time of investment. The slowdown in global economic activities that began with the intensification of the housing and credit crises during the third quarter of 2008 resulted in a global devaluation of assets. For example, between the beginning and end of the fourth quarter of 2008, the Dow Jones Industrial Average dropped 19.1 percent, the S&P 500 dropped 22.5 percent, and the Nasdaq dropped 24.6 percent. From December 31, 2007, to December 31, 2008, the Dow Jones Industrial Average dropped by 33.8 percent, the S&P 500 dropped 38.5 percent and the Nasdaq dropped 40.5 percent. We view this devaluing process as both a concern and an opportunity. We have historically not used leverage or debt financing when making an investment; thus, we continue to finance our new and follow-on investments from our cash reserves, currently invested in U.S. treasury obligations. We have considered how the current conditions will affect how we will fund our own portfolio based on the potential for an increased time to liquidity event, how we will make new investments, what our pace of investment will be and how we will syndicate with others.

Many of our portfolio companies are cash flow negative and, therefore, need additional rounds of financing to continue operations. Articles published in newspapers such as The Wall Street Journal, The New York Times, The Financial Times and other sources present data that supports the conclusion that the availability of capital has been severely affected by this economic downturn. Many venture capital firms, including us, are evaluating their investment portfolios carefully to assess future potential capital needs. In the current business climate, this evaluation may result in a decrease in the number of companies we decide to finance going forward or may increase the number of companies we decide to sell before reaching their full potential. Our ownership in portfolio companies that we decide to stop funding may be subject to punitive action that reduces or eliminates value. This could result in an unprofitable investment or a complete loss of invested funds. If we decide to proceed with a follow-on investment, these rounds of financing may occur at valuations lower than those at which we invested originally.

From conversations with venture capitalists, we believe that this continued collapse in public market asset prices, the growing intensity of the slowdown in global economic activities, and the quick response being taken by venture capitalists to adjust their plans for new and follow-on investments has resulted in another collapse in the venture market. This conclusion is supported by the results of a survey conducted by the National Venture Capital Association that showed "92 percent of venture capitalists are predicting a slowing of venture investment in 2009." Similar to 2008, we expect that our investment pace for new investments will decrease as compared with recent years as we monitor the state of the capital markets. We do not, however, intend to stop making investments and will continue to evaluate investments in companies enabled by nanotechnology and microsystems. Our aim is to preserve our cash and manage our current operating expenses to enable us to make follow-on investments in current portfolio companies and to look for new investment opportunities. In July 2008, the SEC amended a rule expanding the definition of eligible portfolio companies in which BDCs can invest to include publicly traded securities of companies with a market capitalization of less than \$250 million. We believe this action greatly increases our opportunity to invest in public companies involved in nanotechnology. As of December 31, 2008, approximately 51 percent of companies listed on a major U.S. stock exchange had market capitalizations of less than \$250 million. Although we do not currently have any investments in publicly traded securities in our portfolio, we intend to adjust our investment focus, as needed, to comply with and/or take advantage of the new rule, as well as other regulatory, legislative, administrative or judicial actions in this area.

For new and follow-on investments, we generally syndicate with other venture capital firms and corporate investors. We plan to continue this approach, while taking into account that the current economic turmoil has affected the availability of capital to our potential co-investors, particularly firms that manage a small amount of assets. This fact may reduce the number of potential co-investors available to us when forming syndicates. The inability to form a syndicate of investors may decrease the number of investments made by us in both new and current portfolio companies.

#### 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.

Net Realized Gain / (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.

Years Ended December 31, 2008, 2007, and 2006

During the years ended December 31, 2008, 2007, and 2006, we had net decreases in net assets resulting from operations of \$49,181,497, \$6,716,445, and \$11,773,112, respectively.

Investment Income and Expenses:

During the years ended December 31, 2008, 2007, and 2006, we had net operating losses of \$10,687,151, \$11,827,543, and \$7,612,935, respectively. The variation in these results is primarily owing to the changes in investment income and operating expenses, including non-cash expense of \$5,965,769 in 2008, \$8,050,807 in 2007, and \$5,038,956 in 2006 associated with the granting of stock options. During the years ended December 31, 2008, 2007, and 2006, total investment income was \$1,987,347, \$2,705,636, and \$3,028,761, respectively. During the years ended December 31, 2008, 2007, and 2006, total operating expenses were \$12,674,498, \$14,533,179, and \$10,641,696, respectively.

During 2008, as compared with 2007, investment income decreased from \$2,705,636 to \$1,987,347, reflecting a decrease in our average holdings of U.S. government securities throughout the period and a decrease in interest rates. During the twelve months ended December 31, 2008, our average holdings of such securities were \$55,978,372, as compared with \$62,184,565 during the year ended December 31, 2007.

Operating expenses, including non-cash, stock-based compensation expenses, were \$12,674,498 and \$14,533,179 for the twelve months ended December 31, 2008, and December 31, 2007, respectively. The decrease in operating expenses for the twelve months ended December 31, 2008, as compared to the twelve months ended December 31, 2007, was primarily owing to decreases in salaries, benefits and stock-based compensation expenses and to decreases in administration and operations expense, professional fees and directors' fees and expenses. Salaries, benefits and non-cash, stock-based compensation expense decreased by \$1,344,671, or 11.8 percent, through December 31, 2008, as compared to December 31, 2007, primarily as a result of a decrease in non-cash expense of \$2,085,038 through December 31, 2008, associated with the Harris & Harris Group, Inc. 2006 Equity Incentive Plan (the "Stock Plan"), offset by an increase in salaries and benefits owing to bonus payments and increased health insurance costs. While the non-cash, stock-based, compensation expense for the Stock Plan increased our operating expenses by \$5,965,769, 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. Administration and operations expense decreased by \$272,628, or 19.0 percent, for the twelve months ended December 31, 2008, as compared with the same period in 2007, primarily as a result of a decrease in our directors' and officers' liability insurance expense, decreases in the cost of the annual report and proxy-related expenses, and decreases in fees associated with the exercise of stock options. Professional fees decreased by \$208,904, or 23.1 percent, primarily as a result of a reduction in the cost of our annual compliance program audit and a reduction in certain legal and accounting fees. Directors' fees and expenses decreased by \$67,677, or 15.6 percent, primarily as a result of fewer meetings held during the year ended December 31, 2008, as compared with the same period through December 31, 2007.

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 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 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 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 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.

#### Realized Gains and Losses from Investments:

During the year ended December 31, 2008, we realized net losses on investments of \$8,323,634. During the years ended December 31, 2007, and 2006, we had net realized income from investments of \$30,162, and \$258,693, respectively. The variation in these results is primarily owing to variations in gross realized gains and losses from investments and income taxes in each of the three years. For the years ended December 31, 2008, 2007, and 2006, we realized (losses) gains from investments, before taxes, of \$(8,289,513), \$118,137, and \$31,338, respectively. Income tax expense (benefit) for the years ended December 31, 2008, 2007, and 2006 was \$34,121, \$87,975, and \$(227,355), respectively.

During the year ended December 31, 2008, we realized net losses of \$8,289,513, consisting primarily of realized losses on our investments in Chlorogen, Inc., of \$1,326,072, on Evolved Nanomaterial Sciences, Inc., of \$2,800,000, on NanoOpto Corporation of \$3,688,581, on Phoenix Molecular Corporation of \$93,487, on Questech Corporation of \$16,253 and on Zia Laser of \$1,478,500, offset by realized gains of \$1,110,821 on the sale of U.S. government securities. During the first quarter of 2008, we received a payment of \$105,714 from the NanoOpto Corporation bridge note.

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.

#### Net Unrealized Appreciation and Depreciation of Portfolio Securities:

During the year ended December 31, 2008, net unrealized depreciation on total investments increased by \$30,170,712.

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

During the year ended December 31, 2006, net unrealized depreciation on total investments increased by \$4,418,870.

During the year ended December 31, 2008, net unrealized depreciation on our venture capital investments increased by \$29,557,704, or 647.2 percent, from net unrealized depreciation of \$4,567,144 at December 31, 2007, to net unrealized depreciation of \$34,124,848 at December 31, 2008, owing primarily to decreases in the valuations of the following investments held:

Investment	Amount of Write-Down
Adesto Technologies Corporation	\$ 1,100,000
Ancora Pharmaceuticals, Inc.	299,439
BioVex Group, Inc.	2,439,250
BridgeLux, Inc.	3,624,553
Cambrios Technologies Corporation	1,297,012
Cobalt Technologies, Inc.	187,499
Crystal IS, Inc.	1,001,300
CSwitch Corporation	5,177,946
D-Wave Systems, Inc.	22,670
Ensemble Discovery Corporation	1,000,000
Innovalight, Inc.	1,927,946
Kereos, Inc.	159,743
Kovio, Inc.	761,497
Mersana Therapeutics, Inc.	1,019,613
Metabolon, Inc.	2,136,734
Molecular Imprints, Inc.	2,365,417

Investment	Amount of Write-Down
NanoGram Corporation	4,415,417
Nanomix, Inc.	980,418
Neophotonics Corporation	4,024,305
Nextreme Thermal Solutions, Inc.	2,182,133
Polatis, Inc.	276,526
PolyRemedy, Inc.	122,250
Questech Corporation	463,968
Siluria Technologies, Inc.	160,723
SiOnyx, Inc.	1,076,153
Starfire Systems, Inc.	750,000
TetraVitae Bioscience, Inc.	125,000

We also had decreases in unrealized depreciation attributable to the reversal of depreciation owing to net realized losses on Chlorogen, Inc., of \$1,326,072, on Evolved Nanomaterial Sciences, Inc., of \$2,800,000, on NanoOpto Corporation of \$3,688,581, on Questech Corporation of \$16,253 owing to a realized loss on an unexercised warrant that expired on November 19, 2008, and on Zia Laser, Inc., of \$1,478,672. For the twelve months ended December 31, 2008, we had increases in the valuations of our investments in Exponential Business Development Company of \$25 and Solazyme, Inc., of \$820,534. We had a decrease owing to foreign currency translation of \$590,329 on our investment in D-Wave Systems, Inc. Unrealized appreciation on our U.S. government securities portfolio decreased from \$640,660 at December 31, 2007, to \$27,652 at December 31, 2008.

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 Corporation, 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 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 securities portfolio increased from \$69,541 at December 31, 2005, to \$556,451 at December 31, 2006.

## Financial Condition

December 31, 2008

At December 31, 2008, our total assets and net assets were \$111,627,601 and \$109,531,113, respectively. Our net asset value ("NAV") per share at that date was \$4.24, and our shares outstanding increased to 25,859,573 at December 31, 2008.

Significant developments in the twelve months ended December 31, 2008, included a decrease in the value of our venture capital investments of \$21,145,231 and a decrease in our holdings in U.S. government obligations of \$7,209,653. The decrease in the value of our venture capital investments from \$78,110,384 at December 31, 2007, to \$56,965,153 at December 31, 2008, resulted primarily from a decrease in the net value of our venture capital investments of \$29,557,704, offset by four new and 25 follow-on investments of \$17,779,462. The decrease in the net value of our venture capital investments is primarily owing to the non-performance risk associated with our portfolio companies in the current economic environment and secondarily to adjustments of valuation to reflect specific fundamental developments unique to particular portfolio companies. The decrease in the value of our U.S. government obligations from \$60,193,593 at December 31, 2007, to \$52,983,940 at December 31, 2008, is primarily owing to the payment of cash basis operating expenses of \$6,397,424 and to new and follow-on venture capital investments totaling \$17,779,462, offset by investment of net proceeds of \$14,383,497 received through the registered direct stock offering.

The following table is a summary of additions to our portfolio of venture capital investments made during the twelve months ended December 31, 2008:

New Investment	Amount
Cobalt Technologies, Inc.	\$ 240,000
Laser Light Engines, Inc.	\$ 2,000,000
PolyRemedy, Inc.	\$ 244,500
TetraVitae Bioscience, Inc.	\$ 250,000
Follow-on Investment	
Adesto Technologies Corporation	\$ 1,052,174
Ancora Pharmaceuticals Inc.	\$ 800,000
BioVex Group, Inc.	\$ 200,000
BridgeLux, Inc.	\$ 1,000,001
Cobalt Technologies, Inc.	\$ 134,999
CFX Battery, Inc.	\$ 526,736
CSwitch Corporation	\$ 986,821

Follow-on Investment	Amount
CSwitch Corporation	\$ 250,000
D-Wave Systems, Inc.	\$ 736,019
D-Wave Systems, Inc.	\$ 487,804
Ensemble Discovery Corporation	\$ 250,286
Kovio, Inc.	\$ 1,500,000
Mersana Therapeutics, Inc.	\$ 200,000
Metabolon, Inc.	\$ 1,000,000
NeoPhotonics Corporation	\$ 200,000
Nextreme Thermal Solutions, Inc.	\$ 377,580
Nextreme Thermal Solutions, Inc.	\$ 200,000
Nextreme Thermal Solutions, Inc.	\$ 200,000
Nextreme Thermal Solutions, Inc.	\$ 800,000
Nextreme Thermal Solutions, Inc.	\$ 1,050,000
Phoenix Molecular Corporation	\$ 25,000
Phoenix Molecular Corporation	\$ 25,000
Siluria Technologies, Inc.	\$ 42,542
Solazyme, Inc.	\$ 2,000,000
Solazyme, Inc.	\$ 1,000,000
Total	\$ 17,779,462

The following tables summarize the values of our portfolios of venture capital investments and U.S. government obligations, as compared with their cost, at December 31, 2008, and December 31, 2007:

	December 31,	
	2008	2007
Venture capital investments, at cost	\$ 91,090,001	\$ 82,677,528
Net unrealized depreciation (1)	34,124,848	4,567,144
Venture capital investments, at value	\$ 56,965,153	\$ 78,110,384

	December 31,	
	2008	2007
U.S. government obligations, at cost	\$ 52,956,288	\$ 59,552,933
Net unrealized appreciation (1)	27,652	640,660
U.S. government obligations, at value	\$ 52,983,940	\$ 60,193,593

(1) At December 31, 2008, and December 31, 2007, the net accumulated unrealized depreciation on investments was \$34,097,196 and \$3,926,484, respectively.

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 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 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:

New Investments	Cost
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
<b>Follow-on Investments</b>	
BridgeLux, Inc.	\$ 350,877
BridgeLux, Inc.	\$ 233,918
BridgeLux, Inc.	\$ 916,928
Cambios Technologies Corporation	\$ 1,300,000
Chlorogen, Inc.	\$ 7,042
CSwitch Corporation	\$ 32,624
CSwitch Corporation	\$ 529,852
Innovalight, Inc.	\$ 1,993,568

Follow-on Investments	Cost
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
Total	\$ 20,595,161

#### Cash Flow

##### Year Ended December 31, 2008

Net cash used in operating activities for the year ended December 31, 2008, was \$4,155,439, primarily owing to the payment of operating expenses.

Cash used in investing activities for the year ended December 31, 2008, was \$9,865,758, primarily reflecting a net decrease in our investment in U.S. government securities of \$7,798,836 and investments in private placements of \$17,779,462, less proceeds from the sale of venture capital investments of \$136,837.

Cash provided by financing activities for the year ended December 31, 2008, was \$14,383,497, resulting from the issuance of 2,545,000 new shares of our common stock on June 20, 2008, in a registered direct stock offering.

##### 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 obligations 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 obligations 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.

#### Liquidity and Capital Resources

Our liquidity and capital resources are generated and generally available through our cash holdings, interest earned on our investments on U.S. government securities, cash flows from the sales of U.S. government securities, proceeds from periodic follow-on equity offerings and realized capital gains retained for reinvestment.

We fund our day-to-day operations using interest earned and proceeds from the sales of our investments in U.S. government securities. The increase or decrease in the valuations of our private portfolio companies does not impact our daily liquidity. At December 31, 2008, and December 31, 2007, we had no investments in money market mutual funds. We have no debt outstanding, and, therefore, are not subject to credit agency downgrades.

The crisis in the global credit markets during the past year, and more specifically subsequent to September 30, 2008, has adversely affected all industry sectors. We believe that the market disruption may continue to adversely affect financial services companies with respect to the valuation of their investment portfolios, tighter lending standards and reduced access to capital. In addition, the economies of the U.S. and many other countries are in recession, which may be severe and prolonged. These conditions may lead to a further decline in earnings and/or decline in valuation of our portfolio companies. Although we cannot predict future market conditions, we believe that our current cash and U.S. government security holdings and our ability to adjust our investment pace will provide us with adequate liquidity to execute our current business strategy.



Except for a rights offering, we are also generally not able to issue and sell our common stock at a price below our net asset value per share, exclusive of any distributing commission or discount, without shareholder approval. As of December 31, 2008, our net asset value per share was \$4.24 per share and our closing market price was \$3.95 per share. We do not have shareholder approval to issue or sell shares below our net asset value per share.

December 31, 2008

At December 31, 2008, and December 31, 2007, our total net primary liquidity was \$53,701,819 and \$61,183,136, respectively.

Our net primary sources of liquidity, which consist of cash, U.S. government obligations and receivables, are adequate to cover our gross cash operating expenses. Our gross cash operating expenses for 2008 and 2007 totaled \$6,397,424 and \$6,263,510, respectively.

The decrease in our primary liquidity from December 31, 2007, to December 31, 2008, is primarily owing to the use of funds for investments and payment of net operating expenses, partially offset by the proceeds received through the registered direct stock offering.

On June 25, 2007, we completed the sale of 1,300,000 shares of our common stock from the 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 used the net proceeds of this offering to make new investments in nanotechnology, as well as for follow-on investments in our existing venture capital investments and for working capital. Through December 31, 2008, we have used all of the net proceeds from this offering for these purposes.

On June 20, 2008, we completed the sale of 2,545,000 shares of our common stock, for total gross proceeds of \$15,651,750; net proceeds of this offering, after placement agent fees and offering costs of \$1,268,253, were \$14,383,497. We intend to use, and have been using, the net proceeds of this offering to make new investments in nanotechnology, as well as for follow-on investments in our existing venture capital investments and for working capital. Through December 31, 2008, we have used \$11,723,553 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 57th 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 \$186,698 in 2008, \$178,167 in 2007, and \$174,625 in 2006. The minimum sublease payments in 2009 will be \$197,700 and \$65,969 thereafter for the remaining term.

On July 1, 2008, we signed a five-year lease for office space at 420 Florence Street, Suite 200, Palo Alto, California, commencing on August 1, 2008, and expiring on August 31, 2013. Total rent expense for our office space in Palo Alto was \$51,525 in 2008. Future minimum lease payments in each of the following years are: 2009 - \$125,206; 2010 - \$128,962; 2011 - \$132,831; 2012 - \$136,816 and 2013 - \$93,135.

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.

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.

#### 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:

#### Valuation of Portfolio Investments

The most significant estimate inherent in the preparation of our consolidated financial statements is the valuation of investments and the related amounts of unrealized appreciation and depreciation of investments recorded. As a BDC, we invest in primarily illiquid securities that generally have no established trading market.

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, 2008, our financial statements include private venture capital investments valued at \$56,965,153, the fair values of which were determined in good faith by, or under the direction of, the Board of Directors. At December 31, 2008, approximately 51.0 percent of our total assets represent investments in portfolio companies valued at fair value by the Board of Directors.

Determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment, although our valuation policy is intended to provide a consistent basis for determining fair value of the portfolio investments. Factors that may be considered include, but are not limited to, readily available public market quotations; the cost of the Company's investment; transactions in the portfolio company's securities or unconditional firm offers by responsible parties; 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 revenues, 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 the applicable securities laws; the achievement of milestones; and the rights and preferences of the class of securities we own as compared with other classes of securities the portfolio has issued.

The ongoing financial markets turmoil and severe recession have made it extremely difficult for many companies to raise capital. Moreover, the cost of capital has increased substantially. Historically, difficult venture capital environments have resulted in weak companies not receiving financing and being subsequently closed down with a loss of investment to venture investors, and/or strong companies receiving financing but at significantly lower valuations than the preceding venture rounds, leading to very deep dilution for those who do not participate in the new rounds of investment. This economic and financing environment has caused an increase in the non-performance risk for venture-backed companies. We define non-performance risk as the risk that a portfolio company will be: (a) unable to raise capital, will need to be shut down and will not return our invested capital; or (b) able to raise capital, but at a valuation significantly lower than the implied post-money valuation. Our best estimate of the non-performance risk of our portfolio companies has been quantified and included in the valuation of the companies at December 31, 2008.

All investments recorded at fair value are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels, defined by Statement of Financial Accounting Standards No. 157, "Fair Value Measurements," ("SFAS No. 157") and directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets, are as follows:

- Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2: Quoted prices in active markets for similar assets or liabilities, or quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability.
- Level 3: Unobservable inputs for the asset or liability.

At December 31, 2008, all of our private portfolio investments were classified as Level 3 in the hierarchy, indicating a high level of judgment required in their valuation.

The values assigned to our assets 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 be reasonably determined until the individual investments are actually liquidated or become readily marketable. Upon sale of investments, the values that are ultimately realized may be different from what is presently estimated. This difference could be material.

## 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-Merton option pricing model to estimate the fair value of employee stock options, consistent with the provisions of Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment," ("SFAS No. 123(R)"). Management uses the Black-Scholes-Merton 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-Merton option pricing model.

Option pricing models, including the Black-Scholes-Merton 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-Merton 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-Merton 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 of the underlying share-based awards.

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.

## 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 Citigroup Pension Liability Index in the determination of the appropriate discount rate assumptions. The weighted average rate we utilized to measure our post retirement medical benefit obligation as of December 31, 2008, and to calculate our 2009 expense was 5.71 percent, which is a decrease from the 6.55 percent rate used in determining the 2008 expense. We used a discount rate of 5.75 percent to calculate our pension obligation.

#### Recent Developments — Portfolio Companies

On February 4, 2009, we made a \$408,573 follow-on investment in a privately held tiny technology portfolio company.

On February 13, 2009, we made a \$200,000 follow-on investment in a privately held tiny technology portfolio company.

On March 11, 2009, we made a \$3,492 follow-on investment in a privately held tiny technology portfolio company.

On December 31, 2008, we valued the shares of one of our privately held tiny technology portfolio companies at \$2.5188 per share. On February 27, 2009, that company raised additional funding from a third party, independent financial investor at \$5.0376 per share. This transaction could be a material input to our determination of the value of our shares of this portfolio company at March 31, 2009. A valuation calculated based on this input alone could increase the value of this portfolio company at March 31, 2009, ranging from \$0 to approximately \$5,400,000, or \$0 to approximately \$0.21 per share, from the value at December 31, 2008. This input will be one of many used by our Valuation Committee, which is made up of all of our independent directors, to set the value of this portfolio company at March 31, 2009.

#### 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.

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. During the twelve months ended December 31, 2008, we recorded gross write-downs of \$39,671,588. These write-downs are primarily owing to the non-performance risk associated with our portfolio companies in the current economic environment and secondarily to adjustments of valuation to reflect specific fundamental developments unique to particular portfolio companies.

We generally also invest in 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 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 securities with three-month maturities which corresponds to the maturities of the Company's holdings at December 31, 2008, were to increase by 25, 75 and 150 basis points, the average value of these securities held by us at December 31, 2008, would decrease by approximately \$132,463, \$397,388 and \$794,775, 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 \$265,758 at December 31, 2008.

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 and the current credit crisis 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.

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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, 2008. 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, 2008, 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 58 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 at December 31, 2008 and December 31, 2007, and the results of their operations, changes in net assets, cash flows, and the financial highlights for each of the three years in the period ended December 31, 2008 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, 2008 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 57 of the 2008 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 the Consolidated Financial Statements, the financial statements include investments valued at \$56,965,153 (52.1% of net assets ) at December 31, 2008, 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 13, 2009

HARRIS & HARRIS GROUP, INC.  
CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES

	December 31, 2008	December 31, 2007
<b>ASSETS</b>		
Investments, in portfolio securities at value:		
Unaffiliated companies (cost: \$24,208,281 and \$21,435,392, respectively)	\$ 12,086,503	\$ 21,103,836
Non-controlled affiliated companies (cost: \$60,796,720 and \$54,306,393, respectively)	39,650,187	52,651,189
Controlled affiliated companies (cost: \$6,085,000 and \$6,935,743, respectively)	5,228,463	4,355,359
Total, investments in private portfolio companies at value (cost: \$91,090,001 and \$82,677,528, respectively)	\$ 56,965,153	\$ 78,110,384
Investments, in U.S. Treasury obligations at value (cost: \$52,956,288 and \$59,552,933, respectively)	52,983,940	60,193,593
Cash and cash equivalents	692,309	330,009
Restricted funds (Note 7)	191,955	2,667,020
Receivable from portfolio company	0	524
Interest receivable	56	647,337
Prepaid expenses	484,567	488,667
Other assets	309,621	455,798
Total assets	\$ 111,627,601	\$ 142,893,332
<b>LIABILITIES &amp; NET ASSETS</b>		
Accounts payable and accrued liabilities (Note 7)	\$ 2,088,348	\$ 4,515,463
Deferred rent	8,140	14,525
Total liabilities	2,096,488	4,529,988
Net assets	\$ 109,531,113	\$ 138,363,344
Net assets are comprised of:		
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 12/31/08 and 12/31/07; 27,688,313 issued at 12/31/08 and 25,143,313 issued at 12/31/07	276,884	251,434
Additional paid in capital (Note 10)	181,251,507	160,927,691
Accumulated net operating and realized loss	(34,494,551)	(15,483,766)
Accumulated unrealized depreciation of investments	(34,097,196)	(3,926,484)
Treasury stock, at cost (1,828,740 shares at 12/31/08 and 12/31/07)	(3,405,531)	(3,405,531)
Net assets	\$ 109,531,113	\$ 138,363,344
Shares outstanding	25,859,573	23,314,573
Net asset value per outstanding share	\$ 4.24	\$ 5.93

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

HARRIS & HARRIS GROUP, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31, 2008	Year Ended December 31, 2007	Year Ended December 31, 2006
<b>Investment income:</b>			
<b>Interest from:</b>			
Fixed-income securities	\$ 1,971,178	\$ 2,705,597	\$ 2,991,261
Miscellaneous income	16,169	39	37,500
<b>Total investment income</b>	<b>1,987,347</b>	<b>2,705,636</b>	<b>3,028,761</b>
<b>Expenses:</b>			
Salaries, benefits and stock-based compensation (Note 5)	10,090,658	11,435,329	7,933,276
Administration and operations	1,160,025	1,432,653	1,250,080
Profit-sharing provision	0	0	50,875
Professional fees	694,007	902,911	737,828
Rent	276,023	235,998	239,846
Directors' fees and expenses	367,383	435,060	340,750
Depreciation	54,795	63,113	64,916
Custodian fees	31,607	28,115	24,125
<b>Total expenses</b>	<b>12,674,498</b>	<b>14,533,179</b>	<b>10,641,696</b>
<b>Net operating loss</b>	<b>(10,687,151)</b>	<b>(11,827,543)</b>	<b>(7,612,935)</b>
<b>Net realized (loss) gain from investments:</b>			
<b>Realized gain (loss) from:</b>			
Unaffiliated companies	3,588	119,082	32,484
Non-controlled affiliated companies	(6,509,404)	0	0
Controlled affiliated companies	(2,893,487)	0	0
U.S. Treasury obligations/other	1,109,790	(945)	(1,146)
<b>Realized (loss) gain from investments</b>	<b>(8,289,513)</b>	<b>118,137</b>	<b>31,338</b>
Income tax expense (benefit) (Note 8)	34,121	87,975	(227,355)
<b>Net realized (loss) gain from investments</b>	<b>(8,323,634)</b>	<b>30,162</b>	<b>258,693</b>
<b>Net (increase) decrease in unrealized depreciation on investments:</b>			
Change as a result of investment sales	8,292,072	0	0
Change on investments held	(38,462,784)	5,080,936	(4,418,870)
<b>Net (increase) decrease in unrealized depreciation on investments</b>	<b>(30,170,712)</b>	<b>5,080,936</b>	<b>(4,418,870)</b>
<b>Net decrease in net assets resulting from operations:</b>			
<b>Total</b>	<b>\$ (49,181,497)</b>	<b>\$ (6,716,445)</b>	<b>\$ (11,773,112)</b>
<b>Per average basic and diluted outstanding share</b>	<b>\$ (1.99)</b>	<b>\$ (0.30)</b>	<b>\$ (0.57)</b>

Average outstanding shares	24,670,516	22,393,030	20,759,547
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The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31, 2008	Year Ended December 31, 2007	Year Ended December 31, 2006
<b>Cash flows used in operating activities:</b>			
Net decrease in net assets resulting from operations	\$ (49,181,497)	\$ (6,716,445)	\$ (11,773,112)
Adjustments to reconcile net decrease in net assets resulting from operations to net cash used in operating activities:			
Net realized and unrealized loss (gain) on investments	38,460,225	(5,199,073)	4,420,619
Depreciation of fixed assets, amortization of premium or discount on U.S. government securities, and bridge note interest	(179,809)	(60,009)	(426,168)
Stock-based compensation expense	5,965,769	8,050,807	5,038,956
<b>Changes in assets and liabilities:</b>			
Restricted funds	2,475,065	(517,235)	(419,351)
Receivable from portfolio company	524	(524)	75,000
Interest receivable	621,856	(21,965)	(376,808)
Prepaid expenses	4,100	(477,722)	(7,951)
Other receivables	0	819,905	(819,905)
Other assets	111,828	(152,012)	(176,325)
Accounts payable and accrued liabilities	(2,427,115)	400,163	1,002,643
Accrued profit sharing	0	(261,661)	(1,846,197)
Deferred rent	(6,385)	(6,801)	(9,677)
Current income tax liability	0	0	(9,637,026)
<b>Net cash used in operating activities</b>	<b>(4,155,439)</b>	<b>(4,142,572)</b>	<b>(14,955,302)</b>
<b>Cash flows from investing activities:</b>			
Purchase of U.S. government securities	(133,032,933)	(60,744,292)	(70,030,872)
Sale of U.S. government securities	140,831,769	60,508,538	107,624,461
Investment in private placements and notes	(17,779,462)	(20,595,161)	(24,408,187)
Proceeds from sale of private placements and notes	136,837	174,669	28,295
Purchase of fixed assets	(21,969)	(41,640)	(15,086)
<b>Net cash (used in) provided by investing activities</b>	<b>(9,865,758)</b>	<b>(20,697,886)</b>	<b>13,198,611</b>
<b>Cash flows from financing activities:</b>			
Gross proceeds from public offering (Note 10)	15,651,750	14,027,000	0
Gross expenses for public offering (Note 10)	(1,268,253)	(1,033,832)	0
Proceeds from stock option exercises (Note 5)	0	10,105,511	2,615,190
<b>Net cash provided by financing activities</b>	<b>14,383,497</b>	<b>23,098,679</b>	<b>2,615,190</b>
<b>Net (decrease) increase in cash and cash equivalents:</b>			



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Cash and cash equivalents at beginning of the year	330,009	2,071,788	1,213,289
Cash and cash equivalents at end of the year	692,309	330,009	2,071,788
Net increase (decrease) in cash and cash equivalents	\$ 362,300	\$ (1,741,779)	\$ 858,499
Supplemental disclosures of cash flow information:			
Income taxes paid	\$ 45,765	\$ 80,236	\$ 9,425,922

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

HARRIS & HARRIS GROUP, INC.  
CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS

	Year Ended December 31, 2008	Year Ended December 31, 2007	Year Ended December 31, 2006
<b>Changes in net assets from operations:</b>			
Net operating loss	\$ (10,687,151)	\$ (11,827,543)	\$ (7,612,935)
Net realized (loss) gain on investments	(8,323,634)	30,162	258,693
Net decrease in unrealized depreciation on investments as a result of sales	8,292,072	0	0
Net (increase) decrease in unrealized depreciation on investments held	(38,462,784)	5,080,936	(4,418,870)
Net decrease in net assets resulting from operations	(49,181,497)	(6,716,445)	(11,773,112)
<b>Changes in net assets from capital stock transactions:</b>			
Issuance of common stock upon the exercise of stock options	0	9,996	2,587
Issuance of common stock on offering	25,450	13,000	0
Additional paid in capital on common stock issued	14,358,047	23,075,683	2,612,603
Stock-based compensation expense	5,965,769	8,050,807	5,038,956
Net increase in net assets resulting from capital stock transactions	20,349,266	31,149,486	7,654,146
Changes in net assets from adoption of SFAS No. 158	0	0	61,527
Net (decrease) increase in net assets	(28,832,231)	24,433,041	(4,057,439)
<b>Net Assets:</b>			
Beginning of the year	138,363,344	113,930,303	117,987,742
End of the year	\$ 109,531,113	\$ 138,363,344	\$ 113,930,303

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

HARRIS & HARRIS GROUP, INC.  
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Unaffiliated Companies (2)(3) – 11.0% of net assets at value			
Private Placement Portfolio (Illiquid) – 11.0% of net assets at value			
BioVex Group, Inc. (4)(5)(6)(7)(8) — Developing novel biologics for treatment of cancer and infectious disease			
Series E Convertible Preferred Stock	(M)	2,799,552	\$ 60,750
Unsecured Convertible Bridge Note (including interest)	(M)	\$ 200,000	203,222
			263,972
Cobalt Technologies, Inc. (4)(5)(6)(9)(10) – Developing biobutanol through biomass fermentation			
Series C Convertible Preferred Stock	(M)	176,056	187,500
Exponential Business Development Company (4)(5) — Venture capital partnership focused on early stage companies			
Limited Partnership Interest	(M)	1	2,219
Kereos, Inc. (4)(5)(6) — Developing emulsion-based imaging agents and targeted therapeutics to image and treat cancer and cardiovascular disease			
Common Stock	(M)	545,456	0
Molecular Imprints, Inc. (4)(5) — Manufacturing nanoimprint lithography capital equipment			
Series B Convertible Preferred Stock	(M)	1,333,333	1,083,333
Series C Convertible Preferred Stock	(M)	1,250,000	1,015,625
Warrants at \$2.00 expiring 12/31/11	(I)	125,000	35,625
			2,134,583
Nanosys, Inc. (4)(5) — Developing zero and one-dimensional inorganic nanometer-scale materials and devices			
Series C Convertible Preferred Stock	(M)	803,428	2,370,113
Series D Convertible Preferred Stock	(M)	1,016,950	3,000,003
			5,370,116

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

HARRIS & HARRIS GROUP, INC.  
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Unaffiliated Companies (2)(3) – 11.0% of net assets at value (cont.)			
Private Placement Portfolio (Illiquid) – 11.0% of net assets at value (cont.)			
Nantero, Inc. (4)(5)(6) — Developing a high-density, nonvolatile, random access memory chip, enabled by carbon nanotubes			
Series A Convertible Preferred Stock	(M)	345,070	\$ 1,046,908
Series B Convertible Preferred Stock	(M)	207,051	628,172
Series C Convertible Preferred Stock	(M)	188,315	571,329
			2,246,409
NeoPhotonics Corporation (4)(5) — Developing and manufacturing optical devices and components			
Common Stock	(M)	716,195	181,262
Series 1 Convertible Preferred Stock	(M)	1,831,256	463,472
Series 2 Convertible Preferred Stock	(M)	741,898	187,767
Series 3 Convertible Preferred Stock	(M)	2,750,000	695,995
Series X Convertible Preferred Stock	(M)	2,000	101,236
Warrants at \$0.15 expiring 01/26/10	(I)	16,364	2,373
Warrants at \$0.15 expiring 12/05/10	(I)	14,063	2,349
			1,634,454
Polatis, Inc. (4)(5)(6)(11) — Developing MEMS-based optical networking components			
Series A-1 Convertible Preferred Stock	(M)	16,775	0
Series A-2 Convertible Preferred Stock	(M)	71,611	0
Series A-4 Convertible Preferred Stock	(M)	4,774	0
Series A-5 Convertible Preferred Stock	(M)	16,438	0
			0
PolyRemedy, Inc. (4)(5)(6)(9) — Developing a robotic manufacturing platform for wound treatment patches			
Series B-1 Convertible Preferred Stock	(M)	287,647	122,250
Starfire Systems, Inc. (4)(5) — Producing ceramic-forming polymers			
Common Stock	(M)	375,000	0
Series A-1 Convertible Preferred Stock	(M)	600,000	0
			0

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



HARRIS & HARRIS GROUP, INC.  
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Unaffiliated Companies (2)(3) – 11.0% of net assets at value (cont.)			
Private Placement Portfolio (Illiquid) – 11.0% of net assets at value (cont.)			
TetraVitae Bioscience, Inc. (4)(5)(6)(9)(12) — Developing alternative fuels through biomass fermentation			
Series B Convertible Preferred Stock	(M)	118,804 \$	125,000
Total Unaffiliated Private Placement Portfolio (cost: \$24,208,281)		\$	12,086,503
Total Investments in Unaffiliated Companies (cost: \$24,208,281)		\$	12,086,503

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

HARRIS & HARRIS GROUP, INC.  
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (2)(13) – 36.2% of net assets at value			
Private Placement Portfolio (Illiquid) – 36.2% of net assets at value			
Adesto Technologies Corporation (4)(5)(6) — Developing semiconductor-related products enabled at the nanoscale			
Series A Convertible Preferred Stock	(M)	6,547,619	\$ 1,100,000
Ancora Pharmaceuticals, Inc. (4)(5)(6) — Developing synthetic carbohydrates for pharmaceutical applications			
Series B Convertible Preferred Stock	(M)	1,663,808	1,200,000
BridgeLux, Inc. (4)(5)(14) — Manufacturing high-power light emitting diodes			
Series B Convertible Preferred Stock	(M)	1,861,504	1,396,128
Series C Convertible Preferred Stock	(M)	2,130,699	1,598,025
Series D Convertible Preferred Stock	(M)	666,667	500,000
Warrants at \$0.7136 expiring 12/31/14	(I)	98,340	60,774
Warrants at \$0.7136 expiring 12/31/14	(I)	65,560	40,516
			3,595,443
Cambrios Technologies Corporation (4)(5)(6) — Developing nanowire-enabled electronic materials for the display industry			
Series B Convertible Preferred Stock	(M)	1,294,025	647,013
Series C Convertible Preferred Stock	(M)	1,300,000	650,000
			1,297,013
CFX Battery, Inc. (4)(5)(6)(15) — Developing batteries using nanostructured materials			
Series A Convertible Preferred Stock	(M)	1,880,651	1,473,264

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

HARRIS & HARRIS GROUP, INC.  
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (2)(13) – 36.2% of net assets at value (cont.)			
Private Placement Portfolio (Illiquid) – 36.2% of net assets at value (cont.)			
Crystal IS, Inc. (4)(5) — Developing single-crystal aluminum nitride substrates for optoelectronic devices			
Series A Convertible Preferred Stock	(M)	391,571	\$ 76,357
Series A-1 Convertible Preferred Stock	(M)	1,300,376	253,574
Warrants at \$0.78 expiring 05/05/13	(I)	15,231	1,584
Warrants at \$0.78 expiring 05/12/13	(I)	2,350	244
Warrants at \$0.78 expiring 08/08/13	(I)	4,396	479
			332,238
CSwitch Corporation (4)(5)(6)(16) — Developing next-generation, system-on-a-chip solutions for communications-based platforms			
Series A-1 Convertible Preferred Stock	(M)	6,863,118	0
Unsecured Convertible Bridge Note (including interest)	(M)	\$ 1,766,673	118,624
			118,624
D-Wave Systems, Inc. (4)(5)(6)(17) — Developing high-performance quantum computing systems			
Series B Convertible Preferred Stock	(M)	1,144,869	1,038,238
Series C Convertible Preferred Stock	(M)	450,450	408,496
Series D Convertible Preferred Stock	(M)	1,533,395	1,390,578
			2,837,312
Ensemble Discovery Corporation (4)(5)(6)(18) — Developing DNA Programmed Chemistry for the discovery of new classes of therapeutics and bioassays			
Series B Convertible Preferred Stock	(M)	1,449,275	1,000,000
Unsecured Convertible Bridge Note (including interest)	(M)	\$ 250,286	256,375
			1,256,375
Innovalight, Inc. (4)(5)(6) — Developing solar power products enabled by silicon-based nanomaterials			
Series B Convertible Preferred Stock	(M)	16,666,666	4,288,662
Series C Convertible Preferred Stock	(M)	5,810,577	1,495,176
			5,783,838

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





HARRIS & HARRIS GROUP, INC.  
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (2)(13) – 36.2% of net assets at value (cont.)			
Private Placement Portfolio (Illiquid) – 36.2% of net assets at value (cont.)			
Kovio, Inc. (4)(5)(6) — Developing semiconductor products using printed electronics and thin-film technologies			
Series C Convertible Preferred Stock	(M)	2,500,000	\$ 2,561,354
Series D Convertible Preferred Stock	(M)	800,000	819,633
Series E Convertible Preferred Stock	(M)	1,200,000	1,229,450
Warrants at \$1.25 expiring 12/31/12	(I)	355,880	253,066
			4,863,503
Mersana Therapeutics, Inc. (4)(5)(6)(19) — Developing advanced polymers for drug delivery			
Series A Convertible Preferred Stock	(M)	68,451	68,451
Series B Convertible Preferred Stock	(M)	866,500	866,500
Warrants at \$2.00 expiring 10/21/10	(I)	91,625	33,718
Unsecured Convertible Bridge Note (including interest)	(M)	\$ 200,000	208,110
			1,176,779
Metabolon, Inc. (4)(5) — Discovering biomarkers through the use of metabolomics			
Series B Convertible Preferred Stock	(M)	2,173,913	882,768
Series B-1 Convertible Preferred Stock	(M)	869,565	353,107
Warrants at \$1.15 expiring 3/25/15	(I)	434,783	127,391
			1,363,266
NanoGram Corporation (4)(5) — Developing solar power products enabled by silicon-based nanomaterials			
Series I Convertible Preferred Stock	(M)	63,210	31,131
Series II Convertible Preferred Stock	(M)	1,250,904	616,070
Series III Convertible Preferred Stock	(M)	1,242,144	611,756
Series IV Convertible Preferred Stock	(M)	432,179	212,848
			1,471,805
Nanomix, Inc. (4)(5) — Producing nanoelectronic sensors that integrate carbon nanotube electronics with silicon microstructures			
Series C Convertible Preferred Stock	(M)	977,917	23,622
Series D Convertible Preferred Stock	(M)	6,802,397	6,428
			30,050

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

HARRIS & HARRIS GROUP, INC.  
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (2)(13) – 36.2% of net assets at value (cont.)			
Private Placement Portfolio (Illiquid) – 36.2% of net assets At value (cont.)			
Nextreme Thermal Solutions, Inc. (4)(5) — Developing thin-film thermoelectric devices for cooling and energy conversion			
Series A Convertible Preferred Stock	(M)	17,500	\$ 875,000
Series B Convertible Preferred Stock	(M)	4,870,244	1,327,629
			2,202,629
Questech Corporation (4)(5) — Manufacturing and marketing proprietary metal and stone decorative tiles			
Common Stock	(M)	655,454	128,266
Warrants at \$1.50 expiring 11/19/09	(I)	5,000	20
			128,286
Siluria Technologies, Inc. (4)(5)(6) — Developing next-generation nanomaterials			
Series S-2 Convertible Preferred Stock	(M)	482,218	0
Unsecured Bridge Note (including interest)	(M)	\$ 42,542	42,731
			42,731
Solazyme, Inc. (4)(5)(6) — Developing algal biodiesel, industrial chemicals and special ingredients based on synthetic biology			
Series A Convertible Preferred Stock	(M)	988,204	2,489,088
Series B Convertible Preferred Stock	(M)	495,246	1,247,426
Series C Convertible Preferred Stock	(M)	651,309	1,640,517
			5,377,031
Xradia, Inc. (4)(5) — Designing, manufacturing and selling ultra-high resolution 3D x-ray microscopes and fluorescence imaging systems			
Series D Convertible Preferred Stock	(M)	3,121,099	4,000,000
Total Non-Controlled Private Placement Portfolio (cost: \$60,796,720)			\$ 39,650,187
Total Investments in Non-Controlled Affiliated Companies (cost: \$60,796,720)			\$ 39,650,187

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



HARRIS & HARRIS GROUP, INC.  
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Controlled Affiliated Companies (2)(20) – 4.8% of net assets at value			
Private Placement Portfolio (Illiquid) – 4.8% of net assets at value			
Laser Light Engines, Inc. (4)(5)(6)(9) — Manufacturing solid-state light sources for digital cinema and large-venue projection displays			
Series A Convertible Preferred Stock	(M)	7,499,062	\$ 2,000,000
SiOnyx, Inc. (4)(5)(6) — Developing silicon-based optoelectronic products enabled by its proprietary "Black Silicon"			
Series A Convertible Preferred Stock	(M)	233,499	101,765
Series A-1 Convertible Preferred Stock	(M)	2,966,667	1,292,948
Series A-2 Convertible Preferred Stock	(M)	4,207,537	1,833,750
			3,228,463
Total Controlled Private Placement Portfolio (cost: \$6,085,000)			\$ 5,228,463
Total Investments in Controlled Affiliated Companies (cost: \$6,085,000)			\$ 5,228,463
Total Private Placement Portfolio (cost: \$91,090,001)			\$ 56,965,153

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

HARRIS & HARRIS GROUP, INC.  
 CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008

	Method of Valuation (1)	Shares/ Principal	Value
U.S. Government Securities (21) – 48.4% of net assets at value			
U.S. Treasury Bill — due date 01/29/09	(M)	\$ 52,985,000	\$ 52,983,940
Total Investments in U.S. Government Securities (cost: \$52,956,288)			\$ 52,983,940
Total Investments (cost: \$144,046,289)			\$ 109,949,093

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

HARRIS & HARRIS GROUP, INC.  
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008

Notes to Consolidated Schedule of Investments

- (1) See Footnote to Consolidated Schedule of Investments on page 87 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 \$24,208,281. 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 \$13,853,972.
- (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) 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.
- (7) 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 on September 27, 2012. The exercise price of this warrant shall be 110 percent of the initial public offering price.

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



HARRIS & HARRIS GROUP, INC.  
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008

- (8) With our investment in a convertible bridge note issued by BioVex Group, Inc., we received a warrant to purchase a number of shares of the class of stock sold in the next financing of BioVex equal to \$60,000 divided by the price per share of the class of stock sold in the next financing of BioVex. The ability to exercise this warrant is, therefore, contingent on BioVex completing successfully a subsequent round of financing. This warrant shall expire and no longer be exercisable on November 13, 2015. The cost basis of this warrant is \$200.
- (9) Initial investment was made during 2008.
- (10) Cobalt Technologies, Inc., does business as Cobalt Biofuels.
- (11) Continuum Photonics, Inc., merged with Polatis, Ltd., to form Polatis, Inc.
- (12) With our purchase of the Series B Convertible Preferred Stock of TetraVitae Bioscience, Inc., we received the right to purchase, at a price of \$2.63038528 per share, a number of shares in the Series C financing equal to the number of shares of Series B Preferred Stock purchased. The ability to exercise this right is contingent on TetraVitae Bioscience completing successfully a subsequent round of financing.
- (13) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated companies is \$60,796,720. The gross unrealized appreciation based on the tax cost for these securities is \$2,798,072. The gross unrealized depreciation based on the tax cost for these securities is \$23,944,605.
- (14) BridgeLux, Inc., was previously named eLite Optoelectronics, Inc.
- (15) On February 28, 2008, Lifco, Inc., merged with CFX Battery, Inc. The surviving entity is CFX Battery, Inc.
- (16) With our investments in secured convertible bridge notes issued by CSwitch, we received three warrants to purchase a number of shares of the class of stock sold in the next financing of CSwitch equal to \$529,322, \$985,835 and \$249,750, respectively, the principal of the notes, divided by the lowest price per share of the class of stock sold in the next financing of CSwitch. The ability to exercise these warrants is, therefore, contingent on CSwitch completing successfully a subsequent round of financing. The warrants will expire five years from the date of the close of the next round of financing. The cost basis of these warrants is \$529, \$986 and \$250, respectively.

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

HARRIS & HARRIS GROUP, INC.  
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2008

- (17) 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."
- (18) With our investment in a convertible bridge note issued by Ensemble Discovery, we received a warrant to purchase a number of shares of the class of stock sold in the next financing of Ensemble Discovery equal to \$125,105.40 divided by the price per share of the class of stock sold in the next financing of Ensemble Discovery. The ability to exercise this warrant is, therefore, contingent on Ensemble Discovery completing successfully a subsequent round of financing. This warrant shall expire and no longer be exercisable on September 10, 2015. The cost basis of this warrant is \$75.20.
- (19) Mersana Therapeutics, Inc., was previously named Nanopharma Corp.
- (20) The aggregate cost for federal income tax purposes of investments in controlled affiliated companies is \$6,085,000. 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 \$856,537.
- (21) The aggregate cost for federal income tax purposes of our U.S. government securities is \$52,956,288. The gross unrealized appreciation on the tax cost for these securities is \$27,652. The gross unrealized depreciation on the tax cost of these securities is \$0.

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

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

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Unaffiliated Companies (2)(3) – 15.25% of net assets at value			
Private Placement Portfolio (Illiquid) – 15.25% of net assets at value			
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.

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

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Unaffiliated Companies (2)(3) – 15.25% of net assets at value (cont.)			
Private Placement Portfolio (Illiquid) – 15.25% of net assets at value (cont.)			
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
Total Unaffiliated Private Placement Portfolio (cost: \$21,435,392)			\$ 21,103,836
Total Investments in Unaffiliated Companies (cost: \$21,435,392)			\$ 21,103,836

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

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (2)(10) – 38.06% of net assets at value			
Private Placement Portfolio (Illiquid) – 38.06% of net assets at value			
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.

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

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (2)(10) – 38.06% of net assets at value (cont.)			
Private Placement Portfolio (Illiquid) – 38.06% of net assets at value (cont.)			
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 Corporation. (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.

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

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (2)(10) – 38.06% of net assets at value (cont.)			
Private Placement Portfolio (Illiquid) – 38.06% of net assets at value (cont.)			
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.

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

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (2)(10) – 38.06% of net assets at value (cont.)			
Private Placement Portfolio (Illiquid) – 38.06% of net assets at value (cont.)			
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.



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

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (2)(10) – 38.06% of net assets at value (cont.)			
Private Placement Portfolio (Illiquid) – 38.06% of net assets at value (cont.)			
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
Total Non-Controlled Private Placement Portfolio (cost: \$54,306,393)			\$ 52,651,189
Total Investments in Non-Controlled Affiliated Companies (cost: \$54,306,393)			\$ 52,651,189

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

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Controlled Affiliated Companies (2)(19) – 3.15% of net assets at value			
Private Placement Portfolio (Illiquid) – 3.15% of net assets at value			
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
Total Controlled Private Placement Portfolio (cost: \$6,935,743)			\$ 4,355,359
Total Investments in Controlled Affiliated Companies (cost: \$6,935,743)			\$ 4,355,359
Total Private Placement Portfolio (cost: \$82,677,528)			\$ 78,110,384

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

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
Total Investments in U.S. Government and Agency Securities (cost: \$59,552,933)			\$ 60,193,593
Total Investments (cost: \$142,230,461)			\$ 138,303,977

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 of our December 31, 2007, Annual Report on Form 10-K for a description of the Valuation Procedures at December 31, 2007.
- (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 this consolidated schedule.

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.

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

VALUATION PROCEDURES

I. Determination of Net Asset Value

The 1940 Act requires periodic valuation of each investment in the portfolio of the Company to determine its 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.

The Board of Directors is responsible for (1) determining overall valuation guidelines and (2) ensuring that the investments of the Company are valued within the prescribed guidelines.

The Valuation Committee, comprised of all of the independent Board members, is responsible for reviewing and approving the valuation of the Company's assets within the guidelines established by the Board of Directors. The Valuation Committee receives information and recommendations from management.

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

II. Approaches to Determining Fair Value

Statement of Financial Accounting Standards No. 157, "Fair Value Measurements," ("SFAS No. 157") defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price).

The main approaches to measuring fair value utilized are the market approach and the income approach.

- Market Approach (M): The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. For example, the market approach often uses market multiples derived from a set of comparables. Multiples might lie in ranges with a different multiple for each comparable. The selection of where within the range each appropriate multiple falls requires judgment considering factors specific to the measurement (qualitative and quantitative).

- Income Approach (I): The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present value amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts. Those valuation techniques include present value techniques; option-pricing models, such as the Black-Scholes-Merton formula (a closed-form model) and a binomial model (a lattice model), which incorporate present value techniques; and the multi-period excess earnings method, which is used to measure the fair value of certain assets.

SFAS No. 157 classifies the inputs used to measure fair value by these approaches into the following hierarchy:

- Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2: Quoted prices in active markets for similar assets or liabilities, or quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability.
- Level 3: Unobservable inputs for the asset or liability.

Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

### III. Investment Categories

The Company's investments can be classified into five broad categories for valuation purposes:

- Equity-related securities;
- Long-term fixed-income securities;
- Short-term fixed-income securities;
- Investments in intellectual property, patents, research and development in technology or product development; and
- All other securities.

The Company applies the methods for determining fair value discussed above to the valuation of investments in each of these five broad categories as follows:

#### A. EQUITY-RELATED SECURITIES

Equity-related securities, including warrants, are fair valued using the market or income approaches. The following factors may be considered when the market approach is used to fair value these types of securities:

§ Readily available public market quotations;

§ 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 company's progress towards milestones.

§ 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 income approach is used to value warrants, the Company uses the Black-Scholes-Merton formula.

## B. LONG-TERM FIXED-INCOME SECURITIES

1. Readily Marketable: Long-term fixed-income securities for which market quotations are readily available are valued using the most recent bid quotations when available.

2. Not Readily Marketable: Long-term fixed-income securities for which market quotations are not readily available are fair valued using the market approach. The factors that may be considered when valuing these types of securities by the market approach include:

- Credit quality;
- Interest rate analysis;
- Quotations from broker-dealers;
- Prices from independent pricing services that the Board believes are reasonably reliable; and
- Reasonable price discovery procedures and data from other sources.



C. SHORT-TERM FIXED-INCOME SECURITIES

Short-term fixed-income securities are valued using the market approach 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.

D. INVESTMENTS IN INTELLECTUAL PROPERTY, PATENTS, RESEARCH AND DEVELOPMENT IN TECHNOLOGY OR PRODUCT DEVELOPMENT

Such investments are fair valued using the market approach. The Company may consider factors specific to these types of investments when using the market approach including:

- The cost of the Company's 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 and milestone progress;
    - Commercial prospects;
    - Term of patent;
    - Projected markets; and
    - Other subjective factors.

E. ALL OTHER SECURITIES

All other securities are reported at fair value as determined in good faith by the Valuation Committee using the approaches for determining valuation as described above.

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 approaches of valuation discussed in Section III. 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 is used to hold certain interests in portfolio companies. 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. For the year ended December 31, 2008, there was no 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 and include the accounts of the Company and its wholly owned subsidiary. 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 and the reported amounts of revenues and expenses. 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.

**Cash and Cash Equivalents.** Cash and cash equivalents includes demand deposits. Cash and cash equivalents are carried at cost which approximates 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, 2008, our financial statements include private venture capital investments valued at \$56,965,153, 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.

The Company adopted SFAS No. 157 on a prospective basis on January 1, 2008. SFAS No. 157 requires the Company to assume that the portfolio investment is to be sold in the principal market to market participants, or in the absence of a principal market, the most advantageous market, which may be a hypothetical market.

On October 10, 2008, FASB Staff Position 157-3, "Determining the Fair Value of a Financial Asset When the Market for that Asset is Not Active," ("FSP 157-3") was issued. FSP 157-3 reiterated that an entity should utilize its own assumptions, information and techniques to estimate fair value when relevant observable inputs are not available, including the use of risk-adjusted discount factors for non-performance risk or liquidity risk.

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 twelve months ended December 31, 2008, included in the net decrease in unrealized depreciation on investments was a \$626,593 loss resulting from foreign currency translation.

Securities Transactions. Securities transactions are accounted for on the date the transaction for the purchase or sale of the securities is entered into by the Company (i.e., trade date).

Interest Income Recognition. Interest income, adjusted for amortization of premium and accretion of discount, is recorded on accrual basis. When securities are determined to be non-income producing, the Company ceases accruing interest 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 SFAS No. 123(R). See "Note 5. 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 Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes," and FIN 48, "Accounting for Uncertainty in Income Taxes." The Company recognizes interest and penalties in income tax expense.

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."

**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. The final payment from this rabbi trust will be made on July 31, 2009, after which the rabbi trust will be closed.

**Property and Equipment.** Property and equipment are included in "Other Assets" and are carried at \$119,180 and \$153,528 at December 31, 2008, and 2007, respectively, representing cost, less accumulated depreciation. Depreciation is provided using the straight-line method over the estimated useful lives of the premises and equipment. We estimate the useful lives to be five to ten years for furniture and fixtures, three years for computer equipment, and five to seven years for leasehold improvements.

**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.

### NOTE 3. BUSINESS RISKS AND UNCERTAINTIES

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 greater risk of loss than is the case with traditional investment securities.

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 and bridge note 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 and is subject to significant estimates and judgments. 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.

#### NOTE 4. INVESTMENTS

At December 31, 2008, our financial assets were categorized as follows in the fair value hierarchy for SFAS No. 157 purposes:

#### Fair Value Measurement at Reporting Date Using:

Description	December 31, 2008	Fair Value Measurement at Reporting Date Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Government Securities	\$ 52,983,940	\$ 52,983,940	\$ 0	\$ 0
Portfolio Companies	\$ 56,965,153	\$ 0	\$ 0	\$ 56,965,153
Total	\$ 109,949,093	\$ 52,983,940	\$ 0	\$ 56,965,153

The following chart shows the components of change in the financial assets categorized as Level 3, for the year ended December 31, 2008.

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
	Portfolio Companies	
Beginning Balance, January 1, 2008	\$	78,110,384
Total realized losses included in changes in net assets		(9,402,893)
Total unrealized losses included in changes in net assets		(29,557,705)
Purchases and interest on bridge notes		17,949,104
Disposals		(133,737)
Ending Balance, December 31, 2008	\$	56,965,153
The amount of total losses for the period included in changes in net assets attributable to the change in unrealized gains or losses relating to assets still held at the reporting date	\$	(38,851,029)

#### NOTE 5. 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 Harris & Harris Group, Inc. 2006 Equity Incentive Plan (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 the Company has 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 stockholder approval for such provisions, the Compensation Committee may, in the future, authorize awards of stock options under an amended Stock Plan to non-employee directors of the Company and authorize grants of restricted stock to officers and 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 must 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.

During the years ended December 31, 2008, 2007, and 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.

The option grants during the years ended December 31, 2008, 2007, and 2006 were as follows:

Grant Date	No. of Options Granted	Option Type	Vesting Period	Exercise Price
August 13, 2008	1,163,724	NQSO	12/08 to 08/12	\$ 6.92
March 19, 2008	348,032	NQSO	03/09 to 03/12	\$ 6.18
June 27, 2007	1,700,609	NQSO	12/07 to 06/14	\$ 11.11
June 26, 2006	3,958,283	NQSO & ISO	12/06 to 06/14	\$ 10.11

The exercise price for the August 2008, March 2008, and June 2007 option grants was the closing volume weighted average price of our shares of common stock on the date of grant. The full Board of Directors ratified and approved the June 2006 grants on August 3, 2006, on which date the Company's common stock price fluctuated between \$9.76 and \$10.00. 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), 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. For the years ended December 31, 2008, 2007, and 2006, 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 zero 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 options vested and pre-vesting forfeitures. 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-Merton 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-Merton 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-Merton 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	
Total		1,700,609						

The assumptions used in the calculation of fair value of the stock options granted on March 19, 2008, using the Black-Scholes-Merton model for the contract term was 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	9.78 Years	348,032	6.14	57.1%	0%	2.62%	\$3.45	
Total		348,032						\$3.45

The assumptions used in the calculation of fair value of the stock options granted on August 13, 2008, using the Black-Scholes-Merton model for the contract term was 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	9.38 Years	976,685	5.94	55.1%	0%	3.40%	\$3.79
Non-qualified stock options	9.38 Years	187,039	4.88	50.6%	0%	3.24%	\$3.25
Total		1,163,724					

For the years ended December 31, 2008, December 31, 2007, and December 31, 2006, the Company recognized \$5,965,769, \$8,050,807 and \$5,038,956 of compensation expense in the Consolidated Statements of Operations, respectively. As of December 31, 2008, there was approximately \$7,575,244 of unrecognized compensation cost related to unvested stock option awards. This cost is expected to be recognized over a weighted-average period of approximately 2.1 years.

For the year ended December 31, 2008, no stock options were exercised. 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.

The grant date fair value of options vested during the years ended December 31, 2008, December 31, 2007, and December 31, 2006, was \$6,779,996, \$6,851,874, and \$3,781,681, respectively.

For the years ended December 31, 2008, 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 for the year ended December 31, 2008, 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, 2007	3,967,744	\$ 10.54	\$ 4.77		
Granted	1,511,756	\$ 6.75	\$ 3.64	8.99	
Exercised	0	\$ 0	\$ 0		
Forfeited or Expired	841,287	\$ 10.58	\$ 2.43		
Options Outstanding at December 31, 2008	4,638,213	\$ 9.30	\$ 4.83	6.03	\$ 0
Options Exercisable at December 31, 2008	2,467,587	\$ 10.24	\$ 5.03	4.68	\$ 0
Options Exercisable and Expected to be Exercisable at December 31, 2008	4,567,402	\$ 9.28	\$ 4.79	6.00	\$ 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 \$3.95 on the last trading day of 2008 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, 2008.

At December 31, 2007, there were 2,250,619 unvested options with a weighted average grant date fair value of \$5.02. At December 31, 2008, there were 2,170,626 unvested options with a weighted average grant date fair value of \$4.60.

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. No options were exercised during 2008.

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 6. DISTRIBUTABLE EARNINGS

As of December 31, 2008, December 31, 2007, and December 31, 2006, 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.

The Company did not declare dividends for the years ended December 31, 2008, 2007 or 2006.

#### NOTE 7. EMPLOYEE BENEFITS

##### Employment Agreement with Charles E. Harris

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 received 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. Mr. Harris's base salary for 2006 was increased to \$300,000 (thereby also increasing his SERP benefit as described below). 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 was 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 furnished Mr. Harris with certain perquisites, which included 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 provided Mr. Harris with life insurance for the benefit of his designated beneficiary in the amount of at least \$2,000,000; provided reimbursement for uninsured medical expenses, not to exceed \$10,000 per annum, adjusted for inflation, over the period of the agreement; provided Mr. Harris and his spouse with long-term care insurance; and provided Mr. Harris with disability insurance providing for continuation of 100 percent of his base salary for a specified period. These benefits were for the term of the Employment Agreement. The Employment Agreement provided that the term of Mr. Harris's employment could not be extended beyond December 31, 2008, unless a committee of the Board consisting of non-interested Directors extended the date by one year pursuant to the Executive Mandatory Retirement Benefit Plan, and Mr. Harris agreed to serve beyond December 31, 2008. Mr. Harris retired on December 31, 2008.

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

Other than Mr. Harris, our Chairman and Chief Executive Officer through December 31, 2008, 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.

#### SERP

The Employment Agreement provided that we adopt a supplemental executive retirement plan (the "SERP") for the benefit of Mr. Harris. Under the SERP, each month, we deposited one-twelfth of Mr. Harris's annual salary to a special account maintained on our books for the benefit of Mr. Harris, provided that Mr. Harris was employed by us on the last business day of that month. The amounts credited to the SERP Account were deemed invested or reinvested in such investments as were requested by Mr. Harris and agreed to by the Company. The SERP Account was 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 equaled the balance in the SERP Account and such benefit was 100 percent vested (i.e., not forfeitable).

We established a rabbi trust for the purpose of accumulating funds to satisfy the obligations incurred by us under the SERP, which amounted to \$188,454 and \$2,667,020 at December 31, 2008, and 2007, respectively, and is included in accounts payable and accrued liabilities. The restricted funds for the SERP Account totaled \$188,454 and \$2,667,020 at December 31, 2008, and 2007, respectively. Mr. Harris's rights to benefits pursuant to this SERP are no greater than those of a general creditor of us.

Mr. Harris received a distribution from his SERP Account totaling \$2,889,717 during 2008. The balance at December 31, 2008, of \$188,454, plus any interest or earnings credited to the account through July 31, 2009, will be paid on July 31, 2009.

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

#### 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, 2008, the Compensation Committee approved a 100 percent match which amounted to \$180,500. The 401(k) Company match for the years ended December 31, 2007, and 2006 was \$176,873 and \$155,000, 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:

	2008	2007
Accumulated Postretirement Benefit Obligation at Beginning of Year	\$ 628,745	\$ 696,827
Service Cost	86,497	102,676
Interest Cost	39,972	33,935
Actuarial (Gain)/Loss	109,312	(196,248)
Benefits Paid	(10,847)	(8,445)
Accumulated Postretirement Benefit Obligation at End of Year	\$ 853,679	\$ 628,745

In accounting for the plan, the assumption made for the discount rate was 5.71 percent and 6.55 percent for the years ended December 31, 2008, and 2007, respectively. The assumed health care cost trend rates in 2008 were nine percent grading to six percent over three years for medical and five percent per year for dental. 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 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	\$ 98,688	\$ 126,469	\$ 164,286
Accumulated Postretirement Benefit Obligation	\$ 700,499	\$ 853,679	\$ 1,056,068

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, 2008, 2007, and 2006:

	2008	2007	2006
Service Cost	\$ 86,497	\$ 102,676	\$ 79,381
Interest Cost on Accumulated Postretirement Benefit Obligation	39,972	33,935	33,786
Amortization of Transition Obligation	0	0	0
Amortization of Net (Gain)/Loss	(11,215)	(6,234)	0
Net Periodic Post Retirement Benefit Cost	\$ 115,254	\$ 130,377	\$ 113,167

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

2009	\$ 23,639
2010	\$ 25,584
2011	\$ 20,213
2012	\$ 21,663
2013	\$ 23,175
2014 through 2017	\$ 146,044

On December 31, 2006, the Company adopted the recognition and disclosure provisions of Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," ("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 Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," and No. 87, "Employers' Accounting for Pensions." 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 are 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, 2008, net unrecognized actuarial losses, which resulted from the decrease in the discount rate referred to above, decreased by \$120,527, which represents \$109,312 of actuarial losses arising during the year, net of an \$11,215 reclassification adjustment which increased the net periodic benefit cost for the year.

For the year ended December 31, 2007, net unrecognized actuarial gains, which resulted from the increase in the discount rate, 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 through December 31, 2008, Douglas W. Jamison, the Chairman and Chief Executive Officer, Daniel B. Wolfe, the President, Chief Operating Officer and 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, 2008, and 2007, we had accrued \$380,737 and \$382,932, respectively, for benefits under this plan. At December 31, 2008, \$229,294 was accrued for Mr. Melsheimer and \$151,443 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 was 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. On December 31, 2008, Mr. Harris retired pursuant to the Executive Mandatory Retirement Benefit Plan. Mr. Harris's projected mandatory benefit will be approximately \$151,443 and will be 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 investment companies that 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 2007, 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.

For federal tax purposes, the Company's 2005 through 2008 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 2008 tax years remain open for examination by the tax authorities under a four year statute of limitations.

During 2008, we paid \$17,592 in federal, state and local income taxes. At December 31, 2008, 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, 2008, 2007, and 2006, our income tax expense for Harris & Harris Enterprises, Inc., was \$16,528, \$3,231, and \$9,475, respectively.

Tax expense included in the Consolidated Statement of Operations consists of the following:

	2008	2007	2006
Current	\$ 34,121	\$ 87,975	\$ (227,355)
Total income tax (benefit) expense	\$ 34,121	\$ 87,975	\$ (227,355)

For the years ended December 31, 2008, 2007, and 2006, we paid \$706, \$74,454, and \$0, respectively, in interest and penalties. At December 31, 2008, we had capital loss carryforwards of \$8,292,068, which expire in 2016.

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 & CONTINGENCIES

On April 17, 2003, we signed a seven-year sublease for office space at 111 West 57th 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 \$186,698 in 2008, \$178,167 in 2007 and \$174,625 in 2006. Future minimum sublease payments in each of the following years are: 2009 — \$197,700; and thereafter, for the remaining term — \$65,969.

On July 1, 2008, we signed a five-year lease for office space at 420 Florence Street, Suite 200, Palo Alto, California, commencing on August 1, 2008, and expiring on August 31, 2013. Total rent expense for our office space in Palo Alto was \$51,525 in 2008. Future minimum lease payments in each of the following years are: 2009 - \$125,206; 2010 - \$128,962; 2011 - \$132,831; 2012 - \$136,816 and 2013 - \$93,135.

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, 2008, and 2007, 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 shelf registration statement with the SEC on Form N-2 to register 4,000,000 shares of our common stock, which was declared effective by the SEC on May 11, 2007. The common stock could 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.

On June 20, 2008, we completed the sale of 2,545,000 shares of our common stock for gross proceeds of \$15,651,750; net proceeds of this offering, after placement agent fees and offering costs of \$1,268,253, were \$14,383,497.

## 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, 2008, 2007, and 2006.

	2008	2007	2006
Numerator for decrease in net assets per share	\$ (49,181,497)	\$ (6,716,445)	\$ (11,773,112)
Denominator for basic and diluted weighted average shares	24,670,516	22,393,030	20,759,547
Basic and diluted net decrease in net assets per share resulting from operations	(1.99)	\$ (0.30)	\$ (0.57)

## NOTE 12. SUBSEQUENT EVENTS

On February 4, 2009, we made a \$408,573 follow-on investment in a privately held tiny technology portfolio company.

On February 13, 2009, we made a \$200,000 follow-on investment in a privately held tiny technology portfolio company.

On March 11, 2009, we made a \$3,492 follow-on investment in a privately held tiny technology portfolio company.

On December 31, 2008, we valued the shares of one of our privately held tiny technology portfolio companies at \$2.5188 per share. On February 27, 2009, that company raised additional funding from a third party, independent financial investor at \$5.0376 per share. This transaction could be a material input to our determination of the value of our shares of this portfolio company at March 31, 2009. A valuation calculated based on this input alone could increase the value of this portfolio company at March 31, 2009, ranging from \$0 to approximately \$5,400,000, or \$0 to approximately \$0.21 per share, from the value at December 31, 2008. This input will be one of many used by our Valuation Committee, which is made up of all of our independent directors, to set the value of this portfolio company at March 31, 2009.

## NOTE 13. SELECTED QUARTERLY DATA (UNAUDITED)

	2008			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Total investment income	\$ 576,302	\$ 467,625	\$ 587,918	\$ 355,502
Net operating loss	\$ (2,480,618)	\$ (2,638,283)	\$ (2,196,739)	\$ (3,371,511)
Net (decrease) increase in net assets resulting from operations	\$ (3,289,035)	\$ 1,354,709	\$ (34,032,747)	\$ (13,214,424)
Net (decrease) increase in net assets resulting from operations per average outstanding share	\$ (0.14)	\$ 0.06	\$ (1.32)	\$ (0.51)
	2007			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
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 (decrease) increase 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

HARRIS & HARRIS GROUP, INC.  
FINANCIAL HIGHLIGHTS

	Year Ended December 31, 2008	Year Ended December 31, 2007	Year Ended December 31, 2006
<b>Per Share Operating Performance</b>			
Net asset value per share, beginning of year	\$ 5.93	\$ 5.42	\$ 5.68
Net operating (loss)*	(0.43)	(0.53)	(0.37)
Net realized (loss) income on investments*	(0.34)	0.00	0.01
Net decrease in unrealized depreciation as a result of sales*	0.34	0.00	0.00
Net (increase) decrease in unrealized depreciation on investments held*(1)	(1.49)	0.23	(0.21)
Total from investment operations*	(1.92)	(0.30)	(0.57)
Net increase as a result of stock-based compensation expense*	0.24	0.36	0.24
Net increase as a result of proceeds from exercise of options	0.00	0.19	0.07
Net (decrease) increase as a result of stock offering, net of offering expenses	(0.01)	0.26	0.00
Total increase from capital stock transactions	0.23	0.81	0.31
Net asset value per share, end of year	\$ 4.24	\$ 5.93	\$ 5.42
Stock price per share, end of year	\$ 3.95	\$ 8.79	\$ 12.09
Total return based on stock price	(55.06)%	(27.3)%	(13.0)%
<b>Supplemental Data:</b>			
Net assets, end of year	\$ 109,531,113	\$ 138,363,344	\$ 113,930,303
Ratio of expenses to average net assets	9.6%	11.6%	9.2%
Ratio of net operating loss to average net assets	(8.1)%	(9.5)%	(6.6)%
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	\$ 0.00
Number of shares outstanding, end of year	25,859,573	23,314,573	21,015,017

\*Based on average shares outstanding.

(1) Net unrealized gains (losses) includes rounding adjustments to reconcile change in net asset value per share. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a description of unrealized losses on investments.

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, 2008, 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 2008 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.

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 5, 2009, to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934 (the "2009 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, Chief Accounting 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).

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 Nasdaq Stock Market.

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 2009 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 "How Many Shares Do the Company's Principal Shareholders, Directors and Executive Officers Own?" in the 2009 Proxy Statement is herein incorporated by reference. The "Equity Compensation Plan Information" chart is set forth herein 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 2009 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 2008 and 2007" in the 2009 Proxy Statement is herein incorporated by reference.

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, 2008, and 2007;
- Consolidated Statements of Operations for the years ended December 31, 2008, 2007, and 2006;
- Consolidated Statements of Cash Flows for the years ended December 31, 2008, 2007, and 2006;
- Consolidated Statements of Changes in Net Assets for the years ended December 31, 2008, 2007, and 2006;
  - Consolidated Schedule of Investments as of December 31, 2008;
  - Consolidated Schedule of Investments as of December 31, 2007;
  - Footnote to Consolidated Schedule of Investments;
  - Notes to Consolidated Financial Statements; and
- Financial Highlights for the years ended December 31, 2008, 2007, and 2006.

(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.

4\* Form of Specimen Certificate of Common Stock.

10.1\* Harris & Harris Group, Inc. Form of Custody Agreement with The Bank of New York Mellon.

10.2\*Form of Indemnification Agreement which has been established with all directors and executive officers of the Company.

10.3Deferred 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.

10.4Amendment 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.

10.5Amendment 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.

10.7Trust 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.

10.8Harris & Harris Group, Inc. Amended and Restated Employee Profit-Sharing Plan, incorporated by reference as Exhibit 10.8 to the Company's Form 10-K for the year ended December 31, 2007 (File No. 814-00176) filed on March 13, 2008.

10.9Harris & 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.

10.10Form 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.

10.12Amended 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.

10.13Amended 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.

10.14Amended 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.

10.15Amended 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.

- 10.16 Agreement of Sub-Sublease, dated April 18, 2003, by and between Prominent USA, Inc. and Harris & Harris Group, Inc., incorporated by reference as Exhibit 10.17 to the Company's Form 10-K for the year ended December 31, 2007 (File No. 814-00176) filed on March 13, 2008.
- 10.17 Amendment to Agreement of Sub-Sublease, dated May 9, 2003, by and between Prominent USA, Inc., and Harris & Harris Group, Inc., incorporated by reference as Exhibit 10.18 to the Company's Form 10-K for the year ended December 31, 2007 (File No. 814-00176) filed on March 13, 2008.
- 10.18 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., incorporated by reference as Exhibit 10.19 to the Company's Form 10-K for the year ended December 31, 2007 (File No. 814-00176) filed on March 13, 2008.
- 10.19 Lease dated July 1, 2008 by and between Jack Rominger, Tommie Plemons and Dale Denson as Lessor and Harris & Harris Group, Inc., a New York corporation, as Lessee, incorporated by reference as Exhibit 10.1 to the Company's Form 10-Q (File No. 814-00176) filed on November 7, 2008.
- 10.20 Nonsolicitation and Noncompetition Agreement between the Company and Charles E. Harris, dated July 31, 2008, incorporated by reference as Exhibit 10 to the Company's Form 8-K (File No. 814-00176) filed on August 1, 2008.
- 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 August 1, 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 13, 2009

By: /s/ Douglas W. Jamison  
Douglas W. Jamison  
Chairman of the Board and  
Chief Executive Officer

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/ Douglas W. Jamison Douglas W. Jamison	Chairman of the Board and Chief Executive Officer	March 13, 2009
/s/ Daniel B. Wolfe Daniel B. Wolfe	Chief Financial Officer	March 13, 2009
/s/ Patricia N. Egan Patricia N. Egan	Chief Accounting Officer and Senior Controller	March 13, 2009
/s/ W. Dillaway Ayres, Jr. W. Dillaway Ayres, Jr.	Director	March 13, 2009
/s/ C. Wayne Bardin C. Wayne Bardin	Director	March 13, 2009

/s/ Phillip A. Bauman Phillip A. Bauman	Director	March 13, 2009
/s/ G. Morgan Browne G. Morgan Browne	Director	March 13, 2009
/s/ Dugald A. Fletcher Dugald A. Fletcher	Director	March 13, 2009
/s/ Lori D. Pressman Lori D. Pressman	Director	March 13, 2009
/s/ Charles E. Ramsey Charles E. Ramsey	Director	March 13, 2009
/s/ James E. Roberts James E. Roberts	Director	March 13, 2009
/s/ Richard P. Shanley Richard P. Shanley	Director	March 13, 2009

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
3.2	Restated By-laws.
4	Form of Specimen Certificate of Common Stock.
10.1	Harris & Harris Group, Inc. Form of Custody Agreement with The Bank of New York Mellon.
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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.