UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

Form 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934

For quarterly period ended June 30, 1998

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _______________ to __________________

Commission File Number: 0-11576

HARRIS & HARRIS GROUP, INC.
- ---
(Exact name of registrant as specified in its charter)

New York	13-3119827
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

One Rockefeller Plaza, Rockefeller Center, New York, New York	10020
(Address of Principal Executive Offices)	(Zip Code)

212/332-3600
- ---
(Registrant's telephone number, including area code)

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 __X__ No ____

Harris & Harris Group, Inc.
Form 10-Q, June 30, 1998

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Harris & Harris Group, Inc.
Form 10-Q, June 30, 1998

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

The information furnished in the accompanying financial statements reflects all adjustments that are, in the opinion of management, necessary for a fair presentation of the results for the interim period presented. Certain information and disclosures normally included in the financial statements in accordance with Generally Accepted Accounting Principles have been condensed or omitted as permitted by Regulation S-X and Regulation S-K. It is suggested that the accompanying financial statements be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 1997 contained in the Company's 1997 Annual Report.

On June 30, 1994, the Company's shareholders approved a proposal to allow the Company to make an election to become a Business Development Company ("BDC") under the Investment Company Act of 1940, as amended. The Company made such election on July 26, 1995. On September 25, 1997, the Company's Board of Directors approved a proposal to seek qualification of the Company in 1998 as a Regulated Investment Company ("RIC") under Sub-Chapter M of the Internal Revenue (the "Code"). (At that time, the Company was taxable under Sub-Chapter C of the Code (a "C Corporation").) On April 8, 1998, the Company announced that it had received a certification from the Securities and Exchange Commission for 1997 relating to the Company's status under section 851(e) of the Code. That certification was necessary for the Company to qualify as a RIC for 1998 and subsequent taxable years.

Pursuant to the Company's receipt of the section 851(e) certification, the Company's Board of Directors declared and paid a one-time cash dividend of $0.75 per share to meet one of the Company's requirements for qualification for Sub-Chapter M tax treatment in 1998. The Company has requested rulings from the Internal Revenue Service (the "IRS") regarding other issues relevant to the Company's tax status as a RIC. (See Note 5 of Notes to Financial Statements.) Although there is no assurance such rulings will be issued, the management of the Company believes favorable rulings are likely.

The qualification of the Company as a RIC under Sub-Chapter M of the Code depends on it satisfying certain technical requirements regarding its income, investment portfolio, and distributions. (See "Management's Discussion and Analysis of Financial Condition and Results of Operations --

Taxation under Sub-Chapter M.") There can be no assurance that the Company will qualify for Sub-Chapter M treatment for 1998 or subsequent years. In addition, under certain circumstances, even if the Company were qualified for Sub-Chapter M treatment in 1998 or a subsequent year, the Company might elect to be taxed in that year as a C Corporation. Nevertheless, the Company's financial statements for 1998 assume that the Company will qualify for such treatment and that the rulings requested from the IRS will be issued.

<TABLE>
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STATEMENTS OF ASSETS AND LIABILITIES

ASSETS

<S>	<C> June 30, 1998 (Unaudited)	<C> December 31, 1997 (Audited)
Investments, at value (See accompanying schedule of investments and notes)	$ 25,707,972	$ 38,659,230
Cash and cash equivalents.	150,677	145,588
Prepaid expenses	73,580	85,126
Other assets	171,058	383,840
	------------	-------------
Total assets	$ 26,103,287	$ 39,273,784
	============	=============
LIABILITIES & NET ASSETS		
Accounts payable and accrued liabilities .	$ 532,937	$ 899,491
Deferred rent.	47,035	51,662
Deferred income tax liability (Note 5) . .	0	667,697
Note Payable (Note 6).	2,500,000	4,000,000
	------------	-------------
Total liabilities.	3,079,972	5,618,850
	------------	-------------
Commitments and contingencies (Note 6)		
Net assets	$ 23,023,315	$ 33,654,934
	------------	-------------
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, 25,000,000 shares authorized; 10,641,400 outstanding at 6/30/98 and 10,692,971 issued and outstanding at 12/31/97	106,930	106,930
Additional paid in capital	16,178,727	16,178,979
Accumulated net realized income.	3,893,147	12,028,191
Accumulated unrealized appreciation of investments, net of deferred tax liability of $1,856,958 at 6/30/98 and $2,817,898 at 12/31/97	2,980,246	5,340,834
Treasury stock, at cost (51,571 shares). .	(135,735)	0
	------------	------------
Net assets	$ 23,023,315	$ 33,654,934
	------------	------------
Total net assets and liabilities	$ 26,103,287	$ 39,273,784
	============	============
Shares outstanding	10,641,400	10,692,971
	------------	------------
Net asset value per outstanding share. . .	$ 2.16	$ 3.15
	============	============

</TABLE>

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

<TABLE>
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STATEMENTS OF OPERATIONS

(Unaudited)

<S> <C> <C>

	Three Months Ended 6/30/98	Three Months Ended 6/30/97	Six Months Ended 6/30/98	Six Months Ended 6/30/97
Investment income:				
Interest from:				
Fixed-income securities. . .	$ 75,375	$ 78,944	$ 267,666	$ 215,231
Affiliated companies	27,453	8,889	86,485	18,889
Other income	0	7,500	7,348	8,369
Total investment income. . .	102,828	95,333	361,499	242,489
Expenses:				
Salaries and benefits.	227,537	345,919	464,148	786,243
Profit sharing expense	(225,045)	0	(423,808)	0
Administration and operations.	109,744	127,449	197,948	225,776
Professional fees.	91,073	54,732	180,099	142,829
Rent	38,807	33,219	77,615	72,716
Directors' fees and expenses .	41,392	14,878	70,134	50,726
Depreciation	12,500	15,000	25,000	30,000
Custodian fees	3,291	3,637	6,198	7,143
Interest expense (Note 6). . .	0	0	73,415	0
Total expenses	299,299	594,834	670,749	1,315,433
Operating loss before income taxes	(196,471)	(499,501)	(309,250)	(1,072,944)
Income tax (provision) benefit (Note 5)	0	(30,534)	(393,243)	168,347
Net operating loss	(196,471)	(530,035)	(702,493)	(904,597)
Net realized gain on investments:				
Realized gain on sale of investments	508,516	168,030	587,177	791,138
Total realized gain.	508,516	168,030	587,177	791,138
Income tax provision (Note 5).	0	(58,810)	0	(276,898)
Net realized gain on investments	508,516	109,220	587,177	514,240
Net realized (loss) income . . .	312,045	(420,815)	(115,316)	(390,357)
Net decrease in unrealized appreciation on investments:				
Increase as a result of investment sales	110,625	0	110,625	0
Decrease as a result of investment sales	(705,314)	0	(793,212)	(1,764,909)
Increase on investments held. .	0	1,430,872	3,777,692	2,845,226
Decrease on investments held.	(2,341,712)	(5,420,882)	(6,416,633)	(7,674,552)
Change in unrealized appreciation on investments	(2,936,401)	(3,990,010)	(3,321,528)	(6,594,235)
Income tax benefit (Note 5).	151,983	1,384,519	960,940	2,295,998
Net decrease in unrealized appreciation on investments	(2,784,418)	(2,605,491)	(2,360,588)	(4,298,237)
Net decrease in net assets from operations:				
Total	$(2,472,373)	$(3,026,306)	$(2,475,904)	$(4,688,594)
Per outstanding share . . .	$ (0.23)	$ (0.29)	$ (0.23)	$ (0.45)

</TABLE>

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

<TABLE>
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STATEMENTS OF CASH FLOWS

(Unaudited)

<S>	<C> Six Months Ended June 30, 1998	<C> Six Months Ended June 30, 1997
Cash flows used in operating activities:		
Net decrease in net assets resulting from operations	$ (2,475,904)	$ (4,688,594)
Adjustments to reconcile net decrease in net assets from operations to net cash used in operating activities:		
Net realized and unrealized loss on investments	2,734,351	5,803,097
Deferred income taxes	(667,697)	(2,187,447)
Depreciation.	25,000	30,000
Changes in assets and liabilities:		
Prepaid expenses.	11,546	41,952
Interest receivable	101,106	82,652
Other assets.	86,675	104,581
Accounts payable and accrued liabilities	(314,752)	26,132
Deferred rent	(4,627)	(4,626)
Purchase of fixed assets.	0	(18,427)
	-----------	----------
Net cash used in operating activities	(504,302)	(810,680)
Cash provided by investing activities:		
Net sale of short-term investments and marketable securities	11,060,414	3,437,835
Investment in private placements and loans	(895,308)	(2,650,565)
	-----------	-----------
Net cash provided by investing activities	10,165,106	787,270
Cash flows used in financing activities:		
Payment of dividend	(8,019,728)	0
Payment of note payable (Note 6) . .	(1,500,000)	0
Purchase of Treasury stock (Note 6)	(165,714)	0
Proceeds from sale of stock.	29,727	0
	----------	----------
Net cash used in financing activities	(9,655,715)	0
Net increase (decrease) in cash and cash equivalents:		
Cash and cash equivalents at beginning of the period	145,588	155,440
Cash and cash equivalents at end of the period	150,677	132,030
	------------	-------------
Net increase (decrease) in cash and cash equivalents	$ 5,089	$ (23,410)
	============	=============
Supplemental disclosures of cash flow information:		
Income taxes paid	$ 300	$ 5,959
Interest paid	$ 73,415	$ 0

</TABLE>

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STATEMENTS OF CHANGES IN NET ASSETS

(Unaudited)

<S>	<C> Three Months Ended 6/30/98	6/30/97	<C> Six Months Ended 6/30/98	6/30/97
Changes in net assets from operations:				

Net operating loss.	$ (196,471)	$ (530,035)	$ (702,493)	$(904,597)
Net realized gain on investments.	508,516	109,220	587,177	514,240
Net decrease in unrealized appreciation on investments as a result of sales. . .	(594,689)	0	(682,587)	(1,147,190)
Net decrease in unrealized appreciation on investments held	(2,189,729)	(2,605,491)	(1,678,001)	(3,151,047)
Net decrease in net assets resulting from operations .	(2,472,373)	(3,026,306)	(2,475,904)	(4,688,594)
Changes in net assets from capital stock transactions:				
Payment of dividends.	(8,019,728)	0	(8,019,728)	0
Proceeds from sale of stock .	29,727	0	29,727	0
Purchase of Treasury stock. .	(165,714)	0	(165,714)	0
Net decrease in net assets resulting from capital stock transactions	(8,155,715)	0	(8,155,715)	0
Net decrease in net assets . .	(10,628,088)	(3,026,306)	(10,631,619)	(4,688,594)
Net assets:				
Beginning of the period . .	33,651,403	34,270,315	33,654,934	35,932,603
End of the period	$ 23,023,315	$31,244,009	$23,023,315	$31,244,009

</TABLE>

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

<TABLE>
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SCHEDULE OF INVESTMENTS JUNE 30, 1998
(Unaudited)

<S>	<C> Method of Valuation (3)	<C> Shares/ Principal	<C> Value
Investments in Unaffiliated Companies (12)(13)(14) -- 13.1% of total investments			
Publicly Traded Portfolio (Common stock unless noted otherwise) -- 11.0% of total investments			
Oil and Gas Related			
CORDEX Petroleums Inc. (1) Argentine and Chilean oil and gas exploration -- 2.01% of fully diluted equity			
Class A Common Stock.	(C)	4,052,080	$ 93,863
Biotechnology and Healthcare Related			
Somnus Medical Technology, Inc. (1)(4). .	(C)	35,000	286,580
Energy Research Corporation (1) -- Fuel cell energy	(C)	55,000	1,086,250
Princeton Video Image, Inc. (1)(2)(7) -- Real time sports and entertainment advertising -- 1.4% of fully diluted equity	(C)	150,200	576,302
Voice Control Systems, Inc. (1)(2) -- Supplier of speech recognition and related speech input technology -- 2.2% of			

fully diluted equity	(C)	268,343	795,805

Total Publicly Traded Portfolio (cost: $3,664,180)			$ 2,838,800
Private Placement Portfolio (Illiquid) -- 2.1% of total investments			
Exponential Business Development Company (1)(2)(5) -- Venture capital partnership focused on early stage companies -- 0.87% of fully diluted equity Limited partnership interest	(A)	--	$ 25,000
MedLogic Global Corporation (1)(2) -- Medical cyanoacrylate adhesive -- 0.42% of fully diluted equity Series B Convertible Preferred Stock . . .	(B)	60,319	
Common Stock	(B)	25,798	511,692

Total Private Placement Portfolio (cost: $1,058,775)			$ 536,692

Total Investments in Unaffiliated Companies (cost: $4,722,955)			$ 3,375,492

</TABLE>

The accompanying notes are an integral part of this schedule.

<TABLE>
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SCHEDULE OF INVESTMENTS JUNE 30, 1998
(Unaudited)

<S>	<C> Method of Valuation (3)	<C> Shares/ Principal	<C> Value
Investments in Non-Controlled Affiliates (12)(14) -- 51.1% of total investments			
Publicly Traded Portfolio -- 11.4% of total investments Nanophase Technologies Corporation (1)(6)(8) -- Manufactures and markets inorganic crystals of nanometric dimensions -- 5.10% of fully diluted equity Common Stock	(C)	730,916	$ 2,923,664

Total Publicly Traded Portfolio (cost: $1,626,204)			$ 2,923,664

Private Placement Portfolio (Illiquid) -- 39.7% of total investments Genomica Corporation (1)(2)(5)(6)(9) -- Develops software that enables the study of complex genetic diseases -- 10.8% of fully diluted equity Common Stock	(A)	199,800	
Series A Voting Convertible Preferred Stock.	(A)	1,660,200	$ 1,000,304
InSite Marketing Technology, Inc. (1)(2)(4) -- Integrates marketing science and sales strategy into e-commerce -- 7.21% of fully diluted equity Common Stock	(A)	1,351,351	500,000
NBX Corporation (1)(2)(6)(10) -- Exploits innovative distributed computing technology for use in small business telephone systems -- 14.6% of fully diluted equity Series A Convertible Preferred Stock .	(B)	500,000	
Series C Convertible Preferred Stock .	(B)	240,793	
Series D Convertible Preferred Stock .	(A)	59,965	4,540,298
Promissory Note			

-- 8% due March 16, 2001 . . . . . . (A) $ 10,000 10,000

PHZ Capital Partners Limited Partnership (2)
-- Organizes and manages investment
partnerships -- 20.0% of fully
diluted equity
Limited partnership interest . . . . (D) -- 1,405,622
Demand Promissory Note -- 8% . . . . (A) $ 500,000 500,000

Questech Corporation (1)(2)(6)
-- Manufactures and markets proprietary
decorative tiles and signs -- 12.6% of
fully diluted equity
Common Stock . . . . (D) 565,792 2,263,168
Warrants at $4.00 expiring 11/28/01. .(A) 166,667 167

Total Private Placement Portfolio (cost: $6,420,308). . . . . $ 10,219,559

Total Investments in
Non-Controlled Affiliates (cost: $8,046,512) . . . . $ 13,143,223
</TABLE>
The accompanying notes are an integral part of this schedule.

<TABLE>
<CAPTION>
SCHEDULE OF INVESTMENTS JUNE 30, 1998
(Unaudited)

<S>	<C> Method of Valuation (3)	<C> Shares/ Principal	<C> Value
Private Placement Portfolio in Controlled Affiliates (12)(14) (Illiquid) -- 15.1% of total investments			
BioSupplyNet, Inc. (1)(2)(6)(11) -- Expands commercially the print and World Wide Web product directories developed by Cold Spring Harbor Laboratory Press -- 47.6% fully diluted equity			
Series A Convertible Preferred Stock. .	(A)	775,000	$ 775,000
Warrants at $1.00 expiring 6/30/07. . .	(A)	235,000	
Revolving Credit Facility (Note 6). . .	(A)	$ 235,000	235,000
MultiTarget, Inc. (1)(2)(6) -- Developing intellectual property related to localized treatment of cancer -- 37.5% of fully diluted equity			
Series A Convertible Preferred Stock. .	(A)	375,000	210,000
NeuroMetrix, Inc. (1)(2)(6) -- Developing devices for: 1) diabetics to monitor their blood glucose and 2) detection of carpal tunnel syndrome -- 27.6% of fully diluted equity			
Series A Convertible Preferred Stock. .	(B)	175,000	
Series B Convertible Preferred Stock. .	(B)	125,000	
Series C-2 Convertible Preferred Stock.	(A)	229,620	2,648,100

Total Private Placement Portfolio in Controlled Affiliates (cost: $2,778,100)			$ 3,868,100
U.S. Government Obligations -- 20.7% of total investments			
U.S. Treasury Bill dated 02/05/98 due date 08/06/98 -- 4.7% yield. . .	(K)	$ 250,000	$ 248,791
U.S. Treasury Bill dated 03/05/98 due date 09/03/98 -- 4.8% yield . . .	(K)	$ 395,000	391,571
U.S. Treasury Bill dated 04/02/98 due date 10/01/98 -- 5.0% yield . . .	(K)	$ 2,250,000	2,221,470
U.S. Treasury Bill dated 04/30/98 due date 10/29/98 -- 4.9% yield . . .	(K)	$ 2,500,000	2,459,325

Total Investments in U.S. Government Obligations (cost: $5,323,201)	$ 5,321,157
Total Investments -- 100% (cost: $20,870,768)	$25,707,972

</TABLE>

The accompanying notes are an integral part of this schedule.

SCHEDULE OF INVESTMENTS JUNE 30, 1998
(Unaudited)

Notes to Schedule of Investments

(1) Represents a non-income producing security. Equity investments that have not paid dividends within the last twelve months are considered to be non-income producing.
(2) Legal restrictions on sale of investment.
(3) See Footnote to Schedule of Investments for a description of the Method of Valuation A to L.
(4) These investments were made during 1998. Accordingly, the amounts shown on the schedule represent the gross additions in 1998.
(5) No changes in valuation occurred in these investments during the six months ended June 30, 1998.
(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 has not yet commenced its planned principal operations or has commenced such operations but has not realized significant revenue from them.
(7) Formerly named Princeton Electronic Billboard, Inc. As of June 30, 1998, the market price per share of Princeton Video Image, Inc. ("PVII") was $4.625. As of August 3, 1998, the market price was $4.875 and the Company valued its holding at $617,815. The Company is subject to a lock-up agreement on the stock, which expires December 16, 1998.
(8) As of June 30, 1998, the market price per share of Nanophase Technologies Corporation ("NANX") was $5.00. As of August 3, 1998, the market price per share was $3.50, and the Company valued its holding at $2,046,565.
(9) Genomica Corporation was cofounded by the Company, Cold Spring Harbor Laboratory and Falcon Technology Partners, LP. Mr. G. Morgan Browne serves on the Board of Directors of the Company and is Administrative Director of Cold Spring Harbor Laboratory.
(10) Formerly named PowerVoice Technologies, Inc.
(11) BioSupplyNet, Inc. was cofounded by the Company, Cold Spring Harbor Laboratory and other investors. Mr. G. Morgan Browne serves on the Board of Directors and is Administrative Director of Cold Spring Harbor Laboratory.
(12) Investments in unaffiliated companies consist of investments in which Harris & Harris Group,Inc. (the "Company") owns less than 5 percent of the investee company. Investments in non-controlled affiliated companies consist of investments where the Company owns more than 5 percent but less than 25 percent of the investee company. Investments in controlled affiliated companies consist of investments where the Company owns more than 25 percent of the investee company.
(13) The aggregate cost for federal income tax purposes of investments in unaffiliated companies is $4,830,632. The gross unrealized appreciation based on tax cost for these securities is $170,469. The gross unrealized depreciation based on the tax cost for these securities is $1,625,608.
(14) The percentage ownership of each investee company disclosed in the Schedule of Investments expresses the potential common equity interest in each such investee. The calculated percentage represents the amount of the issuer's common stock the Company owns or can acquire as a percentage of the issuer's total outstanding common stock plus common shares reserved for issued and outstanding warrants, convertible securities and stock options.

The accompanying notes are an integral part of this schedule.

FOOTNOTE TO SCHEDULE OF INVESTMENTS

ASSET VALUATION POLICY GUIDELINES

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

1) EQUITY-RELATED SECURITIES

2) INVESTMENTS IN INTELLECTUAL PROPERTY OR PATENTS OR RESEARCH AND DEVELOPMENT IN TECHNOLOGY OR PRODUCT DEVELOPMENT

3) LONG-TERM FIXED-INCOME SECURITIES
4) SHORT-TERM FIXED-INCOME INVESTMENTS
5) ALL OTHER INVESTMENTS

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

The Company's Board of Directors is responsible for 1) determining overall valuation guidelines and 2) ensuring the valuation of investments within the prescribed guidelines.

The Company's Investment and Valuation Committee, comprised of at least three or more Board members, is responsible for reviewing and approving the valuation of the Company's assets within the guidelines established by the Board of Directors.

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

Valuation assumes that, in the ordinary course of its business, the Company will eventually sell its investment.

The Company's valuation policy with respect to the five broad investment categories is as follows:

EQUITY-RELATED SECURITIES

Equity-related securities are carried at fair value using one or more of the following basic methods of valuation:

A. Cost: The cost method is based on the original cost to the Company. This method is generally used in the early stages of a company's development until significant positive or negative events occur subsequent to the date of the original investment that dictate a change to another valuation method. Some examples of such events are: 1) a major recapitalization; 2) a major refinancing; 3) a significant third-party transaction; 4) the development of a meaningful public market for the company's common stock; 5) significant positive or negative changes in the company's business.

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

C. Public Market: The public market method is used when there is an established public market for the class of the company's securities held by the Company. The Company discounts market value for securities that are subject to significant legal, contractual or practical restrictions, including large blocks in relation to trading volume. Other securities, for which market quotations are readily available, are carried at market value as of the time of valuation.

Market value for securities traded on securities exchanges or on the Nasdaq National Market is the last reported sales price on the day of valuation. For other securities traded in the over-the-counter market and listed securities for which no sale was reported on that day, market value is the mean of the closing bid price and asked price on that day.

This method is the preferred method of valuation when there is an established public market for a company's securities, as that market provides the most objective basis for valuation.

D. Analytical Method: The analytical method is generally used to value an investment position when there is no established public or private market in the company's securities or when the factual information available to the Company dictates that an investment should no longer be valued under either the cost or private market method. This valuation method is inherently imprecise and ultimately the result of reconciling the judgments of the Company's Investment and Valuation Committee members, based on the data available to them. The resulting valuation, although stated as a precise number, is necessarily within a range of values that vary depending upon the significance attributed to the various factors being considered. Some of the factors considered may include the financial condition and operating results of the company, the long-term potential of the business of the company, the values of similar securities issued by

companies in similar businesses, the proportion of the company's securities owned by the Company and the nature of any rights to require the company to register restricted securities under applicable securities laws.

INVESTMENTS IN INTELLECTUAL PROPERTY OR PATENTS OR RESEARCH AND DEVELOPMENT IN TECHNOLOGY OR PRODUCT DEVELOPMENT

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

E. Cost: The cost method is based on the original cost to the Company. Such method is generally used in the early stages of commercializing or developing intellectual property or patents or research and development in technology or product development until significant positive or adverse events occur subsequent to the date of the original investment that dictate a change to another valuation method.

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

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

LONG-TERM FIXED-INCOME SECURITIES

H. Fixed-Income Securities for which market quotations are readily available are carried at market value as of the time of valuation using the most recent bid quotations when available.

Securities for which market quotations are not readily available are carried at fair value using one or more of the following basic methods of valuation:

I. Fixed-Income Securities are valued by independent pricing services that provide market quotations based primarily on quotations from dealers and brokers, market transactions, and other sources.

J. Other Fixed-Income Securities that are not readily marketable are valued at fair value by the Investment and Valuation Committee.

SHORT-TERM FIXED-INCOME INVESTMENTS

K. Short-Term Fixed-Income Investments are valued at market value at the time of valuation. Short-term debt with remaining maturity of 60 days or less is valued at amortized cost.

ALL OTHER INVESTMENTS

L. All Other Investments are reported at fair value as determined in good faith by the Investment and Valuation Committee.

The reported values of securities for which market quotations are not readily available and for other assets reflect the Investment and Valuation Committee's judgment of fair values as of the valuation date using the outlined basic methods of valuation. They do not necessarily represent an amount of money that would be realized if the securities had to be sold in an immediate liquidation. The Company makes many of its portfolio investments with the view of holding them for a number of years, and the reported value of such investments may be considered in terms of disposition over a period of time. Thus, valuations as of any particular date are not necessarily indicative of amounts that may ultimately be realized as a result of future sales or other dispositions of investments held.

NOTES TO FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. THE COMPANY

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

The Company elected to become a BDC on July 26, 1995, after receiving the necessary approvals. From September 30, 1992 until the election of BDC status, the Company operated as a closed-end, non-diversified, investment company under the 1940 Act. Upon commencement of operations as an investment company, the Company revalued all of its assets and liabilities at fair value as defined in the 1940 Act. Prior to such time, the Company was registered and filed under the reporting requirements of the Securities and Exchange Act of 1934 as an operating company and, while an operating company, operated directly and through subsidiaries. As a BDC, the Company continues to be subject to such reporting requirements.

On September 25, 1997, the Company's Board of Directors approved a proposal to seek qualification in 1998 as a RIC under Sub-Chapter M of the Code. As a RIC, the Company must, among other things, distribute at least 90 percent of its taxable net income and may either distribute or retain its taxable net realized capital gains on investments. (See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Taxation under Sub-Chapter M.") There can be no assurance that the Company will qualify as a RIC or that if it does qualify, it will continue to qualify. In addition, even if the Company were to qualify as a RIC, under certain circumstances, it might elect in a given year to be taxed as a C Corporation.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Cash and Cash Equivalents. Cash and cash equivalents include money market instruments with maturities of less than three months.

Portfolio Investment Valuations. Investments are stated at "fair value" as defined in the 1940 Act and in the applicable regulations of the Securities and Exchange Commission. All assets are valued at fair value as determined in good faith by, or under the direction of, the Board of Directors. See the Asset Valuation Policy Guidelines in the Footnote to Schedule of Investments.

Securities Transactions. Securities transactions are accounted for on the date the securities are purchased or sold (trade date); dividend income is recorded on the ex-dividend date; and interest income is accrued as earned. Realized gains and losses on investment transactions are determined on the first-in, first-out basis for financial reporting and tax bases.

Income Taxes. Prior to January 1, 1998, the Company recorded income taxes using the liability method in accordance with the provision of Statement of Financial Accounting Standards No. 109. Accordingly, deferred tax liabilities had been established to reflect temporary differences between the recognition of income and expenses for financial reporting and tax purposes, the most significant difference of which relates to the Company's unrealized appreciation on investments.

The June 30, 1998 financial statements do not include a provision for deferred taxes on unrealized gains other than the provision for taxes on the unrealized gains as of December 31, 1997, net of the operating and capital loss carryforwards incurred by the Company through December 31, 1997. (See Note 5. Income Taxes.)

Reclassifications. Certain reclassifications have been made to the December 31, 1997 and June 30, 1997 financial statements to conform to the June 30, 1998 presentation.

Estimates by Management. The preparation of the financial statements in conformity with Generally Accepted Accounting Principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of June 30, 1998 and December 31,1997, and the reported amounts of revenues and expenses for the three months and six months ended June 30, 1998 and June 30, 1997. Actual results could differ from these estimates.

NOTE 3. STOCK OPTION PLAN AND WARRANTS OUTSTANDING

On August 3, 1989, the shareholders of the Company approved the 1988 Long Term Incentive Compensation Plan. On June 30, 1994, the shareholders of the Company approved various amendments to the 1988 Long Term Incentive Compensation Plan: 1) to conform to the provisions of the Business Development Company regulations under the 1940 Act, which allow for the issuance of stock options to qualified participants; 2) to increase the reserved shares under the amended plan; 3) to call the plan the 1988 Stock Option Plan, as Amended and Restated (the "1988 Plan"); and 4) to make various other amendments. On October 20, 1995, the shareholders of the Company approved an amendment to the 1988 Plan authorizing automatic 20,000 share grants of non-qualified stock options to newly elected non-employee directors of the Company. The Company's 1988 Plan was cancelled as of December 31, 1997, canceling all outstanding stock options and eliminating all potential stock option grants.

The Company accounted for the 1988 Plan under APB Opinion No. 25, under which no compensation cost has been recognized. Had compensation cost for the 1988 Plan been determined consistent with the fair value method required by FASB Statement No. 123 ("FASB No. 123"), the Company's net realized (loss) income and net asset value per share would have been reduced to the following pro-forma amounts:

<TABLE>

<S>	<C> Three Months Ended June 30, 1997	<C> Six Months Ended June 30, 1997
Net Realized (Loss) Income:		
As Reported	$ (420,815)	$ (390,357)
Pro Forma	$ (526,580)	$ (601,888)
Net Asset Value per share:		
As Reported	$ 2.99	$ 2.99
Pro Forma	$ 2.98	$ 2.97

</TABLE>

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

<TABLE>

<S>	<C> June 30, 1997
Stock volatility	0.60
Risk-free interest rate	6.3%
Option term in years	7
Stock dividend yield	- -

</TABLE>

The FASB No. 123 method of accounting has not been applied to options granted prior to January 1, 1995.

A summary of the status of the Company's 1988 Plan at June 30, 1997 and changes during the six months then ended is presented in the table and narrative below. The Company's 1988 Plan was cancelled as of December 31, 1997, canceling all outstanding stock options and eliminating all potential stock option grants.

<TABLE>

	June 30, 1997	
<S>	<C> Shares	<C> Weighted Average Exercise Price
Outstanding at beginning of period	1,080,000	$4.58
Granted	320,000	$3.94
Exercised	- -	- -
Forfeited	270,000	$5.34
Expired	- -	- -
Canceled	- -	- -
Outstanding at end of period	1,130,000	$4.22

Exercisable at end of period	357,000	$3.19
Weighted average fair value of options granted		$2.50

</TABLE>

As of January 1, 1998, the Company began implementing the Harris & Harris Group, Inc. Employee Profit Sharing Plan (the "Plan") that provides for profit sharing equal to 20 percent of the net realized income of the Company as reflected on the statement of operations of the Company for such year, less the nonqualifying gain, if any. Under the Plan, net realized income of the Company includes investment income, realized gains and losses, and operating expenses (including taxes paid or payable by the Company), but it will be calculated without regard to dividends paid or distributions made to shareholders, payments under the Plan, unrealized gains and losses, and loss carry-overs from other years ("Qualifying Income"). The portion of net after-tax realized gains attributable to asset values as of September 30, 1997 will be considered nonqualifying gain, which will reduce "Qualifying Income." As of June 30, 1998, the Company does not have an accrual for the Plan and in the six months ended June 30, 1998 reversed a bonus accrual of $423,808 established as of December 31, 1997; $198,763 in the three months ended March 31, 1998 and $225,045 in the three months ended June 30, 1998.

NOTE 4. EMPLOYEE BENEFITS

The Company has an employment and severance contract ("Employment Contract") with its Chairman, Charles E. Harris, pursuant to which he is to receive compensation in the form of salary and other benefits. On January 1, 1998 Mr. Harris' Employment Contract was amended to reduce his salary to $200,000 and to allow him to participate in other business opportunities and investments. The term of the contract expires on December 31, 1999. Base salary is to be increased annually to reflect inflation and in addition may be increased by such amount as the Compensation Committee of the Board of Directors of the Company deems appropriate. In addition, Mr. Harris would be entitled, under certain circumstances, to receive severance pay under the employment and severance contracts.

As of January 1, 1989, the Company adopted an employee benefits program covering substantially all employees of the Company under a 401(k) Plan and Trust Agreement. The Company's contribution to the plan is determined by the Compensation Committee in the fourth quarter.

On June 30, 1994, the Company adopted a plan to provide medical and health coverage for retirees, their spouses and dependents who, at the time of their retirement, have ten years of service with the Company and have attained 50 years of age or have attained 45 years of age and have 15 years of service with the Company. On February 10, 1997, the Company amended this plan to include employees who "have seven full years of service and have attained 58 years of age." The coverage is secondary to any government provided or subsequent employer provided health insurance plans. Based upon actuarial estimates, the Company provided an original reserve of $176,520 that was charged to operations for the period ending June 30, 1994. As of June 30, 1998, the Company had a reserve of $255,430 for the plan.

NOTE 5. INCOME TAXES

For the three months ended June 30, 1998 and 1997, the Company's income tax benefit was allocated as follows:

<TABLE>

<S>	<C> Three Months Ended 6/30/98	<C> Three Months Ended 6/30/97	<C> Six Months Ended 6/30/98	<C> Six Months Ended 6/30/97
Investment operations	$ 0	$ 30,534	$ 393,243	$ (168,347)

Realized gain on investments	0	58,810	0	276,898
Net decrease in unrealized appreciation on investments	(151,983)	(1,384,519)	(960,940)	(2,295,998)
Total income tax benefit	$(151,983)	$(1,295,175)	$(567,697)	$(2,187,447)
The above tax benefit consists of the following:				
Current -- Federal	$ 0	$ (16,197)	$ 100,000	$ 0
Deferred -- Federal	(151,983)	(1,278,978)	(667,697)	(2,187,447)
Total income tax benefit	$(151,983)	$(1,295,175)	$(567,697)	$(2,187,447)

</TABLE>

The Company's net deferred tax liability at June 30, 1998 and December 31, 1997 consists of the following:

<TABLE>
<S> <C> <C>

	June 30, 1998	December 31, 1997
Unrealized appreciation on investments	$ 1,856,958	$ 2,817,898
Net operating loss and capital carryforward	(1,856,958)	(1,856,958)
Medical retirement benefits	- -	(81,345)
Other	- -	(211,898)
Net deferred income tax liability	$ 0	$ 667,697

</TABLE>

On September 25, 1997, the Company's Board of Directors approved a proposal to seek qualification in 1998 as a RIC under Sub-Chapter M of the Code. As a RIC, the Company annually must distribute at least 90 percent of its investment company taxable income as a dividend and may either distribute or retain its taxable net capital gains from investments. There can be no assurance that the Company will qualify as a RIC or that, if it does qualify, it will continue to qualify or will elect to qualify. To initially qualify as a RIC, among other requirements, the Company had to pay a dividend to shareholders equal to the Company's pre-RIC cumulative realized earnings and profits ("E&P"). On April 9, 1998, the Company declared a one-time cash dividend of $0.75 per share to meet this requirement (for a total of $8,019,728). The cash dividend was paid on May 12, 1998. Continued qualification as a RIC requires the Company to satisfy certain portfolio diversification requirements in future years. The Company's ability to satisfy those requirements may not be controllable by the Company. (See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Taxation under Sub-Chapter M.")

The Company incurred ordinary and capital losses for a total of approximately $5.3 million during its C Corporation taxable years that remain available for use and may be carried forward to its 1998 and subsequent taxable years. Ordinarily, a corporation that elects to qualify as a RIC may not use its loss carryforwards from C Corporation taxable years to offset RIC investment company taxable income or net capital gains. In addition, a 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 from sales of assets that were held by the corporation on the effective date of the election ("C Corporation Assets") to the extent of any gain built into the assets on such date ("Built-In Gain"). The Company has filed a private ruling request with the Internal Revenue Service ("IRS") asking the IRS to rule that the Company can carry forward its C Corporation losses to offset any Built-In Gains resulting from sales of its C Corporation Assets, thereby enabling the Company to retain some or all of the proceeds from such sales without disqualifying itself as a RIC or incurring corporate level income tax. The Company intends to use the $5.3 million loss carryforward to reduce the taxes due to Built-In Gains. The June 30, 1998 NAV includes the ordinary and capital loss carryforwards which is approximately $0.17.

In addition, because a RIC is not permitted to have, as of the close of any RIC taxable year, E&P accumulated during any C Corporation taxable year, the Company has also requested a ruling that its sale of C Corporation Assets with Built-In Gains during RIC taxable years will not generate C Corporation E&P. Although there is no guarantee that the IRS will rule favorably on the Company's request for rulings, the management of the Company believes that favorable rulings are likely.

The Company's net deferred income tax liability as of June 30, 1998 would have been approximately $0 had it continued to account for its taxes as a C Corporation.

NOTE 6. COMMITMENTS AND CONTINGENCIES

During 1993, the Company signed a ten-year lease with sublet provisions for office space. In 1995, this lease was amended to include additional office space. Rent expense under this lease was $38,807 and $33,219 and for the three months ended June 30, 1998 and 1997, respectively and $77,615 and $72,716 for the six months ended June 30, 1998 and 1997, respectively. Future minimum lease payments in each of the following years are: 1999 -- $176,030; 2000 -- $178,561; 2001 -- $178,561; 2002 -- $178,561; 2003 -- $101,946.

In December 1993, the Company and MIT announced the establishment by the Company of the Harris & Harris Group Senior Professorship at MIT. Prior to the arrangement for the establishment of this Professorship, the Company had made gifts of stock in start-up companies to MIT. These gifts, together with the contribution of $700,000 in cash in 1993, which was expensed by the Company in 1993, were used to establish this named chair. The Company contributed to MIT securities with a cost basis of $3,280, $20,000 and $20,000 in 1993, 1994, and 1995, respectively. These contributions will be applied to the MIT Pledge at their market value at the time the shares become publicly traded or otherwise monetized in a commercial

transaction and are free from restriction as to sale by MIT. At June 30, 1998, the Company would have to fund additional cash and/or property that would have to be valued at a total of approximately $760,000 by December 1998, in order for the Senior Professorship to become permanent.

In June 1997, the Company agreed to provide one of its investee companies with a $450,000 revolving line of credit, of which $235,000 had been used through June 30, 1998. The purpose of this line of credit, which will be secured by accounts receivable, is to provide for seasonal cash flow. To the extent that this line of credit is utilized, the Company will also receive warrants to purchase common stock.

In December 1997, the Company signed a Demand Promissory Note for a $4,000,000 line of credit with J.P. Morgan collateralized by the Company's U.S. Treasury obligations. In March 1998 the line of credit was increased to $6,000,000. As of December 31, 1997, the Company had borrowed $4,000,000 against the line of credit. From December 31, 1997 to January 2, 1998, the rate on the line of credit was prime (8.5 percent). From January 2, 1998 to April 2, 1998, the interest rate on the line of credit was LIBOR plus 1.5 percent (7.3125 percent). In March 1998, the Company paid down $2,500,000; in April 1998, the Company paid the remaining balance. On June 30, 1998, the Company borrowed $2,500,000 against the line of credit at an interest rate of 8.5 percent through July 2, 1998. From July 2, 1998 forward the interest rate was LIBOR plus 1.5 percent (7.21875 percent).

On April 15, 1998, the Company announced that the Board of Directors had approved the purchase of up to 700,000 shares of Company stock in the open market. As of June 30, 1998, the Company had purchased a total of 61,400 shares for a total of $165,714 or an average of $2.70 per share.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The Company accounts for its operations under Generally Accepted Accounting Principles for investment companies. On this basis, the principal measure of its financial performance is captioned "Net (decrease) increase in net assets from operations," which is the sum of three elements. The first element is "Net operating loss," which is the difference between the Company's income from interest, dividends, and fees and its operating expenses, net of applicable income tax (provision) benefit. The second element is "Net realized gain on investments," which is the difference between the proceeds received from dispositions of portfolio securities and their stated cost, net of applicable income tax provisions. These two elements are combined in the Company's financial statements and reported as "Net realized (loss) income." The third element, "Net decrease in unrealized appreciation on investments," is the net change in the fair value of the Company's investment portfolio, net of increase (decrease) in deferred income taxes that would become payable if the unrealized appreciation were realized through the sale or other disposition of the investment portfolio.

"Net realized gain on investments" and "Net decrease in unrealized appreciation on investments" are directly related. When a security is sold to realize a (loss) gain, net unrealized appreciation (increases) decreases and net realized gain (decreases) increases.

Financial Condition

The Company's total assets and net assets were, respectively, $26,103,287 and $23,023,315 at June 30, 1998, compared to $39,273,784 and $33,654,934 at December 31, 1997. The decrease is mainly due to the payment of a one-time cash dividend of approximately $8 million to meet one of the Company's requirements for qualifications for Sub-Chapter M tax treatment in 1998; and a decrease of approximately $3.9 million in the valuation of one of the Company's investee companies, Nanophase Technologies Corporation. Net asset value per share was $2.16 at June 30, 1998 and $3.15 at December 31, 1997.

The Company's outstanding shares were 10,641,400 as of June 30, 1998 and 10,692,971 as of December 31, 1997. The Company's outstanding shares were reduced as a result of its buyback program of 61,400 shares for a total of $165,714. However the treasury shares were then decreased by purchases of Company stock by directors with 50 percent of their director compensation.

The Company's financial condition is dependent on the success of its investments. The Company has invested a substantial portion of its assets in private development stage or start-up companies. These private businesses tend to be thinly capitalized, unproven, small companies that lack management depth or have no history of operations. At June 30, 1998, approximately 56.0 percent of the Company's $26.1 million in total assets consisted of investments at fair value in private businesses, of which net unrealized appreciation was approximately $4.4 million before taxes. At December 31, 1997, approximately 34.0 percent of the Company's $39.3 million in total assets consisted of investments at fair value in private businesses, of which net unrealized appreciation

was approximately $2.5 million before taxes, if applicable.

A summary of the Company's investment portfolio is as follows:

<TABLE>

<S>	<C> June 30, 1998	<C> December 31, 1997
Investments, at cost	$20,870,768	$30,500,498
Unrealized appreciation*	4,837,204	8,158,732
	-----------	-----------
Investments, at fair value	$25,707,972	$38,659,230
	==========	==========

</TABLE>

*The accumulated unrealized appreciation on investments net of deferred taxes is $2,980,246 at June 30, 1998, versus $5,340,834 at December 31, 1997. (See Note 5 of Notes to Financial Statements.)

Following an initial investment in a private company, the Company may make additional investments in such investee in order to: (1) increase its ownership percentage; (2) to exercise warrants or options that were acquired in a prior financing; (3) to preserve the Company's proportionate ownership in a subsequent financing; or (4) attempt to preserve or enhance the value of the Company's investment. Such additional investments are referred to as "follow-on" investments. There can be no assurance that the Company will make follow-on investments or have sufficient funds to make additional investments. The failure to make such follow-on investments could jeopardize the viability of the investee company and the Company's investment or could result in a missed opportunity for the Company to participate to a greater extent in an investee's successful operations. The Company attempts to maintain adequate liquid capital to make follow-on investments in its private investee portfolio companies. The Company may elect not to make a follow-on investment either because it does not want to increase its concentration of risk or because it prefers other opportunities, even though the follow-on investment opportunity appears attractive.

The following table is a summary of the cash investments made by the Company and other increases in cost in its private placement portfolio during the six months ended June 30, 1998:

<TABLE>

<S>	<C>
New Investments	Amount
InSite Marketing Technology, Inc.	$ 500,000
Follow-on Investments:	
MultiTarget, Inc.	$ 51,802
Exercise of Warrants:	
Voice Control Systems, Inc.	$ 82,953
Loans:	
BioSupplyNet, Inc.	$ 185,000
NBX Corporation	10,000

Sub-total	$ 195,000

Interest on Loans*	
NeuroMetrix, Inc.	$ 48,100
Voice Control Systems, Inc.	17,453

Sub-total	$ 65,553

Total	$ 895,308
	==========

</TABLE>

*The Company received additional shares in NeuroMetrix, Inc. and Voice Control Systems, Inc. in exchange for the accrued interest on its loans.

Results of Operations

Investment Income and Expenses:

The Company's principal objective is to achieve capital appreciation. Therefore, a significant portion of the investment portfolio is structured to maximize the potential for capital appreciation and provides little or no current yield in the form of dividends or interest. The Company does earn interest income from fixed-income securities, including U.S. Government Obligations. The amount of interest income earned varies based upon the average balance of the Company's fixed-income portfolio and the average yield on this portfolio.

The Company had interest income from fixed-income securities of $267,666 and $215,231 for the six months ended June 30, 1998 and 1997, respectively. The increase is due to the additional funds the Company had available for investment in fixed-income securities in 1998 as a result of the funds borrowed against the JP Morgan line of credit.

The Company had interest income from affiliated companies of $86,485 and $18,889 for the six months ended June 30, 1998 and 1997, respectively. The increase is due to the receipt of interest income on loans outstanding to investee companies.

Operating expenses were $670,749 and $1,315,433 for six months ended June 30, 1998 and 1997, respectively. The decrease is primarily due to: the reversal of $423,808 for the Company's profit-sharing plan accrual made in the fourth quarter of 1997, a decrease in salaries as a result of reduced staff and a decrease in the Chairman's salary, and a decrease in overall expenses as a result of the Company's effort to cut expenses. The decreases were offset by the

interest expense on the funds drawn on the JP Morgan line of credit. Most of the Company's operating expenses are related to employee and director compensation, office and rent expenses and consulting and professional fees (primarily legal and accounting fees).

Net operating losses before taxes were $309,250 and $1,072,944 for the six months ended June 30, 1998 and 1997, respectively.

The Company had interest income from fixed-income securities of $75,375 and $78,944 for the three months ended June 30, 1998 and 1997, respectively. The slight decrease is a result of the Company having less available funds as a result of operating expenses and additional investments.

The Company had interest income from affiliated companies of $27,453 and $8,889 for the three months ended June 30, 1998 and 1997, respectively. The increase is due to the receipt of interest income on loans outstanding to investee companies.

Operating expenses were $299,299 and $594,834 for three months ended June 30, 1998 and 1997, respectively. The decrease is primarily due to: the reversal of $225,045 for the Company's profit-sharing plan accrual made in the fourth quarter of 1997, a decrease in salaries as a result of reduced staff and a decrease in the Chairman's salary, and a decrease in administration and operation expenses as a result of the Company's effort to cut expenses. The decreases were offset by: an increase in professional fees, particularly legal fees as a result of the Company's change of tax structure; an increase in directors' fee as a result of additional Board meetings held during the three months ended June 30, 1998.

Net operating losses before taxes were $196,471 and $499,501 for the three months ended June 30, 1998 and 1997, respectively.

For a discussion of the tax benefit and provision for the three months and six months ended June 30, 1998, see Note 5 of Notes to Financial Statements.

The Company has in the past relied, and continues to rely to a large extent, upon proceeds from sales of investments, rather than investment income, to defray a significant portion of its operating expenses. Because such sales cannot be predicted with certainty, the Company attempts to maintain adequate working capital to provide for fiscal periods when there are no such sales.

Realized Gains and Losses on Sales on Portfolio Securities:

During the six months ended June 30, 1998, the Company sold various investments, realizing a net pre-tax gain of $587,177 of which a net of $682,587 has been recognized in prior periods, therefore, it decreased unrealized appreciation on investments.

During the six months ended June 30, 1997, the Company sold various public securities realizing a net pre-tax gain of $791,138, of which $1,764,909 had been recognized in prior years, therefore, it decreased unrealized appreciation on investments.

During the three months ended June 30, 1998, the Company sold various public securities realizing a net pre-tax gain of $508,516 of which a net gain of $594,689 had been recognized in prior periods, therefore, it decreased unrealized appreciation on investments. During the three months ended June 30, 1997, the Company sold various public securities realizing a net pre-tax gain of $168,030, of which none had been recognized in prior periods.

Unrealized Appreciation and Depreciation on Portfolio Securities:

The Board of Directors values the portfolio securities on a quarterly basis pursuant to the Company's Asset Valuation Policy Guidelines in accordance with the 1940 Act. (See Footnote to Schedule of Investments.)

Net unrealized appreciation on investments before taxes decreased during the six months ended June 30, 1998, $3,321,528 from $8,158,732 to $4,837,204, primarily as a result of decreased valuations in Nanophase Technologies Corporation, Princeton Video Image, Inc. and MedLogic Global Corporation. These decreases were offset primarily by increased valuations in NeuroMetrix, Inc. and Voice Control Systems, Inc.

Net unrealized appreciation on investments before taxes decreased, during the six months ended June 30, 1997, $6,594,235 from $6,667,589 to $73,354 owing primarily to decreased valuations in Gel Sciences, Inc. (subsequently acquired by MedLogic Global Corporation), Harber Brothers Productions, Inc., nFX Corporation, Princeton Video Image, Inc. and PureSpeech, Inc. (subsequently acquired by Voice Control Systems, Inc.), offset by the increased valuation in NBX Corporation and Nanophase Technologies Corporation.

Net unrealized appreciation on investments before taxes decreased during the three months ended June 30, 1998, $2,936,401 from $7,773,605 to $4,837,204 owing primarily to decreases in Voice Control Systems, Inc., MedLogic Global Corporation, Princeton Video Image, Inc., and Energy Research Corporation.

Net unrealized appreciation on investments before taxes decreased, during the three months ended June 30, 1997, $3,990,010 from $4,063,364 to $73,354 owing primarily to decreased valuations in Gel Sciences, Inc. (subsequently acquired by MedLogic Global Corporation), nFX Corporation and Princeton Video Image, Inc., offset by an increased valuation in Nanophase Technologies Corporation.

The Company's investee companies may have an overall increase in valuation over the six months period ended June 30, 1998, but a decrease in the three month period ended June 30, 1998 compared to the three month period ended March 31, 1998.

Liquidity and Capital Resources

The Company reported total cash, receivables and marketable securities (the primary measure of liquidity) at June 30, 1998 of $8,734,298 (net of $2,500,000 drawn from the JP Morgan line of credit) versus $21,693,067 (net of $4,000,000 drawn from the J.P. Morgan line of credit) at December 31, 1997. Included in marketable securities are the Company's holdings in Nanophase Technologies Corporation of $2,923,664 and Princeton Video Image, Inc. of $576,302. Princeton Video Image, Inc. is subject to a lock-up agreement and both holdings are valued at June 30, 1998 at discounts from market value: a 20 percent discount in the case of Nanophase Technologies Corporation and a 17.04 percent discount in the case of Princeton Video Image, Inc.

As of June 30, 1998, the Company had a $6,000,000 line of credit in place with J.P. Morgan, of which the Company had borrowed $2,500,000.

Management believes that its cash, receivables and marketable securities provide the Company with sufficient liquidity for its operations over the next 12 months.

On May 12, 1998, the Company paid out a one-time cash dividend of $0.75 per share for a total of $8,019,728, to meet one of the requirements for qualification for Sub-Chapter M tax treatment in 1998.

Taxation Under Sub-Chapter M

The Company presently intends to elect to be treated as a RIC for federal income tax purposes for 1998 and intends to continue to maintain that status. (See Item 1. Financial Statements Note 1.) As a qualifying RIC, if the Company distributes to stockholders annually in a timely manner at least 90 percent of its "investment company taxable income," as defined in the Code (i.e., net investment income, including accrued original issue discount, and net short-term capital gains) (the "90 percent Distribution Requirement"), it will not be subject to federal income tax on the portion of its investment company taxable income and net capital gains (net long-term capital gain in excess of net short-term capital loss) distributed to stockholders. In addition, if the Company distributes in a timely manner 98 percent of its capital gain net income for each one-year period ending on December 31, and distributes 98 percent of its net ordinary income for each calendar year (as well as any income not distributed in prior years), it will not be subject to the 4 percent nondeductible federal excise tax imposed with respect to certain undistributed income of RICs. The Company generally will endeavor to distribute to stockholders all of its investment company taxable income and its net capital gain, if any, for each taxable year so that such Company will not incur income and excise taxes on its earnings.

In order to qualify as a RIC for federal income tax purposes, the Company must, among other things: (a) continue to qualify as a BDC under the 1940 Act, (b) derive in each taxable year at least 90 percent of its gross income from dividends, interest, payments with respect to securities loans, gains from the sale of stock or securities, or other income derived with respect to its business of investing in such stock or securities (the "90 percent Income Test"); and (c) adequately diversify its holdings pursuant to detailed rules set forth in section 851 of the Code.

If the Company acquires or is deemed to have acquired debt obligations that were issued originally at a discount or that otherwise are treated under applicable tax rules as having original issue discount, the Company will be required to include in income each year a portion of the original issue discount that accrues over the life of the obligation regardless of whether cash representing such income is received in the same taxable year and to make distributions accordingly.

Although it does not presently expect to do so, the Company is authorized to borrow funds and to sell assets in order to satisfy distribution requirements. However, under the 1940 Act, the Company is not permitted to make distributions to stockholders while the Company's debt obligations and other senior securities are outstanding unless certain "asset coverage" tests are met. Moreover, the Company's ability to dispose of assets to meet its distribution requirements may be limited by other requirements relating to its status as a RIC, including the diversification requirements. If the Company disposes of assets in order to meet distribution requirements, the Company may make such dispositions at times which, from an investment standpoint, are not advantageous.

If the Company fails to satisfy the 90 percent Distribution Requirement or otherwise fails to qualify as a RIC in any taxable year, it will be subject to tax in such year on all of its taxable income, regardless of whether the Company makes any distributions to its stockholders. In addition, in that case, all of the Company's distributions to its stockholders will be characterized as ordinary income (to the extent of the Company's current and accumulated earnings and profits). In contrast, as is explained below, if the Company qualifies as a RIC, a portion of its distributions may be characterized as long-term capital gain in the hands of stockholders.

Other than distributions properly designated as "capital gain dividends" as is described below, dividends to stockholders of the investment company taxable income of the Company will be taxable as ordinary income to stockholders to the extent of the Company's current or accumulated earnings and profits, whether paid in cash or reinvested in additional shares. Distributions of the Company's net capital gain properly designated by the Company as "capital gain dividends" will be taxable to stockholders as a long-term capital gain regardless of the stockholder's holding period for his or her shares. Distributions in excess of the Company's earnings and profits will first reduce the adjusted tax basis of the stockholder's shares and, after the adjusted basis is reduced to zero, will constitute capital gains to the stockholder. For a summary of the tax rates applicable to capital gains, including capital gains dividends, see discussion below.

To the extent that the Company retains any net capital gain, it may designate such retained gain as "deemed distributions" and pay a tax thereon for the benefit of its stockholders. In that event, the stockholders will be required to report their share of retained net capital gain on their tax returns as if it had been distributed to them and report a credit, or claim a refund, for the tax paid thereon by the Company. The amount of the deemed distribution net of such tax will be added to the stockholder's cost basis for his or her shares. Since the Company expects to pay tax on net capital gain at its regular corporate capital gain tax rate, and since that rate is in excess of the maximum rate currently payable by individuals on net capital gain, the amount of tax that individual stockholders will be treated as having

paid will exceed the amount of tax that such stockholders would be required to pay on net capital gain.

Stockholders who are not subject to federal income tax or tax on capital gains should be able to file a Form 990T or an income tax return on the appropriate form that allows them to recover the taxes paid on their behalf.

Any dividend declared by the Company in October, November, or December of any calendar year, payable to stockholders of record on a specified date in such a month and actually paid during January of the following year, will be treated as if it had been received by the stockholders on December 31 of the year in which the dividend was declared.

Investors should be careful to consider the tax implications of buying shares just prior to a distribution. Even if the price of the shares includes the amount of the forthcoming distribution, the stockholder generally will be taxed upon receipt of the distribution and will not be entitled to offset the distribution against the tax basis in his or her shares.

A stockholder may recognize taxable gain or loss if he or she sells or exchanges his or her shares. Any gain arising from (or, in the case of distributions in excess of earnings and profits, treated as arising from) the sale or exchange of shares generally will be a capital gain or loss. This capital gain or loss normally will be treated as a long-term capital gain or loss if the stockholder has held his or her shares for more than one year; otherwise, it will be classified as short-term capital gain or loss. However, any capital loss arising from the sale or exchange of shares held for six months or less will be treated as a long-term capital loss to the extent of the amount of capital gain dividends received with respect to such shares and, for this purpose, the special rules of Section 246(c)(3) and (4) of the Code generally apply in determining the holding period of shares. It is unclear how any such long-term capital loss offsets capital gains taxable at different rates. All or a portion of any loss realized upon a taxable disposition of shares of the Company may be disallowed if other shares of the Company are purchased within 30 days before or after the disposition.

In general, net capital gain (the excess of net long-term capital gain over net short-term capital loss) of non-corporate taxpayers is currently subject to a maximum federal income tax rate of 20 percent (subject to reduction in many situations) while other income may be taxed at rates as high as 39.6 percent. Corporate taxpayers are currently subject to federal income tax on net capital gain at the maximum 35 percent rate also applied to ordinary income. Tax rates imposed by states and local jurisdictions on capital gain and ordinary income may differ.

The Company may be required to withhold U.S. federal income tax at the rate of 31 percent of all taxable dividends and distributions payable to stockholders who fail to provide the Company with their correct taxpayer identification number or to make required certifications, or regarding

whom the Company has been notified by the IRS that they are subject to backup withholding. Backup withholding is not an additional tax, and any amounts withheld may be credited against a stockholder's U.S. federal income tax liability.

Federal withholding taxes at a 30 percent rate (or a lesser treaty rate) may apply to distributions to stockholders that are nonresident aliens or foreign partnerships, trusts, or corporations. Foreign investors should consult their tax advisors with respect to the possible U.S. federal, state, and local tax consequences and foreign tax consequences of an investment in the Company.

The Company will send to each of its stockholders, as promptly as possible after the end of each fiscal year, a notice detailing, on a per share and per distribution basis, the amounts includible in such stockholder's taxable income for such year as ordinary income and as long-term capital gain. In addition, the federal tax status of each year's distributions generally will be reported to the IRS. Distributions may also be subject to additional state, local, and foreign taxes depending on a stockholder's particular situation. The Company's ordinary income dividends to its corporate shareholders may, if certain conditions are met, qualify for the dividends received deduction to the extent that the Company has received qualifying dividend income during the taxable year; capital gain dividends distributed by the Company are not eligible for the dividends received deduction.

If necessary for liquidity purposes, in lieu of distributing its taxable net capital gains, the Company may retain such net capital gains and elect to be deemed to have made a distribution of the gains, or part thereof, to the shareholders under the "designated undistributed capital gain" rules of section 852(b)(3) of the Code. In such a case, the Company would have to pay a 35 percent corporate level income tax on such "designated undistributed capital gain," but it would not have to distribute the excess of the retained "designated undistributed capital gain" over the amount of tax thereon in order to maintain its RIC status.

Risks

There are significant risks inherent in the Company's venture capital business. The Company has invested a substantial portion of its assets in private development stage or start-up companies. These private businesses tend 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. The Company expects that some of its 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. The Company has been risk seeking rather than risk averse in its approach to venture capital and other investments. Neither the Company's investments nor an investment in the Company is intended to constitute a balanced investment program. The Company has in the past relied and continues to rely to a large extent upon proceeds from sales of investments rather than investment income to defray a significant portion of its operating expenses. In addition, the Company may not qualify or seek to qualify for RIC status.

Risks Relating to the Year 2000 Issue

The Company believes that the Year 2000 problem is not material to the Company. Many computer software systems in use today cannot recognize the Year 2000 and may revert to 1900 or some other date because of the way in which dates were encoded and calculated. The Company could be adversely affected if its computer system or those of its service providers do not properly process and calculate date-related information and data on and after January 1, 2000. The Company has been actively working on necessary changes to its computer systems to prepare for the Year 2000 and intends to obtain reasonable assurances from its service providers that they are taking comparable steps with respect to its computer systems. However, the steps the Company is taking and intends to take do not guarantee complete success or eliminate the possibility that interaction with outside computer systems may have an adverse impact on the Company.

Forward-Looking Statements

The information contained herein contains certain forward-looking statements. These statements include the plans and objectives of management for future operations and financial objectives, portfolio growth and availability of funds. These forward-looking statements are subject to the inherent uncertainties in predicting future results and conditions. Certain factors that could cause actual results and conditions to differ materially from those projected in these forward-looking statements are set forth herein. Other factors that could cause actual results to differ materially include the uncertainties of economic, competitive and market conditions, and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond the control of the Company. Although the Company believes that the assumptions underlying the forward-looking statements included herein are reasonable, any of the assumptions could be inaccurate and therefore, there can be no assurance that the forward-looking statements included or incorporated by reference herein will prove to be accurate. Therefore, the inclusion of such information should not be regarded as a representation by the Company or any other person that the objectives and plans of the Company will be achieved.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not Applicable

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Not Applicable

Item 2. Changes in Securities and Use of Proceeds

Not Applicable

Item 3. Defaults Upon Senior Securities

Not Applicable

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

Not Applicable

Item 5. Other Information

In accordance with recent amendments to the shareholder proposal rules set forth in Rules 14a-4 and 14a-8 under the Securities and Exchange Act of 1934, as amended, written notice of shareholder proposals submitted outside the processes of Rule 14a-8 for consideration at the 1999 Annual Meeting of Shareholders must be received by the Company on or before May 11, 1999, in order to be considered timely for purposes of Rule 14a-4. The persons designated in the Company's proxy statement shall be granted discretionary authority with respect to any shareholder proposal of which the Company does not receive timely notice.

Item 6. Exhibits and Reports on Form 8-K

3.1(a) Restated Certificate of Incorporation of the Company, as amended, incorporated by reference to Exhibit 3.1(a) to the Company's Form 10-K for the year ended December 31, 1995.

3.1(b) Restated By-laws of the Company, incorporated by reference to Exhibit 3.1(b) to the Company's Form 10K for the year ended December 31, 1995.

4.1 Specimen Certificate of Common Stock, incorporated by reference to Exhibit 4 to Company's Registration Statement on Form N-2 filed October 29, 1992.

11.0* Computation of per share earnings. See Statement of Operations.

27.0* Financial Data Schedule.

(b) The Company filed a report on Form 8-K on June 15, 1998 concerning the Company's Employee Profit Sharing Plan.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Harris & Harris Group, Inc.

By: /s/ Rachel M. Pernia

Rachel M. Pernia, Vice President
Treasurer, Controller and Principal
Accounting Officer

Date: August 14, 1998

EXHIBIT INDEX

Item Number (of Item 601 of Regulation S-K)

27. Financial Data Schedule

WARNING: THE EDGAR SYSTEM ENCOUNTERED ERROR(S) WHILE PROCESSING THIS SCHEDULE.

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