

SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 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, 1998

Commission File No. 0-11576

HARRIS & HARRIS GROUP, INC.

-----  
(Exact Name of Registrant 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)

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

-----  
Securities registered pursuant to Section 12(b) of the Act: None

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

Common Stock \$ .01 par value

-----  
(Title of class)

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 [ ]

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. [X]

The aggregate market value of the Common Stock held by non-affiliates of Registrant as of March 5, 1999 was \$17,230,640 based on the last sale price as quoted by Nasdaq National Market on such date (only officers and directors are considered affiliates for this calculation).

As of March 5, 1999, the registrant had 10,426,648 shares of common stock, par value \$.01 per share, outstanding.

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PART I

Item 1. Business

Harris & Harris Group, Inc. (the "Registrant" or "Company") is a venture capital investment company, operating as a Business Development Company ("BDC") under the Investment Company Act of 1940 (the "1940 Act"). The Company's objective is to achieve long-term capital appreciation, rather than current income, from its investments. The Company has invested a substantial portion of its assets in private development stage or start-up companies and in the development of new technologies in a broad range of industry segments. 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. The Company may also invest, to the extent permitted under the 1940 Act, in publicly traded securities, including high risk securities as well as investment grade securities. The Company may participate in expansion financing and leveraged buyout financing of more mature operating companies as well as other investments. As a venture capital company, the Company invests in and provides managerial assistance to its private investees which, in its opinion, have significant potential for growth. There is no assurance that the Company's investment objective will be achieved.

The Company was incorporated under the laws of the State of New York in August 1981. Prior to September 30, 1992, the Company had a class of securities registered, and filed under the reporting requirements, of the Securities Exchange Act of 1934 (the "1934 Act") as an operating company. On that date the Company commenced operations as a closed-end, non-diversified investment company under the 1940 Act. On July 26, 1995, the Company elected to become a BDC subject to the provisions of Sections 55 through 65 of the 1940 Act. As a BDC, 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.

On September 25, 1997, the Company's Board of Directors approved a proposal to seek qualification of the Company as a Regulated Investment Company ("RIC") under Sub-Chapter M of the Internal Revenue Code (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 ("SEC") 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 and its intention to qualify as a RIC, the Company's Board of Directors declared and paid a one-time cash dividend of \$0.75 per share, for a total of \$8,019,728, to meet one of the Company's requirements for qualification for Sub-Chapter M tax treatment. On February 17, 1999, the Company received rulings from the Internal Revenue Service (the "IRS") regarding other issues relevant to the Company's tax status as a RIC. (See "Note 6 of Notes to Financial Statements" contained in "Item 8. Financial Statements and Supplementary Data" & "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations -- Recent Developments - Sub-Chapter M Status".)

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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. The Company was unable to satisfy these requirements for the 1998 tax year owing to the nature of the Company's ownership interest in one of its investee companies, and therefore it will not elect Sub-Chapter M status for 1998. In addition, because the Company realized taxable losses in 1998, it was not strategically advantageous for the Company to elect Sub-Chapter M tax status for 1998. Moreover, the Company received a tax opinion in 1998 that the Company interprets to mean that its tax-loss carryforward at December 31, 1998 of approximately \$7.1 million (resulting in a tax credit of approximately \$2.5 million) would be applicable as a qualifying RIC to its unrealized gains as of December 31, 1998. That opinion was confirmed in one of the rulings received from the IRS in February 1999.

The Company changed the nature of its ownership interest in the non-qualifying investee company effective January 1, 1999 in order to meet the Sub-Chapter M requirements. However, there can be no assurance that the Company will qualify for Sub-Chapter M treatment for 1999 or subsequent years. In addition, under certain circumstances, even if the Company were qualified for Sub-Chapter M treatment in 1999 and elected Sub-Chapter M treatment for that year, the Company might take action in a subsequent year to ensure that it would be taxed in that subsequent year as a C Corporation, rather than a RIC.

#### Venture Capital Investments

The Company has invested a substantial portion of its assets in private development stage or start-up companies. The Company may initially own 100 percent of the securities of a start-up investee company for a period of time and may control such company for a substantial period. In connection with its venture capital investments, the Company may be involved in recruiting management, formulating operating strategies, product development, marketing and advertising, assisting in financial plans, as well as providing management in the initial start-up stages and establishing corporate goals. The Company may assist in raising additional capital for such companies from other potential investors and may subordinate its own investment to that of other investors. The Company may introduce such companies to potential joint-venture partners, suppliers and customers. In addition, the Company may assist in establishing relationships with investment bankers and other professionals. The Company may also assist with mergers and acquisitions. The Company may also find it necessary or appropriate to provide additional capital of its own. The Company may derive income from such companies for the performance of any of the above services. Because of the speculative nature of these investments and the lack of any market for such securities, 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 likely to become successful, but never realize their potential. The Company has in the past sought, and will continue in the future to seek, investments that offer the potential for significantly higher returns but that involve a significantly greater degree of risk than other investments.

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The Company may control an investee company for which it has provided venture capital, or it may be represented on the company's board of directors by one or more of its officers or directors, who may also serve as officers of such company. Particularly during the early stages of an investment, the Company may in effect be conducting the operations of the

investee company. As a venture company emerges from the developmental stage with greater management depth and experience, the Company expects that its role in the company's operations will diminish. The Company seeks to assist each investee company in establishing its own independent capitalization, management and board of directors. The Company expects to be able to reduce its active involvement in the management of its investment in those start-up companies that become successful by a liquidity event, such as a public offering or sale of a company.

The Company has invested a substantial portion of its assets in securities that do not pay interest or dividends and that are subject to legal or contractual restrictions on resale that may adversely affect the liquidity and marketability of such securities.

In addition to the information discussed above, please see "Item 8. Financial Statements and Supplementary Data."

### Intellectual Property

The Company believes there is a role for organizations like itself that can assist in technology transfer. Scientists and institutions that develop and patent intellectual property increasingly seek the rewards of entrepreneurial commercialization of their inventions, particularly as governmental, philanthropic and industrial funding for research has become harder to obtain. The Company believes that several factors combine to give it a high value-added role to play in the commercialization of technology: its experience in organizing and developing successful new companies; its willingness to invest its own capital at the highest risk- seed stage; its access to high-grade institutional sources of intellectual property; its experience in mergers, acquisitions and divestitures; its access to and knowledge of the capital markets; and its willingness to do as much of the early work as it is qualified to do.

The Company invests principally in securities issued by companies involved in: 1) research and development of a technology and/or obtaining licensing rights to intellectual property or patents; 2) outright acquisition of intellectual property or patents; and 3) formation and funding of companies or joint ventures to commercialize intellectual property. Income from the Company's investments in intellectual property or its development may take the form of participation in licensing or royalty income or some other form of remuneration. At some point during the commercialization of a technology, the Company's investment may be transformed into ownership of securities of a development stage or start-up company as discussed above. Investing in intellectual property is highly risky.

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### Illiquidity of Investments

Many of the Company's investments consist of securities acquired directly from the issuer in private transactions. These investments may be subject to restrictions on resale or otherwise be illiquid. The Company does not anticipate that there will be any established trading market for such securities. Additionally, many of the securities that the Company may invest in will not be eligible for sale to the public without registration under the Securities Act of 1933, as amended, which could prevent or delay any sale by the Company of such investments or reduce the amount of proceeds that might otherwise be realized therefrom. Restricted securities generally sell at a price lower than similar securities not subject to restrictions on resale. Further, even if a portfolio company registers its securities and becomes a reporting company under the 1934 Act, the Company may be considered an insider by virtue of its board representation or otherwise and would be restricted in sales of such company's securities.

### Managerial Assistance

The Company generally is required by the 1940 Act to make significant managerial assistance available with respect to investee companies that the Company treats as qualifying assets for purposes of the 70 percent test (see "Regulation"). "Making available significant managerial assistance" as defined in the 1940 Act with respect to a BDC such as the Company means (a) any arrangement whereby a BDC, through its directors, officers, employees or general partners, offers to provide, and if accepted, does so provide,

significant guidance and counsel concerning the management, operations, or business objectives and policies of a portfolio company; or (b) the exercise by a BDC of a controlling influence over the management or policies of a portfolio company by a BDC acting individually or as a part of a group acting together which controls such portfolio company. The Company believes that providing managerial assistance to its investees is critical to its business development activities. The nature, timing and amount of managerial assistance provided by the Company vary depending upon the particular requirements of each investee company.

The Company may be involved with its investees in recruiting management, product planning, marketing and advertising and the development of financial plans, operating strategies and corporate goals. In this connection, the Company may assist clients in developing and utilizing accounting procedures to efficiently and accurately record transactions in books of account, which will facilitate asset and cost control and the ready determination of results of operations. The Company also seeks capital for its investees from other potential investors and occasionally subordinates its own investment to those of other investors. The Company may introduce its investees to potential suppliers, customers and joint venture partners and assists its investees in establishing relationships with commercial and investment bankers and other professionals, including management consultants, recruiters, legal counsel and independent accountants. The Company also assists with joint ventures, acquisitions and mergers.

In connection with its managerial assistance, the Company may be represented by one or more of its officers or directors on the board of directors of an investee. As an investment matures and the investee develops management depth and experience, the Company's role ordinarily will

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become progressively less active. However, when the Company owns or acquires a substantial proportion of a more mature investee company's equity, the Company may remain active in and may initiate planning of major transactions by the investee. The Company typically seeks to assist each investee company in establishing its own independent and effective board of directors and management.

#### Need for Follow-On Investments

Following its initial investment in investees, the Company has made and anticipates that it will continue to make additional investments in such investees as "follow-on" investments, in order to increase its investment in an investee, and may exercise warrants, options or convertible securities that were acquired in the original financing. Such follow-on investments may be made for a variety of reasons including: 1) to increase the Company's exposure to an investee, 2) to acquire securities issued as a result of exercising convertible securities that were purchased in the original financing, 3) to preserve the Company's proportionate ownership in a subsequent financing, or 4) to attempt to preserve or enhance the value of the Company's investment. There can be no assurance that the Company will make follow-on investments or have sufficient funds to make such investments; the Company has the discretion to make any follow-on investments as it determines, subject to the availability of capital resources. The failure to make such follow-on investments may, in certain circumstances, jeopardize the continued viability of an investee and the Company's initial investment, or may result in a missed opportunity for the Company to increase its participation in a successful operation. Even if the Company has sufficient capital to make a desired follow-on investment, the Company may under certain circumstances be inhibited from doing so if such an investment would result in non-compliance with BDC or RIC regulations.

#### Competition

Numerous companies and individuals are engaged in the venture capital business and such business is intensely competitive. Most of the competitors have significantly greater experience, resources and managerial capabilities than the Company and are therefore in a better position than the Company to obtain access to attractive venture capital investments.

#### Regulation

The Small Business Investment Incentive Act of 1980 added the provisions of the 1940 Act applicable to BDC's, which are a special type of closed-end investment company. After filing its election to be treated as a BDC, a company 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 BDC's, and is 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 managerial expertise to companies which do not have ready access to capital through conventional financial channels. Such portfolio companies are termed "eligible portfolio

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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 1934 Act; (iii) operate for the purpose of investing in the securities of certain types of portfolio companies, namely, immature 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; (v) have a majority of "disinterested" directors (as defined in the 1940 Act); and (vi) file a proper notice of election with the SEC.

An eligible portfolio company generally is a domestic company that is not an investment company and that (i) does not have a class of equity securities on which "margin" credit can be extended or (ii) is controlled by a BDC (control under the 1940 Act is presumed to exist where a BDC owns at least 25 percent of the outstanding voting securities of the investee).

The 1940 Act prohibits or restricts companies subject to the 1940 Act from investing in certain types of companies, such as brokerage firms, insurance companies, investment banking firms and investment companies. Moreover, the 1940 Act requires that at least 70 percent of the value of the Company's assets consist of qualifying assets. Qualifying assets include: (i) securities of companies that were eligible portfolio companies at the time the Company acquired their securities; (ii) securities of bankrupt or insolvent companies that were eligible at the time of the Company's initial investment in those companies; (iii) securities received in exchange for or distributed in or with respect to any of the foregoing; and (iv) cash items, government securities and high quality short-term debt. The 1940 Act also places restrictions on the nature of the transactions in which, and the persons from whom, securities can be purchased in order for the securities to be considered qualifying assets.

The Company is permitted by the 1940 Act, under specified conditions, to issue multiple classes of senior debt and a single class of preferred stock if its 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 its net assets).

The Company may sell its securities at a price that is below the prevailing net asset value per share only after a majority of its disinterested directors has determined that such sale would be in the best interest of the Company and its stockholders and upon the approval by the holders of a majority of its outstanding voting securities, including a majority of the voting securities held by non-affiliated persons. If the offering of the securities is underwritten, a majority of the disinterested directors must determine in good faith that the price of the securities being sold is not less than a price which closely approximates market value of the securities, less any distribution discount or commission. As defined by the 1940 Act, the term "majority of the Company's outstanding voting securities" means the vote of (i) 67 percent or more of the Company's Common Stock present at the meeting, if the holders of more than 50 percent of the outstanding Common Stock are present or represented by proxy or (ii) more than 50 percent of the Company's outstanding Common Stock, whichever is less.

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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 the Company and investee companies.

On September 25, 1997, the Company's Board of Directors approved a proposal to seek qualification of the Company as a RIC under Sub-Chapter M of the Code. The Company was unable to satisfy the requirements for Sub-Chapter M for the 1998 tax year. (See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations -- Recent Developments - Sub Chapter M Status.") There can be no assurance that the Company will qualify for Sub-Chapter M treatment for 1999 or subsequent years. In addition, under certain circumstances, even if the Company were qualified for Sub-Chapter M treatment in 1999 and elected Sub-Chapter M treatment for that year, the Company might take action in a subsequent year to ensure that it would be taxed in that subsequent year as a C Corporation, rather than a RIC.

#### Employees

The Company currently employs four full-time employees.

#### Item 2. Properties

The Company maintains its offices at One Rockefeller Plaza, Suite 1430, New York, New York 10020, where it leases approximately 4,700 square feet of office space pursuant to a lease agreement expiring in 2003. A portion of this space was sublet in 1997 and 1998 to an early-stage company in which the Company had an equity interest. See "Note 7 to the Financial Statements" and Schedules contained in "Item 8. Financial Statements and Supplementary Data."

#### Item 3. Legal Proceedings

None.

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

The Company did not submit any matters to a vote of its shareholders during the fourth quarter of the 1998 fiscal year.

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### PART II

#### Item 5. Market for Company's Common Equity and Related Stockholder Matters

##### Stock Transfer Agent

The Bank of New York, 101 Barclay Street, Suite 12W, New York, New York 10286 (Telephone 800-524-4458, Attention: Ms. Diane Ajjan) serves as transfer agent for the Company's common stock. Certificates to be transferred should be mailed directly to the transfer agent, preferably by registered mail.

##### Market Prices

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

<TABLE>

<S>	<C>	<C>
1998 Quarter Ending	Low	High
March 31	\$2.1875	\$3.4375
June 30	\$2.2500	\$3.6875
September 30	\$1.2500	\$2.3750
December 31	\$1.1250	\$1.5938
1997 Quarter Ending	Low	High
March 31	\$3.3750	\$5.1250
June 30	\$3.5000	\$4.8125
September 30	\$2.5000	\$3.7500

December 31                      \$2.5000   \$4.0000  
 </TABLE>

On September 25, 1997, the Company's Board of Directors approved a proposal to seek qualification of the Company as a RIC under Sub-Chapter M of the Code. To initially qualify as a RIC, the Company had, among other things, to pay a dividend to shareholders equal to the Company's cumulative realized earnings and profits ("E&P") from its pre-RIC taxable years. The Company paid a \$0.75 dividend on May 12, 1998 to shareholders of record on April 27, 1998. (See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations -- Recent Developments - Sub-Chapter M Status" and "Note 6 of Notes to Financial Statements" contained in "Item 8. Financial Statements and Supplementary Data".)

On February 22, 1999, NBX Corporation announced that it had agreed to be acquired by 3Com Corporation for approximately \$90 million in cash plus additional consideration for employees of NBX. This transaction was effective on March 5, 1999 and closed on March 8, 1999. On closing, the Company received a total of \$12,432,940 in cash, of which \$1,475,276 was placed in a one-year escrow. On February 23, 1999, the Board of Directors of the Company declared a cash dividend of \$0.35 per share (approximately \$3.7 million) to shareholders of record on March 19, 1999, payable on March 25, 1999. Prior to 1998, the Company had not paid dividends since 1991.

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Recent Sales of Unregistered Securities

The Company has not sold unregistered shares for the years ended December 31, 1998 and 1997 other than the restricted common stock shares sold to Directors as part of their compensation program. In 1997, the Board of Directors approved that effective January 1, 1998, 50 percent of all Director fees be used to purchase Company common stock directly from the Company. During 1998, the Directors have purchased a total of 24,491 shares. (See "Note 4 of Notes To Financial Statements" contained in "Item 8. Financial Statements and Supplementary Data.") On March 1, 1999, the Directors voted to purchase their shares in the open market rather than directly from the Company.

Shareholders

As of February 26, 1999, there were approximately 164 holders of record of the Company's common stock which, the Company has been informed, hold the Company's common stock for approximately 2,000 beneficial owners.

Item 6. Selected Financial Data

The following tables should be read in conjunction with the Financial Statements and Schedules included in Item 8 of this Form 10-K.

<TABLE>  
 <CAPTION>

BALANCE SHEET DATA  
 Financial Position as of December 31:

<S>	<C>	<C>	<C>	<C>	<C>
	1998	1997	1996	1995	1994
Total assets	\$25,358,859	\$39,273,784	\$38,555,290	\$37,524,555	\$32,044,073
Total liabilities	\$ 2,802,150	\$ 5,618,850	\$ 2,622,687	\$ 962,646	\$ 733,271
Net asset value	\$22,556,709	\$33,654,934	\$35,932,603	\$36,561,909	\$31,310,802
Net asset value per share	\$ 2.13	\$ 3.15	\$ 3.44	\$ 3.54	\$ 3.43
Shares outstanding	10,591,232	10,692,971	10,442,682	10,333,902	9,136,747



Operating Data for year ended December 31:

	1998	1997	1996	1995	1994
Investment income	\$ 635,486	\$ 614,046	\$ 1,013,417	\$ 1,109,517	\$ 820,276
Net operating loss	(2,765,112)	(1,498,141)	(1,291,065)	(1,099,409)	(2,278,882)
Net realized (loss) gain on investments	(1,768,528)	(2,079,677)	(2,465,175)	1,371,349	96,856
Net realized (loss) income	(4,533,640)	(3,577,818)	(3,756,240)	271,940	(2,182,026)
Net increase (decrease) in unrealized appreciation on investments	1,655,830	969,243	2,967,248	158,219	(886,040)
Net (decrease) increase in net assets resulting from operations	(2,877,810)	(2,608,575)	(788,992)	430,159	(3,068,066)
(Decrease) increase in net assets resulting from operations per outstanding share	\$ (0.27)	\$ (0.24)	\$ (0.08)	\$ 0.04	\$ (0.34)

</TABLE>

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

Statement 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 resulting 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, fees and other income and its operating expenses, net of applicable income tax benefit (provision). The second element is "Net realized loss on investments," which is the difference between the proceeds received from dispositions of portfolio securities and their stated cost, net of applicable income tax (benefits) provisions. These two elements are combined in the Company's financial statements and reported as "Net realized loss." The third element, "Net increase 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 loss on investments" and "Net increase 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 \$25,358,859 and \$22,556,709 at December 31, 1998, respectively, versus \$39,273,784 and \$33,654,934 at December 31, 1997, respectively. The decrease is primarily owing to: 1) the payment of a one-time cash dividend of \$8,019,728 to meet one of the Company's requirements for qualification for Sub-Chapter M

treatment; 2) the payment of the Company's outstanding balance on the Demand Promissory Note of \$4,000,000, which reduced the Company's total assets in 1998; and 3) the decrease of \$2,877,810 as a result of operations. (See "Statement of Operations" contained in "Item 8. Financial Statements and Supplementary Data".)

Net asset value per share ("NAV") was \$2.13 at December 31, 1998, versus \$3.15 at December 31, 1997. NAV was reduced \$0.75 by the cash dividend paid by the Company in 1998.

The Company's shares outstanding as of December 31, 1998 were 10,591,232, versus 10,692,971 at December 31, 1997. The Company's outstanding shares were reduced as a result of its repurchase in the open market of a total of 126,230 shares as of December 31, 1998. However, the treasury shares were then decreased by purchases of Company stock by directors with 50 percent of their director compensation. (See "Note 4 of Notes to Financial Statements" contained in "Item 8. Financial Statements and Supplementary Data".)

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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 December 31, 1998, \$19,562,386 or 77 percent of the Company's total assets consisted of investments at fair value in private businesses, of which net unrealized appreciation was \$10,250,204 before taxes. At December 31, 1997, \$13,222,857 or 34 percent of the Company's total assets consisted of investments at fair value in private businesses, of which net unrealized appreciation was \$2,464,795 before taxes. The increase in the percentage of private investments from 34 percent in 1997 to 77 percent in 1998 is primarily owing to 1) an increase in the value of several private investments; 2) the payment of the Company's outstanding balance on the Demand Promissory Note of \$4,000,000, which reduced the Company's total assets in 1998; 3) the decrease of \$2,877,810 as a result of operations (See "Statement of Operations" contained in "Item 8. Financial Statements and Supplementary Data"); and 4) the payment of a one-time cash dividend of \$8,019,728 to meet one of the Company's requirements for qualification for Sub-Chapter M treatment.

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

<TABLE>

<S>	<C> December 31, 1998	<C> December 31, 1997
Investments, at cost	\$14,124,643	\$30,500,498
Unrealized appreciation	10,407,548	8,158,732
	-----	-----
Investments, at fair value	\$24,532,191	\$38,659,230
	=====	=====

The accumulated unrealized appreciation on investments net of deferred taxes is \$6,996,664 at December 31, 1998, versus \$5,340,834 at December 31, 1997.

</TABLE>

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) exercise warrants or options that were acquired in a prior financing; (3) 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, because it prefers other opportunities, or because it is inhibited by compliance with BDC or RIC requirements, even though the follow-on investment opportunity appears attractive.

The following table is a summary of the cash investments made by the Company in its private placement portfolio during the year ended December 31, 1998:

<TABLE>

<S>	<C>
New Investments:	Amount
InSite Marketing Technology, Inc.	\$ 500,000
Follow-on Investments:	
MultiTarget, Inc.	\$ 51,802
Loans:	
BioSupplyNet, Inc. (SciQuest, Inc.)	\$ 250,000
NBX Corporation	10,000
	-----
Sub-total	\$ 260,000
Interest on Loans*:	
NeuroMetrix, Inc.	\$ 48,100
Voice Control Systems, Inc.	17,453
	-----
Sub-total	\$ 65,553
Exercise of Warrants Held:	
Voice Control Systems, Inc.	\$ 82,953
	-----
Total	\$ 960,308
	=====

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

</TABLE>

## Results of Operations

### Investment Income and Expenses:

The Company had a net operating loss of \$2,765,112 in 1998, \$1,498,141 in 1997 and \$1,291,065 in 1996. The Company's investment objective is to achieve long-term capital appreciation rather than current income from its investments. 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 total average yield on this portfolio.

The Company had total investment income of \$635,486 in 1998, \$614,046 in 1997 and \$1,013,417 in 1996. The Company had interest income from fixed-income securities of \$355,591 in 1998, \$490,807 in 1997 and \$803,819 in 1996. The decrease from 1997 to 1998 of \$135,216 or 27.5 percent is a result of a decline in the balance of the Company's fixed-income portfolio as a result of the dividend, operating expenses and additional investments in non-income producing private portfolio investments. The decrease from 1996 to 1997 of \$313,012 or 38.9 percent is a result of the decline of the Company's fixed-income portfolio as a result of operating expenses and additional investments in non-income producing private portfolio investments. The Company also received consulting and administrative fees which totaled \$29,870 in 1997 and \$68,185 in 1996. The Company did not receive any consulting or administrative fees in 1998.

The Company had interest income from affiliated companies of \$124,877 in 1998, \$40,000 in 1997 and \$40,779 in 1996. The increase from 1997 to 1998 of \$84,877 or 212.2 percent is owing to the receipt of interest income (either in

funds or additional shares) on loans to investee companies and the increase in loans and outstanding lines of credit to investee companies, principally NeuroMetrix, Inc. and BioSupplyNet, Inc. (which in 1998 was merged with SciQuest, Inc.).

The Company had other income of \$102,468 in 1998, \$869 in 1997 and \$92,610 in 1996. The increase of \$101,599 or 116.9 percent from 1997 to 1998 is a result of the receipt of \$88,000 from BioSupplyNet to reimburse the Company for consulting fees paid and expensed by the Company in 1996 as part of the investment costs of BioSupplyNet.

Also in 1998 and 1997, the Company received or accrued dividends of \$50,000 and \$52,500 from its investment in PHZ Capital Partners, L.P.

Operating expenses were \$3,634,786 in 1998, \$3,045,290 in 1997 and \$2,985,316 in 1996. The increase from 1997 to 1998 of \$589,496 or 19.4% is primarily owing to: an increase in accrual for the Company's profit-sharing plan of \$899,751 or 112.3% over the prior year (See "Note 3 of Notes to Financial Statements" contained in "Item 8. Financial Statements and Supplementary Data"); the final payment on the Harris & Harris Group Senior Professorship Pledge to the Massachusetts Institute of Technology of \$728,862; mitigated by a decrease in salaries and benefits of \$676,136 or 44.9%. To date, no actual payments have been made under the Company's profit-sharing plan.

The increase from 1996 to 1997 of \$59,974 or 2.0% is primarily owing to: the accrual of \$423,808 for the Company's profit-sharing plan; restructuring expenses of \$100,000 incurred by the Company as a result of researching the conversion to RIC status; mitigated by a decrease in overall expenses as a result of the Company's effort to cut expenses. Most of the Company's operating expenses were related to employee and director compensation, office and rent expenses and consulting and professional fees (primarily legal and accounting fees). To date, no actual payments have been made under the Company's profit-sharing plan.

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 of Portfolio Securities:

During the three years ended December 31, 1998, 1997 and 1996, the Company sold various investments, realizing a net loss of \$1,768,528, \$3,199,502 and \$3,792,576, respectively. During 1998, the Company realized losses on: the sale of its privately held investment in MultiTarget, Inc. of \$209,999; publicly-held investments that were once privately held, including CORDEX Petroleum, Inc. in the amount of \$357,736; Nanophase Technologies Corporation of \$329,055 (common stock shares purchased in the open market); Princeton Video Image, Inc. of \$288,369; and Voice Control Systems, Inc.

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(which purchased the Company's investee company, PureSpeech, Inc.) of \$724,826. These losses were offset by a realized net gain of \$141,457 in various publicly traded securities. Net losses of \$1,171,496 had been recognized in prior years and realized in 1998. Realizing losses and gains from prior years increases (for losses) or decreases (for gains) the Unrealized Appreciation on Investments.

During 1997, the Company realized losses on the sale of its investments in: nFX Corporation in the amount of \$2,631,720; Harber Brothers Productions, Inc. of \$1,205,000; Gel Sciences, Inc. of \$633,028; Dynecology, Inc. of \$99,900; and Micracor Corporation of \$66,444. These losses were offset by gains on the sales of Highline Capital Partners of \$750,000 and of various publicly traded securities of \$686,590.

During 1996, the Company realized a loss on the sale of its equity interest in Sonex International Corporation of \$2,579,000. However, because the investment had been written off in 1994, the loss did not affect earnings in 1996. Also during 1996, the Company sold and realized a loss on

the sale of its equity interest in Micracor Corporation of \$999,993 and net losses on sales of various publicly held securities of \$213,583.

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

The Board of Directors values the portfolio securities on a quarterly basis pursuant to the Company's Asset Valuation guidelines in accordance with the 1940 Act. (See "Footnote to Schedule of Investments" contained in "Item 8. Financial Statements and Supplementary Data".)

Net unrealized appreciation on investments before taxes increased by \$2,248,816 or 27.6% during the year ended December 31, 1998, from \$8,158,732 to \$10,407,548. The most significant increases in valuations during 1998 were in NBX Corporation, \$1,865,766; NeuroMetrix, Inc., \$4,400,125; and PHZ Capital Partners, L.P., \$443,432. The most significant decrease during 1998 was Nanophase Technologies Corporation, \$5,508,466. Other changes included an increased valuation of Genomica Corporation, offset primarily by decreased valuations in MedLogic Global Corporation and Princeton Video Image, Inc.

Net unrealized appreciation on investments before taxes increased by \$1,491,143 or 22.4% during the year ended December 31, 1997, from \$6,667,589 to \$8,158,732. The most significant increases in valuations during 1997 were in Nanophase Corporation, \$3,775,701; NBX Corporation, \$2,850,296; and PHZ Capital Partners, L.P., \$405,622. The most significant decreases were in Princeton Video Image, Inc., \$1,563,605 and PureSpeech, Inc., \$1,243,977 (which was subsequently acquired by Voice Control Systems, Inc.).

Net unrealized appreciation on investments before taxes increased by \$4,564,996 or 217.1% during the year ended December 31, 1996, from \$2,102,593 to \$6,667,589. The most significant increases in valuations during 1996 were in Gel Sciences, Inc., \$1,127,500; Nanophase Technologies Corporation, \$1,452,755; and Princeton Video Image, Inc., \$751,000. The most significant decrease was in the valuation of nFX Corporation, \$1,892,240.

#### Liquidity and Capital Resources

The Company reported total cash, receivables and marketable securities (the primary measure of liquidity) at December 31, 1998 of \$5,547,984 versus \$21,693,067 (net of \$4,000,000 drawn from the J.P. Morgan line of credit) at December 31, 1997 and \$19,296,591 at December 31, 1996.

The decrease in cash, receivables and marketable securities from December 31, 1997 to December 31, 1998 is mainly owing to: 1) the payment on May 12, 1998 of a one-time cash dividend of \$0.75 per share for a total of \$8,019,728; 2) the decline in value of the Company's investment in Nanophase Technologies Corporation of approximately \$5.5 million and 3) the use of funds for 1998 cash operating expenses and realized losses.

Included in marketable securities as of December 31, 1998 were the Company's holdings in Nanophase Technologies Corporation of \$1,211,249 and other publicly-held securities of \$359,393. Included in marketable securities as of December 31, 1997 were the Company's holdings in Nanophase Technologies Corporation of \$6,854,660 and Princeton Video Image, Inc. of \$1,064,895. At December 31, 1997, both holdings were subject to lock-up agreements and were valued at discounts from market value: a 26 percent discount in the case of Nanophase Technologies Corporation and a 24 percent discount in the case of Princeton Video Image, Inc.

From 1997 to 1998, receivables from brokers increased by \$380,707 or 100 percent, owing to transactions that settled in January 1999. Note receivables increased by \$32,663 or 100 percent, as a result of the Company receipt of a note from the sale of its investment in one of its investee companies. The Company's liabilities of accrued bonus and deferred income tax liability increased significantly during 1998. Accrued bonus increased by \$899,751 or 112.3 percent to \$1,323,559 as a result of the increase in the appreciation of investments. The accrued bonus will not be paid out until the gains are realized. Therefore, no bonuses were paid in 1998. The deferred tax liability is also based on unrealized appreciation, and taxes will not be paid until the gains are realized.

As of December 31, 1998, the Company had a \$6,000,000 line of credit in place with J.P. Morgan, on which the Company had no outstanding balance. Management believes that its cash, receivables and marketable securities provide the Company with sufficient liquidity for its operations over the next 12 months.

On February 22, 1999, NBX Corporation announced that it had agreed to be acquired by 3Com Corporation for approximately \$90 million in cash plus additional consideration for employees of NBX. This transaction was effective on March 5, 1999 and closed on March 8, 1999. On closing, the Company received a total of \$12,432,940 in cash, of which \$1,475,276 was placed in a one-year escrow. On February 23, 1999, the Board of Directors of the Company declared a cash dividend of \$0.35 per share (approximately \$3.7 million) to shareholders of record on March 19, 1999, payable on March 25, 1999. (See "Note 8 of Notes to Financial Statements" contained in "Item 8. Financial Statements and Supplementary Data".)

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#### Recent Developments -- Sub-Chapter M Status

On September 25, 1997, the Company's Board of Directors approved a proposal to seek qualification of the Company as a RIC under Sub-Chapter M of the Code. In order to qualify as a RIC, the Company must, in general (1) annually derive at least 90 percent of its gross income from dividends, interest and gains from the sale of securities; (2) quarterly meet certain investment diversification requirements; and (3) annually distribute at least 90 percent of its investment company taxable income as a dividend. In addition to the requirement that the Company must annually distribute at least 90 percent of its investment company taxable income, the Company may either distribute or retain its taxable net capital gains from investments, but any net capital gains not distributed could be subject to corporate level tax. Further, the Company could be subject to a four percent excise tax (and in some cases, corporate level income tax) if it fails to distribute 98 percent of its annual taxable income.

Because of the specialized nature of its investment portfolio, the Company could satisfy the diversification requirements under Sub-Chapter M of the Code only if it received a certification from the SEC that it is "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."

On April 8, 1998, the Company announced that it had received such a certification from the SEC for 1997. Pursuant to the Company's receipt of the 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. On February 17, 1999, the Company received rulings from the IRS regarding other issues relevant to the Company's tax status as a RIC. (See "Note 6 of Notes to Financial Statements" contained in "Item 8. Financial Statements and Supplementary Data".) Although the SEC certification for 1997 was issued, there can be no assurance that the Company will receive such certification for 1998 or subsequent years (to the extent it needs additional certification as a result of changes in its portfolio) or that it will qualify as a RIC in 1999 or that, if it does qualify in 1999, it will continue to qualify in subsequent years.

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. The Company was unable to satisfy these requirements for the 1998 tax year owing to the nature of the Company's ownership interest in one of its investee companies. In addition, because it realized taxable losses in 1998, it was not strategically advantageous for the Company to elect Sub-Chapter M tax status for 1998.

The Company changed the nature of its ownership interest in the non-qualifying investee company effective January 1, 1999 in order to meet the Sub-Chapter M requirements. However, there can be no assurance that the Company will qualify for Sub-Chapter M treatment for 1999 or subsequent years. In addition, under certain circumstances, even if the Company were qualified for Sub-Chapter M treatment in 1999 and elected Sub-Chapter M

treatment for that year, the Company might take action in a subsequent year to ensure that it would be taxed in that subsequent year as a C Corporation, rather than a RIC.

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The Company incurred ordinary and capital losses during its C Corporation taxable years that remain available for use and may be carried forward to its 1999 and subsequent taxable years. Ordinarily, a corporation that elects to qualify as a RIC may not use its ordinary loss carryforwards from C Corporation taxable years to offset RIC investment company taxable income, although a RIC may in certain cases use capital loss carryforwards to reduce net capital gains. In addition, a C Corporation that elects to qualify as a RIC and that makes an appropriate election 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").

On February 17, 1999, the Company received a ruling from the IRS concluding that the Company can carry forward its C Corporation losses to offset any Built-In Gains resulting from sales of its C Corporation Assets. That ruling may enable 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, depending on whether the Company's sale of C Corporation Assets with Built-In Gains will generate C Corporation E&P. In general, 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. However, because the realization of Built-In Gains will occur while the Company is a RIC, a strong argument exists that, under current law and IRS pronouncements, the sale of C Corporation Assets with Built-In Gains during RIC taxable years will not generate C Corporation E&P. The Company intends to use the \$7.1 million loss carryforward (which results in a tax credit of approximately \$2.5 million) to reduce the taxes due to Built-In Gains. The December 31, 1998 NAV includes the utilization of the ordinary and capital loss carryforwards of approximately \$0.23 per share. The IRS recently announced an intention to issue formal guidance in 1999 concerning conversions of C Corporation to RICs. Such guidance may include resolution of the E&P issue described above and other issues relevant to the Company.

If necessary for liquidity purposes or to fund investment opportunities, 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.

#### Tax Consequences of Net Capital Gains

The following simplified examples illustrate the tax treatment under Sub-Chapter M of the Code for the Company and its shareholders with regard to three possible alternatives, assuming a net long-term 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 dividend and distributed to shareholders:

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1. No taxation at the Company level.
2. Shareholders receive a \$1.00 per share dividend and pay a maximum tax of 20 percent\* or \$.20 per share, retaining \$.80 per share.

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

1. The Company pays a corporate level 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. Shareholders increase their cost basis in their stock by \$.65 per share. They pay a 20 percent\* capital gains tax on 100 percent of the undistributed gain of \$1.00 per share or \$.20 per share in tax. Offsetting this tax, shareholders receive a tax credit equal to 35 percent of the undistributed gain or \$.35 per share.

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

1. The Company pays a corporate level income tax of 35 percent on the retained gain or \$.35 per share plus an excise tax of 4 percent of \$.98 per share, or about \$.04 per share.

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

\*Assumes all capital gains qualify for long-term rates of 20 percent.

## Risk Factors

### Investment in Small, Private Companies

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.

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### Valuation of Portfolio Investments

There is typically no public market of equity securities of the small private companies in which the Company invests. As a result, the valuation of the equity securities in the Company's portfolio is subject to the good faith estimate of the Company's Board of Directors. (See "Asset Valuation Policy Guidelines" in "Footnote to Schedule of Investments.") In the absence of a readily ascertainable market value, the estimated value of the Company's portfolio of equity securities may differ significantly from the values that would be placed on the portfolio if a ready market for the equity securities existed. Any changes in estimated net asset value are recorded in the Company's statement of operations as "Change in unrealized appreciation on investments." (See "Management's Discussion and Analysis of Financial Condition and Results of Operations.")

### Illiquidity of Portfolio Investments

Most of the investments of the Company are or will be equity securities acquired directly from small companies. The Company's portfolio of equity securities are and will usually be subject to restrictions on resale or otherwise have no established trading market. The illiquidity of most of the Company's portfolio of equity securities may adversely affect the ability of the company to dispose of such securities at times when it may be advantageous for the Company to liquidate such investments.

### Fluctuations of Quarterly Results

The Company's quarterly operating results could fluctuate as a result of a number of factors. These include, among others, variations in and the



timing of the recognition of realized and unrealized gains or losses, the degree to which the Company encounters competition in its markets and general economic 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. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

#### Risk of Loss of Pass Through Tax Treatment

If the Company meets certain diversification and distribution requirements under the Code, it may qualify as a RIC under the Code for pass-through tax treatment. The Company would cease to qualify for pass-through tax treatment if it were unable to comply with these requirements, or if it ceased to qualify as a BDC under the 1940 Act. The Company also could be subject to a four percent excise tax (and, in certain cases, corporate level income tax) if it failed to make certain distributions. (See "Management's Discussion and Analysis of Financial Condition -- Recent Developments - Sub-Chapter M Status.") The lack of Sub-Chapter M tax treatment could have a material adverse effect on the total return, if any, obtainable from an investment in the Company. If the Company fails to qualify as a RIC, the Company would become subject to federal income tax as if it were an ordinary C Corporation, which would result in a substantial reduction in the Company's net assets and the amount of income available for distribution to the Company's stockholders.

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#### Risks Relating to the Year 2000 Issue

The "Year 2000" computer problem has arisen because many computer applications worldwide will not properly recognize the date change from December 31, 1999, to January 1, 2000. The computer applications may revert to 1900 or some other date because of the way in which dates were encoded and calculated, potentially causing production of erroneous data, miscalculations, system failures and other operational problems.

The Company has undertaken the evaluation of the Year 2000 impact on its critical computer hardware and software. The Company has not incurred, nor does it anticipate that it will incur, any material cost in addressing its Year 2000 problem. The Company is developing a strategic plan focusing on achieving Year 2000 compliance. Certain systems are being replaced and or modified to be Year 2000 compliant. At the present time, it is not possible to determine whether any such events are likely to occur or to quantify any potential negative impact they may have on the Company's future results of operations and financial condition.

Ultimately, the potential impact of the Year 2000 issue will depend not only on the success of the corrective measures undertaken by the Company, but also on the way in which the Year 2000 issue is addressed by vendors, service providers, counterparties, utilities, governmental agencies and other entities with which the Company does business.

#### 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 7a. Quantitative and Qualitative Disclosures About Market Risk

The Company does not hold any derivatives.

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Item 8. Financial Statements and Supplementary Data

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

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

Documents	Page
Report of Independent Public Accountants. . . . .	22
Financial Statements	
Statements of Assets and Liabilities as of December 31, 1998 and 1997 . . . . .	23
Statements of Operations for the years ended December 31, 1998, 1997 and 1996 . . . . .	24
Statements of Cash Flows for the years ended December 31, 1998, 1997 and 1996. . . . .	25
Statements of Changes in Net Assets for the years ended December 31, 1998, 1997 and 1996. . . . .	26
Schedule of Investments as of December 31, 1998 . . . . .	27-30
Footnote to Schedule of Investments . . . . .	31-33
Notes to Financial Statements . . . . .	34-40
Selected Per Share Data and Ratios for the years ended December 31, 1998, 1997, 1996, 1995 and 1994. . . . .	41

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

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To Harris & Harris Group, Inc.:

We have audited the accompanying statements of assets and liabilities of Harris & Harris Group, Inc. (a New York corporation) as of December 31, 1998 and 1997, including the schedule of investments as of December 31, 1998, and the related statements of operations, cash flows and changes in net assets for the three years ended December 31, 1998, and the selected per share data and ratios for each of the five years ended December 31, 1998. These financial statements and selected per share data and ratios are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and selected per share data and ratios based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and selected per share data and ratios are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of December 31, 1998 and 1997, by correspondence with the custodian and brokers. An audit also includes

assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As explained in Note 2, the financial statements include securities valued at \$19,562,386 (86.7 percent of net assets), whose values have been estimated by the Board of Directors in the absence of readily ascertainable market values. However, because of the inherent uncertainty of valuation, those estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and the differences could be material.

In our opinion, the financial statements and selected per share data and ratios referred to above present fairly, in all material respects, the financial position of Harris & Harris Group, Inc. as of December 31, 1998 and 1997, the results of its operations, its cash flows and the changes in its net assets for the three years ended December 31, 1998, and the selected per share data and ratios for each of the five years ended December 31, 1998 in conformity with generally accepted accounting principles.

/s/ Arthur Andersen LLP

New York, New York  
February 10, 1999

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<TABLE>  
<CAPTION>

STATEMENTS OF ASSETS AND LIABILITIES

	ASSETS	
<S>	<C>	<C>
	December 31, 1998	December 31, 1997

Investments, at value (See accompanying schedule of investments and notes) . . . . .	\$ 24,532,191	\$ 38,659,230
Cash and cash equivalents . . . . .	164,143	145,588
Receivable from brokers . . . . .	380,707	0
Interest receivable . . . . .	666	111,106
Prepaid expenses . . . . .	90,649	85,126
Note receivable . . . . .	32,663	0
Other assets . . . . .	157,840	272,734
-----		
Total assets . . . . .	\$ 25,358,859	\$ 39,273,784
=====		

LIABILITIES & NET ASSETS

Accounts payable and accrued liabilities \$ 505,118	\$ 475,683	
Accrued bonus (Note 3) . . . . .	1,323,559	423,808
Deferred rent . . . . .	42,409	51,662
Deferred income tax liability (Note 6) . .	931,064	667,697
Demand Promissory Note Payable (Note 7) . .	0	4,000,000
-----		
Total liabilities . . . . .	2,802,150	5,618,850
-----		

Commitments and contingencies (Notes 7 and 8)

Net assets . . . . .	\$ 22,556,709	\$ 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; 10,692,971 issued at 12/31/98 and issued and outstanding at 12/31/97 . . . . .	106,930	106,930
Additional paid in capital . . . . .	16,158,381	16,178,979
Accumulated net realized (loss) income . . .	(525,177)	12,028,191
Accumulated unrealized appreciation of investments, net of deferred tax		

liability of \$3,410,884 at 12/31/98 and \$2,817,898 at 12/31/97 . . . . .	6,996,664	5,340,834
Treasury stock, at cost (101,739 shares) . . .	(180,089)	0
Net assets . . . . .	<u>\$ 22,556,709</u>	<u>\$ 33,654,934</u>
Shares outstanding . . . . .	<u>10,591,232</u>	<u>10,692,971</u>
Net asset value per outstanding share . . . .	<u>\$ 2.13</u>	<u>\$ 3.15</u>

</TABLE>

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

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<TABLE>

<CAPTION>

STATEMENTS OF OPERATIONS

<S>	<C>	<C>	<C>
	Year Ended	Year Ended	Year Ended
	12/31/98	12/31/97	12/31/96
Investment income:			
Interest from:			
Fixed-income securities . . . . .	\$ 355,591	\$ 490,807	\$ 803,819
Affiliated companies . . . . .	124,877	40,000	40,779
Dividend income-- unaffiliated companies . . . . .	2,550	0	8,024
Dividend income-- affiliated companies . . . . .	50,000	52,500	0
Consulting and administrative fees . . . . .	0	29,870	68,185
Other income . . . . .	102,468	869	92,610
Total investment income . . . . .	<u>635,486</u>	<u>614,046</u>	<u>1,013,417</u>
Expenses:			
Salaries and benefits . . . . .	831,121	1,507,257	1,524,826
Bonus accrual (Note 3) . . . . .	899,751	423,808	0
Administration and operations . . . . .	330,879	392,114	474,537
Professional fees . . . . .	411,480	327,038	675,241
Depreciation . . . . .	47,936	48,968	57,426
Rent . . . . .	159,515	130,092	160,601
Directors' fees and expenses . . . . .	129,253	100,496	80,702
Custodian fees . . . . .	10,513	15,517	11,983
Restructuring charges . . . . .	0	100,000	0
Other expense (Note 7) . . . . .	728,862	0	0
Interest expense . . . . .	85,476	0	0
Total expenses . . . . .	<u>3,634,786</u>	<u>3,045,290</u>	<u>2,985,316</u>
Operating loss before income taxes . . . . .	(2,999,300)	(2,431,244)	(1,971,899)
Income tax benefit (Note 6) . . . . .	234,188	933,103	680,834
Net operating loss . . . . .	<u>(2,765,112)</u>	<u>(1,498,141)</u>	<u>(1,291,065)</u>
Net realized loss on investments:			
Realized loss on sale of investments . . . . .	(1,768,528)	(3,199,502)	(3,792,576)
Total realized loss . . . . .	<u>(1,768,528)</u>	<u>(3,199,502)</u>	<u>(3,792,576)</u>
Income tax benefit (Note 6) . . . . .	0	1,119,825	1,327,401
Net realized loss on investments . . . . .	<u>(1,768,528)</u>	<u>(2,079,677)</u>	<u>(2,465,175)</u>
Net realized loss . . . . .	<u>(4,533,640)</u>	<u>(3,577,818)</u>	<u>(3,756,240)</u>
Net increase in unrealized appreciation on investments:			
Increase as a result of investment sales . . . . .	2,135,176	93,999	2,525,548
Decrease as a result of investment sales . . . . .	(963,680)	(2,892,408)	0

Increase on investments held . . .	9,766,320	7,297,164	4,112,413
Decrease on investments held . . .	(8,689,000)	(3,007,612)	(2,072,965)
-----			
Change in unrealized appreciation			
on investments . . . . .	2,248,816	1,491,143	4,564,996
Income tax provision (Note 6) . . .	(592,986)	(521,900)	(1,597,748)
-----			
Net increase in unrealized appreciation			
on investments . . . . .	1,655,830	969,243	2,967,248
-----			
Net decrease in net assets			
resulting from operations:			
Total . . . . .	\$(2,877,810)	\$(2,608,575)	\$(788,992)
=====			
Per outstanding share. . . . .	\$ (0.27)	\$ (0.24)	\$ (0.08)
=====			

</TABLE>

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

<TABLE>

<CAPTION>

STATEMENTS OF CASH FLOWS

<S>	<C>	<C>	<C>
	Year Ended	Year Ended	Year Ended
	12/31/98	12/31/97	12/31/96
Cash flows (used in) provided			
by operating activities:			
Net decrease in net assets			
resulting from operations . . .	\$ (2,877,810)	\$ (2,608,575)	\$ (788,992)
Adjustments to reconcile net decrease in net assets			
resulting from operations to net cash (used in)			
provided by operating activities:			
Net realized and unrealized (gain) loss			
on investments. . . . .	(480,288)	1,708,359	(772,420)
Deferred income taxes . . . . .	263,367	(1,442,094)	1,636,817
Depreciation. . . . .	47,936	48,968	57,426
Other . . . . .	(2,927)	0	(10,144)
Changes in assets and liabilities:			
Receivable from brokers . . . .	(380,707)	0	205,789
Prepaid expenses. . . . .	(5,523)	(3,625)	5,475
Interest receivable . . . . .	110,440	87,236	102,376
Taxes receivable. . . . .	0	2,119,492	(1,679,377)
Notes receivable. . . . .	(32,663)	0	0
Other assets. . . . .	86,312	40,296	(103,981)
Accounts payable			
and accrued liabilities. . . .	81,235	49,555	22,197
Accrued bonus . . . . .	899,751	423,808	0
Deferred rent . . . . .	(9,253)	(9,252)	10,279
Collection on notes receivable.	800,000	0	0
Purchase of fixed assets. . . .	(16,426)	(10,169)	(35,777)
-----			
Net cash (used in) provided			
by operating activities. . . .	(1,516,556)	403,999	(1,350,332)
Cash provided by (used in) investing activities:			
Net sale (purchase) of short-term			
investments and			
marketable securities. . . . .	14,715,834	(155,667)	6,035,532
Investment in			
private placements and loans . .	(960,308)	(4,511,434)	(4,981,614)
-----			
Net cash provided by			
(used in) investing activities	13,755,526	(4,667,101)	1,053,918
Cash flows (used in) provided			
by financing activities:			
Payment of dividend . . . . .	(8,019,728)	0	0
Purchase of treasury stock (Note 4)	(254,786)	0	0
Proceeds from exercise			
of stock options (Note 3) . . .	0	253,250	87,500

Proceeds (payment of)			
from note payable (Note 7) . . .	(4,000,000)	4,000,000	0
Proceeds from sale of			
stock (Note 4) . . . . .	54,099	0	0
	-----	-----	-----
Net cash (used in) provided			
by financing activities. . . .	(12,220,415)	4,253,250	87,500
Net increase (decrease)			
in cash and cash equivalents:			
Cash and cash equivalents			
at beginning of the year. . . .	145,588	155,440	364,354
Cash and cash equivalents			
at end of the year. . . . .	164,143	145,588	155,440
	-----	-----	-----
Net increase (decrease) in cash and			
cash equivalents . . . . .	\$ 18,555	\$ (9,852)	\$ (208,914)
	=====	=====	=====
Supplemental disclosures of cash flow information:			
Income taxes paid. . . . .	\$ 372	\$ 5,909	\$ 57,234
Interest paid. . . . .	\$ 85,378	\$ 0	\$ 0

</TABLE>

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

<TABLE>

<CAPTION>

STATEMENTS OF CHANGES IN NET ASSETS

<S>

	<C>	<C>	<C>
	Year Ended	Year Ended	Year Ended
	12/31/98	12/31/97	12/31/96

Changes in net assets from operations:

Net operating loss. . . . .	\$(2,765,112)	\$(1,498,141)	\$(1,291,065)
Net realized loss on investments. . . . .	(1,768,528)	(2,079,677)	(2,465,175)
Net increase (decrease) in unrealized			
appreciation on investments			
as a result of sales . . . . .	1,171,496	(1,818,966)	1,641,606
Net increase in unrealized			
appreciation on			
investments held . . . . .	484,334	2,788,209	1,325,642
	-----	-----	-----
Net decrease in net assets			
resulting from operations . . . . .	(2,877,810)	(2,608,575)	(788,992)

Changes in net assets from  
capital stock transactions:

Payment of dividend. . . . .	(8,019,728)	0	0
Purchase of treasury stock . . . . .	(254,786)	0	0
Proceeds from exercise of			
stock options and warrants . . . . .	0	253,250	87,500
Proceeds from sale of stock. . . . .	54,099	0	0
Tax benefit of			
restricted stock award			
and common stock transactions . . . . .	0	77,656	72,186
	-----	-----	-----
Net (decrease) increase in			
net assets resulting from			
capital stock transactions . . . . .	(8,220,415)	330,906	159,686
	-----	-----	-----

Net decrease in net assets . . . . .(11,098,225) (2,277,669) (629,306)

Net assets:

Beginning of the year . . . . .	33,654,934	35,932,603	36,561,909
	-----	-----	-----
End of the year . . . . .	\$22,556,709	\$33,654,934	\$35,932,603

</TABLE>

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

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<TABLE>

<CAPTION>

SCHEDULE OF INVESTMENTS DECEMBER 31, 1998

<S>

<C>            <C>            <C>  
Method of     Shares/  
Valuation (3) Principal    Value

Investments in Unaffiliated Companies (10)(11)(12) --  
12.0% of total investments

Publicly Traded Portfolio (Common stock unless noted otherwise) --  
6.4% of total investments

Somnus Medical Technology, Inc. (1)(4) --  
Biotechnology and Healthcare related . .(C)     47,200    \$ 141,600

Nanophase Technologies Corporation (1)(6) --  
Manufactures and markets inorganic crystals of  
nanometric dimensions --  
4.59% of fully diluted equity  
Common Stock . . . . .(C)     672,916    1,211,249

Princeton Video Image, Inc. (1) -- Real time  
sports and entertainment advertising --  
0.59% of fully diluted equity . . . .(C)     62,600    178,410

Voice Control Systems, Inc. (1)(2) -- Supplier  
of speech recognition and  
related speech input technology . . . .(C)     22,964    39,383

Total Publicly Traded Portfolio (cost: \$1,414,202). . . . . \$1,570,642

Private Placement Portfolio (Illiquid) -- 5.6% of total investments

Exponential Business Development Company (1)(2)(5) --  
Venture capital partnership focused on early stage companies  
Limited partnership interest . . . . .(A)     --     \$ 25,000

MedLogic Global Corporation (1)(2) -- Medical cyanoacrylate  
adhesive -- 0.40% of fully diluted equity  
Series B Convertible Preferred Stock . .(B)     60,319  
Common Stock . . . . .(B)     25,798    565,978

SciQuest, Inc. (1)(2)(6)(9) -- Internet e-commerce source for  
scientific products -- 3.61% of fully diluted equity  
Series C Convertible Preferred Stock . .(A)     277,163  
Warrants at \$2.7962 expiring 6/30/07 . .(A)     26,822    775,000

Total Private Placement Portfolio (cost: \$1,833,774). . . . . \$1,365,978

Total Investments in  
Unaffiliated Companies (cost: \$3,247,976) . . . . . \$2,936,620

</TABLE>

The accompanying notes are an integral part of this schedule.

27

<TABLE>

<CAPTION>

SCHEDULE OF INVESTMENTS DECEMBER 31, 1998

<S>

<C>            <C>            <C>  
Method of     Shares/

Valuation(3) Principal Value

Private Placement Portfolio (Illiquid) in Non-Controlled  
Affiliates (10)(12) -- 49.9% of total investments

Genomica Corporation (1)(2)(6)(7) -- Develops software  
that enables the study of complex genetic diseases --  
7.05% of fully diluted equity  
Common Stock . . . . . (B) 199,800  
Series A Voting  
Convertible Preferred Stock . . . . . (B) 1,660,200 \$1,209,730

InSite Marketing Technology, Inc. (1)(2)(4) -- Integrates  
marketing science and sales strategy into e-commerce  
-- 7.12% of fully diluted equity  
Common Stock . . . . . (A) 1,351,351 500,000

NBX Corporation (1)(2)(6) -- Exploits innovative  
distributed computing technology for use in small business  
telephone systems -- 13.95% of fully diluted equity  
Promissory Note --  
8% due March 16, 2001 . . . . . (A) \$ 10,000  
Series A Convertible Preferred Stock . (B) 500,000  
Series C Convertible Preferred Stock . (B) 240,793  
Series D Convertible Preferred Stock . (B) 59,965 6,416,064

PHZ Capital Partners Limited Partnership (2) -- Organizes  
and manages investment partnerships -- 20.0% of fully  
diluted equity  
Limited partnership interest . . . . . (D) -- 1,849,054

Questech Corporation (1)(2)(6) -- Manufactures and  
markets proprietary decorative tiles and signs -- 12.40% of  
fully diluted equity  
Common Stock . . . . . (D) 565,792 2,263,168  
Warrants at \$4.00 expiring 11/28/01 . . (A) 166,667 167

Private Placement Portfolio  
in Non-Controlled Affiliates (cost: \$5,920,308) . . . . . \$12,238,183

</TABLE>

The accompanying notes are an integral part of this schedule.

<TABLE>

<CAPTION>

SCHEDULE OF INVESTMENTS DECEMBER 31, 1998

<S>

<C>	<C>	<C>
Method of Valuation (3)	Shares/ Principal	Value

Private Placement Portfolio in Controlled Affiliates (10)(12)  
(Illiquid) -- 24.3% of total investments

NeuroMetrix, Inc. (1)(2)(6)(8) -- Developing devices for: 1) diabetics  
to monitor their blood glucose and 2) detection of carpal tunnel  
syndrome -- 27.67% 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 . . (B) 229,620 \$ 5,958,225

Total Private Placement Portfolio  
in Controlled Affiliates (cost: \$1,558,100). . . . . \$ 5,958,225

U.S. Government Obligations -- 13.8% of total investments

U.S. Treasury Bill dated 02/05/98 due date  
02/04/99 -- 4.4% yield . . . . . (K) \$ 300,000 \$ 298,878  
U.S. Treasury Bill dated 02/05/98 due date  
02/04/99 -- 4.4% yield . . . . . (K) \$ 600,000 597,756  
U.S. Treasury Bill dated 08/13/98 due date



02/11/99 -- 4.3% yield . . . . .(K)	\$ 400,000	398,160
U.S. Treasury Bill dated 03/05/98 due date		
03/04/99 -- 4.3% yield . . . . .(K)	\$ 1,550,000	1,538,902
U.S. Treasury Bill dated 11/19/98 due date		
05/20/99 -- 4.5% yield . . . . .(K)	\$ 575,000	565,467
-----		
Total Investments in U.S. Government Obligations		
(cost: \$3,398,259). . . . .	\$ 3,399,163	
-----		
Total Investments -- 100% (cost: \$14,124,643). . . . .	\$ 24,532,191	

</TABLE>

The accompanying notes are an integral part of this schedule.

SCHEDULE OF INVESTMENTS DECEMBER 31, 1998

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 year ended December 31, 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) 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.
- (8) The percentage owned by the Company proforma for the January 21, 1999 financing is 18.04%.
- (9) SciQuest, Inc. acquired BioSupplyNet, Inc.
- (10) Investments in unaffiliated companies consist of investments where 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.
- (11) The aggregate cost for federal income tax purposes of investments in unaffiliated companies is \$3,247,976. The gross unrealized appreciation based on tax cost for these securities is \$156,440. The gross unrealized depreciation on the cost for these securities is \$467,796.
- (12) The percentage ownership of each investee disclosed in the Schedule of Investments expresses the potential common equity interest in each such investee. The calculated percentage represents the amount of 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.

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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.

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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.

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#### NOTES TO FINANCIAL STATEMENTS

##### 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"). A BDC is a specialized type of investment company under the 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.

On September 25, 1997, the Company's Board of Directors approved a proposal to seek qualification as a Regulated Investment Company ("RIC") under Sub-Chapter M of the Internal Revenue 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 "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Recent Developments.") 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, and elected Sub-Chapter M treatment for that year, the Company might take action in a subsequent year to ensure that it would be taxed in that subsequent year as a C Corporation, rather than a RIC.

##### 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 reporting or purposes.

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.

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The December 31, 1998 financial statements include a provision for deferred taxes on the net unrealized gains as of December 31, 1998, net of the operating and capital loss carryforwards incurred by the Company through December 31, 1998. (See Note 6. Income Taxes.)

Reclassifications. Certain reclassifications have been made to the December 31, 1996 and December 31, 1997 financial statements to conform to the December 31, 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 December 31, 1998 and 1997, and the reported amounts of revenues and expenses for the three years ended December 31, 1998. 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 BDC 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. As a substitution for the 1988 Stock Option Plan, the Company adopted an employee profit-sharing plan.

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 and net asset value per share would have been reduced to the following pro-forma amounts:

<TABLE>

<S>	<C>	<C>	<C>
	1998	1997	1996
Net Realized Loss:			
As Reported	N/A	\$(3,577,818)	\$(3,756,240)

Pro Forma	N/A	\$(3,921,583)	\$ (4,197,096)
-----------	-----	---------------	----------------

Net Asset Value per share:

As Reported	N/A	\$3.15	\$3.44
-------------	-----	--------	--------

Pro Forma	N/A	\$3.12	\$3.40
-----------	-----	--------	--------

</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> 1998	<C> 1997	<C> 1996
Stock volatility	N/A	0.60	0.60
Risk-free interest rate	N/A	6.3%	6.8%
Option term in years	N/A	7	7
Stock dividend yield	N/A	--	--

</TABLE>

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A summary of the status of the Company's 1988 Plan at December 31, 1997 and 1996 and changes during the years then ended is presented in the table and narrative below:

<TABLE>

<S>	<C> December 31, 1997	<C> December 31, 1996	<C> December 31, 1997	<C> December 31, 1996
	Shares	Weighted Average	Shares	Weighted Average
	Exercise Price		Exercise Price	
Outstanding at beginning of year	1,080,000	\$4.584	1,050,000	\$4.445
Granted	300,000	\$3.875	160,000	\$5.008
Exercised	158,000	\$1.603	50,000	\$1.750
Forfeited	397,000	\$5.267	80,000	\$5.375
Expired	--	--	--	--
Canceled	825,000	\$4.569	--	--
Outstanding at end of year	0	0	1,080,000	\$4.584
Exercisable at end of year	0	0	390,000	\$3.334
Weighted average fair value of options granted	\$2.50	--	\$3.222	--

</TABLE>

During 1997, the Chairman of the Company exercised a warrant to purchase 237,605 shares of common stock at a price of \$2.0641.

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 soon as practicable following year end, the Board of Directors will determine whether, and if so how much, "Qualifying Income" exists for a plan year, and 90 percent of the Qualifying Income will be paid out to Plan participants pursuant to the distribution percentages set forth in the Plan. The remaining 10 percent will be paid out after the Company has filed its federal tax return for that year in which "Qualifying Income" exists. The distribution amounts for each officer and employee is as follows: Charles E. Harris, 13.790%; Mel P. Melsheimer, 4.233%; Rachel M. Pernia, 1.524%; and Jacqueline M. Matthews, 0.453%. If a participant leaves the Company for other than cause, the amount earned will be accrued and paid to such participant, and the remaining amount allocable under the Plan will be redistributed by the Compensation Committee and paid to the other participants.

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Notwithstanding any provisions of the Plan, in no event may the aggregate amount of all awards payable for any Plan year during which the Company remains a "business development company" within the meaning of the Investment Company Act of 1940, as amended (the "1940 Act"), be greater than 20 percent of the Company's "net income after taxes" within the meaning of Section 57(n)(1)(B) of the 1940 Act. In the event the awards exceed such amount, the awards will be reduced pro rata.

The Plan may be modified, amended or terminated by the Company's Board of Directors at any time; provided however, no such modification, amendment or termination may adversely affect any participant that has not consented to such modification, amendment or termination.

The Company calculates the Plan accrual at each quarter end based on the unrealized gains at that date, net of operating expenses for the year. Any adjustments to the Plan accrual are then reflected in the Statement of Operations for the quarter. The Plan accrual is not paid out until the gains are realized. During 1998, the Company accrued bonus expense of \$899,751, bringing the cumulative accrual under the Plan to \$1,323,559 at December 31, 1998.

#### NOTE 4. CAPITAL TRANSACTIONS

In 1998, the Board of Directors approved that effective January 1, 1998, 50 percent of all Director fees be used to purchase Company common stock from the Company. However, effective on March 1, 1999, the Directors may purchase the Company's common stock in the market, rather than from the Company. During 1998, the directors bought a total of 24,491 shares.

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 December 31, 1998, the Company had purchased a total of 126,230 shares for a total of \$254,786 or an average of \$2.02 per share. However, the treasury shares purchased were decreased by the director purchases of a total of 24,491 shares of Company stock.

#### NOTE 5. 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's 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. During 1998, contributions to the plan that have been charged to operations totaled approximately \$37,000.

On June 30, 1994, the Company adopted a plan to provide medical and health insurance 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

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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 December 31, 1998 the Company had a reserve of \$283,305 for the plan.

#### NOTE 6. INCOME TAXES

As of December 31, 1998, the Company had not elected tax treatment available to RICs under Sub-Chapter M of the Code. Accordingly, for federal and state income tax purposes, the Company is taxed at statutory corporate rates on its income, which enables the Company to offset any future net operating losses against prior years' net income. The Company may carry back operating losses against net income two years and carryforward such losses 15 years.

For the years ended December 31, 1998, 1997 and 1996, the Company's income tax (benefit) provision was allocated as follows:

<S>	<C> 1998	<C> 1997	<C> 1996
Investment operations	\$(234,188)	\$ (933,103)	\$ (680,834)
Realized loss on investments	0	(1,119,825)	(1,327,401)
Increase in unrealized appreciation on investments	592,986	521,900	1,597,748
Total income tax (benefit) provision	<u>\$ 358,798</u>	<u>\$(1,531,028)</u>	<u>\$ (410,487)</u>

The above tax (benefit) provision consists of the following:

Current -- Federal	\$ 95,430	\$ 0	\$(2,047,304)
Deferred -- Federal	263,368	(1,531,028)	1,636,817
Total income tax (benefit) provision	<u>\$ 358,798</u>	<u>\$(1,531,028)</u>	<u>\$ (410,487)</u>

</TABLE>

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

<S>	<C> 1998	<C> 1997
Unrealized appreciation on investments	\$ 3,410,885	\$ 2,817,898
Net operating and capital loss carryforward	(2,479,821)	(1,856,989)
Medical retirement benefits	--	(81,345)
Other	--	(211,867)
Net deferred income tax liability	<u>\$ 931,064</u>	<u>\$ 667,697</u>

</TABLE>

On September 25, 1997, the Company's Board of Directors approved a proposal to seek qualification 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. To initially qualify as a RIC, among other requirements, the Company had to pay a dividend to shareholders equal to the Company's 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 "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation - Recent Developments - Sub-Chapter M Status.")

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The Company incurred net ordinary and capital losses for a total of approximately \$7.1 million (which results in a tax credit of approximately \$2.5 million) during its C Corporation taxable years that remain available for use and may be carried forward to its 1999 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"). On February 17, 1999, the Company received a ruling from the IRS concluding that the Company can carry forward its C Corporation losses to offset any Built-In Gains resulting from sales of its C Corporation Assets. That ruling may enable 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, depending on whether the Company's sale of C Corporation Assets with Built-In Gains will generate C Corporation E&P. In general, 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. However, because the realization of Built-In Gains will occur while the Company is a RIC, a strong argument exists that, under current law and IRS pronouncements, the sale of C Corporation Assets with Built-In Gains during RIC taxable years will not generate C Corporation E&P. The Company intends to use the \$7.1 million loss carryforward (which results in a tax credit of approximately \$2.5 million) to reduce its taxes which are due to Built-In Gains. The December 31, 1998 NAV includes the utilization of ordinary and capital loss carryforwards of approximately \$0.23 per share. The IRS recently announced an intention to issue formal guidance in 1999 concerning conversions of C Corporations to RICs. Such guidance may include resolution of the E&P issue described above and other issues relevant to the Company.

There can be no assurance that the Company will qualify as a RIC or that, if it does qualify, it will elect RIC status.

#### NOTE 7. 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 for the year ended December 31, 1998, was \$159,515. 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. During 1993, 1994 and 1995, the Company contributed to MIT securities which were applied to the MIT Pledge at their market value at the time the shares became publicly traded or otherwise monetized in a commercial transaction and were free from restriction as to sale by MIT. On December 31, 1998, the Company finalized the establishment of the Harris & Harris Group Senior Professorship by making the final payment of \$728,862 due on the pledge.

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In June 1997, the Company agreed to provide one of its investee

companies with a \$450,000 revolving line of credit, of which \$50,000 had been used through December 31, 1997. During 1998, through September 30, 1998, the investee company borrowed an additional \$250,000 which was repaid in the fourth quarter of 1998.

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 and did not draw against the line for the remainder of the year.

#### NOTE 8. SUBSEQUENT EVENTS

On February 22, 1999, NBX Corporation announced that it had agreed to be acquired by 3Com Corporation for approximately \$90 million in cash plus additional consideration for employees of NBX. This transaction was effective on March 5, 1999 and closed on March 8, 1999. On closing, the Company received a total of \$12,432,940 in cash, of which \$1,475,276 was placed in a one-year escrow.

On February 23, 1999, the Board of Directors of the Company declared a cash dividend of \$0.35 per share (approximately \$3.7 million) to shareholders of record on March 19, 1999, payable on March 25, 1999.

On March 18, 1999, the Company invested \$1,000,000 in the equity of a privately held medical device company with a patented product addressing a very large potential market. At this writing, the Company is still under non-disclosure with respect to the identity of this company. But this investment is the Company's first private equity commitment of part of the proceeds from the capital gains generated by the sale of NBX.

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<TABLE>  
<CAPTION>

#### SELECTED PER SHARE DATA AND RATIOS

Per share operating performance:

<S>	<C>	<C>	<C>	<C>	<C>
	Year Ended	Year Ended	Year Ended	Year Ended	Year Ended
	December	December	December	December	December
	31, 1998	31, 1997	31, 1996	31, 1995	31, 1994

Net asset value, beginning of period \$	3.15 \$	3.44 \$	3.54 \$	3.43 \$	3.66
--	---------	---------	---------	---------	------

Net operating loss	(0.26)	(0.14)	(0.12)	(0.11)	(0.25)
Net realized (loss) gain on investments	(0.16)	(0.19)	(0.24)	0.14	0.01
Net increase (decrease) in unrealized appreciation as a result of sales	0.11	(0.17)	0.16	(0.01)	(0.11)
Net increase in unrealized appreciation on investments held	0.05	0.26	0.13	0.03	0.01
Net decrease as a result of dividend	(0.75)	--	--	--	--
Net (decrease)					

increase from capital stock transactions	(0.01)	(0.05)	(0.03)	0.06	0.11
-----					
Net asset value, end of period	\$ 2.13	\$ 3.15	\$ 3.44	\$ 3.54	\$ 3.43
=====					
Market value per share, end of period*	\$ 1.50	\$ 3.50	\$ 3.75	\$ 7.875	\$ 6.375
Deferred income tax per share	\$ 0.09	\$ 0.06	\$ 0.21	\$ 0.050	\$ 0.030
Ratio of expenses to average net assets	10.9%	9.1%	8.1%	8.3%	13.6%
Ratio of net operating loss to average net assets	(10.4)%	(4.5)%	(3.5)%	(3.2)%	(7.1)%
Investment return based on:					
Stock price	(45.5)%	(6.7)%	(52.4)%	23.5%	(22.7)%
Net asset value	(11.3)%	(8.4)%	(2.8)%	3.2%	(6.3)%
Portfolio turnover	19.71%	77.2%	51.3%	51.2%	136.4%
Net assets, end of period	\$22,556,709	\$33,654,934	\$35,932,603	\$36,561,909	\$31,310,802
Number of shares outstanding	10,591,232	10,692,971	10,442,682	10,333,902	9,136,747

</TABLE>

\*The market value as of December 31, 1998 reflects the decline in market price as a result of the \$0.75 dividend paid on May 12, 1998.

The accompanying notes are an integral part of this schedule.

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#### Item 9. Disagreements on Accounting and Financial Disclosure

None.

### PART III

#### Item 10. Directors and Executive Officers of the Company

The information set forth under the captions "Election of Directors" on page 2, "Executive Officers" on page 8 and "Section 16(a) Beneficial Ownership Reporting Compliance" on page 13 in the Company's Proxy Statement for Annual Meeting of Shareholders to be held April 28, 1999, filed pursuant to Regulation 14A under the Securities Exchange Act of 1934 on or about March 24, 1999 (the "1999 Proxy Statement") is herein incorporated by reference.

#### Item 11. Executive Compensation

The information set forth under the captions "Summary Compensation Table" on pages 9 and 10 and "Compensation of Directors" on page 12 in the 1999 Proxy Statement is herein incorporated by reference.

#### Item 12. Security Ownership of Certain Beneficial Owners and Management

The information set forth under the caption "Security Ownership of

Directors and Executive Officers and other principal holders of the Company's voting securities" on page 7 in the 1999 Proxy Statement is herein incorporated by reference.

#### Item 13. Certain Relationships and Related Transactions

There were no relationships or transactions within the meaning of this item during the year ended December 31, 1998.

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#### PART IV

#### Item 14. Exhibits, Financial Statements, Schedules and Reports on Form 8-K

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

(1) The following Financial Statements of the Company are set forth under Item 8:

Statements of Assets and Liabilities as of December 31, 1998 and 1997  
Statements of Operations for the years ended December 31, 1998, 1997 and 1996  
Statements of Cash Flows for the years ended December 31, 1998, 1997 and 1996  
Statements of Changes in Net Assets for the years ended December 31, 1998, 1997 and 1996  
Schedule of Investments as of December 31, 1998  
Footnote to Schedule of Investments  
Notes to Financial Statements  
Selected Per Share Data and Ratios for the years ended December 31, 1998, 1997, 1996, 1995 and 1994

(2) Report of Independent Public Accountants.

(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. (Asterisk denotes exhibits filed with this report.)

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 10-K for the year ended December 31, 1995 and the Company's Form 10-Q for the quarter ended September 30, 1998.

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

9.1 Harris & Harris Group, Inc. Custodian Agreement with JP Morgan, incorporated by reference to Exhibit 9.1 to the Company's Form 10-K for the year ended December 31, 1995.

10.1 Amended and Restated Employment Agreement between Harris & Harris Group, Inc. and Charles E. Harris dated January 1, 1998.

10.5 Severance Compensation Agreement by and between the Company and Charles E. Harris dated August 15, 1990, incorporated by reference to exhibit 10(s) to the Company's Annual Report on Form 10-K for the year ended December 31, 1990.

10.13 Stock Purchase Agreement, Standstill Agreement and Termination and Release by and among Harris & Harris Group, Inc. and American Bankers Life Assurance Company of Florida dated May 18, 1995, incorporated by reference to Exhibit 10.13 to the Company's Form 10-K for the year ended December 31, 1995.



/s/                    Director                    March 18, 1999  
-----  
G. Morgan Browne

/s/                    Director                    March 19, 1999  
-----  
Harry E. Ekblom

/s/                    Director                    March 19, 1999  
-----  
Dugald A. Fletcher

/s/                    Director                    March 18, 1999  
-----  
Glenn E. Mayer

/s/                    Director                    March 19, 1999  
-----  
William R. Polk

/s/                    Director                    March 18, 1999  
-----  
James E. Roberts

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#### 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

11.0 Computation of Per Share Earnings is set forth under Item 8.

23    Consent of Arthur Andersen LLP.

27.0 Financial Data Schedule.

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

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CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation by reference in this Form 10-K of our report dated February 10, 1999. It should be noted that we have not audited any financial statements of the company subsequent to December 31, 1998 or performed any audit procedures subsequent to the date of our report.

/s/ Arthur Andersen LLP

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New York, New York  
March 25, 1999