

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

Form 10-Q

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

For quarterly period ended March 31, 1999

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

For the transition period from _____ to _____

Commission File Number: 0-11576

HARRIS & HARRIS GROUP, INC.

(Exact name of registrant as specified in its charter)

New York

13-3119827

(State or other jurisdiction of (I.R.S. Employer Identification No.)
incorporation or organization)

One Rockefeller Plaza, Rockefeller Center, New York, New York 10020

(Address of Principal Executive Offices) (Zip Code)

212/332-3600

(Registrant's telephone number, including area code)

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

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of
common stock, as of the latest practicable date.

Class	Outstanding at May 6, 1999
-----	-----
Common Stock, \$0.01 par value per share	10,321,400 shares

Harris & Harris Group, Inc.
Form 10-Q, March 31, 1999

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Harris & Harris Group, Inc.
Form 10-Q, March 31, 1999

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

The information furnished in the accompanying consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair presentation of the results for the interim period presented.

On June 30, 1994, the Company's shareholders approved a proposal to allow the Company to make an election to become a Business Development Company ("BDC") under the Investment Company Act of 1940, as amended. The Company made such election on July 26, 1995. Certain information and disclosures normally included in the financial statements in accordance with Generally Accepted Accounting Principles have been condensed or omitted as permitted by Regulation S-X and Regulation S-K. It is suggested that the accompanying financial statements be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 1998 contained in the Company's 1998 Annual Report.

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 Consolidated Financial Statements" contained in "Item 1. Consolidated Financial Statements" & "Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations -- Sub-Chapter M Status".)

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

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it did 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.

As of December 31, 1998, the Company had a net operating and capital loss carryforward of \$7.1 million. The Company intends to use the \$7.1 million tax loss carryforward to offset the long-term capital gain realized when the Company sold its interest in NBX Corporation. The Company anticipates realizing a tax benefit of approximately \$2.5 million as a result of such offset.

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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<TABLE>
<CAPTION>

CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES

ASSETS		
<S>	<C>	<C>
	March 31, 1999	December 31, 1998
	(Unaudited)	(Audited)
Investments, at value (See accompanying schedule of investments and notes) . . .	\$ 24,438,036	\$ 24,532,191
Cash and cash equivalents	70,808	164,143
Funds in escrow (Note 7)	1,327,748	0
Receivable from broker	0	380,707
Interest receivable	512	666
Note receivable	32,663	32,663
Prepaid expenses	119,451	90,649
Other assets	144,853	157,840
	-----	-----
Total assets	\$ 26,134,071	\$ 25,358,859

LIABILITIES & NET ASSETS

Accounts payable and accrued liabilities	\$ 399,691	\$ 505,118
Payable to broker	77,085	0
Accrued profit sharing (Note 3)	2,224,900	1,323,559
Deferred rent	40,096	42,409
Deferred income tax liability (Note 6)	1,705,509	931,064
	-----	-----
Total liabilities	4,447,281	2,802,150
Commitments and contingencies (Note 7)	-----	-----
	-----	-----
Net assets	\$ 21,686,790	\$ 22,556,709

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 3/31/99 and 12/31/98	106,930	106,930
Additional paid in capital	16,158,400	16,158,381
Accumulated net realized income (deficit)	2,805,185	(525,177)
Accumulated unrealized appreciation of		

investments, net of deferred tax liability of \$1,705,509 at 3/31/99 and \$3,410,884 at 12/31/98.	3,257,549	6,996,664
Treasury stock at cost, 339,446 shares at 3/31/99 and 101,739 shares at 12/31/98. (641,274)	(641,274)	(180,089)
Net assets	\$ 21,686,790	\$ 22,556,709
Total net assets and liabilities	\$ 26,134,071	\$ 25,358,859
Shares outstanding	10,353,525	10,591,232
Net asset value per outstanding share.	\$ 2.09	\$ 2.13

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

<TABLE>
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CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

<S>	<C>	<C>
	Three Months Ended March 31, 1999	Three Months Ended March 31, 1998
Investment income:		
Interest from:		
Fixed-income securities.	\$ 45,209	\$ 192,291
Affiliated companies	628	10,932
Other income	0	7,348
Total investment income.	45,837	210,571
Expenses:		
Salaries and benefits.	207,078	236,611
Profit sharing accrual (reversal) (Note 3).	901,341	(198,763)
Administration and operations.	72,725	88,204
Professional fees.	61,017	89,026
Rent	41,378	38,808
Directors' fees and expenses	36,414	28,742
Depreciation	12,500	12,500
Custodian fees	1,732	2,907
Interest expense (Note 7).	0	73,415
Total expenses	1,334,185	371,450
Operating loss before income taxes	(1,288,348)	(160,879)
Income tax provision (Note 6).	0	(365,712)
Net operating loss	(1,288,348)	(526,591)
Net realized gain on investments:		
Realized gain on sale of investments.	10,745,548	78,661
Total realized gain.	10,745,548	78,661
Income tax provision (Note 6).	(2,479,821)	(27,531)
Net realized gain on investments.	8,265,727	51,130
Net realized income (loss)	6,977,379	(475,461)
Net (decrease) increase in unrealized appreciation on investments:		
Decrease as a result of		

investment sales	(4,784,802)	(87,898)
Increase on investments held . .	58,727	3,825,792
Decrease on investments held . .	(718,416)	(4,074,921)
	-----	-----
Change in unrealized appreciation on investments	(5,444,491)	(337,027)
Income tax benefit (Note 6) . . .	1,705,376	808,957
	-----	-----
Net (decrease) increase in unrealized appreciation on investments . .	(3,739,115)	471,930
	-----	-----
Net increase (decrease) in net assets from operations:		
Total	\$ 3,238,264	\$ (3,531)
	=====	=====
Per outstanding share	\$ 0.31	\$ (0.00)
	=====	=====

</TABLE>

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

<TABLE>

<CAPTION>

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

<S>	<C>	<C>
	Three Months Ended March 31, 1999	Three Months Ended March 31, 1998
Cash flows from operating activities:		
Net increase (decrease) in net assets resulting from operations	\$ 3,238,264	\$ (3,531)
Adjustments to reconcile net increase (decrease) in net assets from operations to net cash used in operating activities:		
Net realized and unrealized (gain) loss on investments . .	(5,301,057)	258,366
Deferred income taxes	774,445	(415,714)
Depreciation	12,500	12,500
Changes in assets and liabilities:		
Receivable from brokers	380,707	0
Interest receivable	154	0
Prepaid expenses	(28,802)	(27,227)
Funds in escrow (Note 7)	(1,327,748)	0
Other assets	485	156,067
Accounts payable and accrued liabilities	(105,427)	(16,956)
Payable to brokers	77,085	0
Accrued profit sharing (Note 3)	901,341	(198,763)
Deferred rent	(2,313)	(2,313)
Collection on notes receivable.	10,000	0
	-----	-----
Net cash used in operating activities	(1,370,366)	(237,571)
Cash flows from investing activities:		
Net purchase (sale) of short-term investments and marketable securities	(5,889,416)	2,877,319
Proceeds from sale of private placement investment	12,274,631	0
Investment in private placements and loans	(1,000,001)	(121,802)
	-----	-----
Net cash provided by investing activities	5,385,214	2,755,517
Cash flows from financing activities:		

Payment of dividend	(3,647,017)	0
Payment of note payable (Note 7)	0	(2,500,000)
Proceeds from sale of stock . .	16,178	0
Purchase of stock (Note 4) . . .	(477,344)	0
	-----	-----
Net cash used in financing activities	(4,108,183)	(2,500,000)
Net (decrease) increase in cash and cash equivalents:		
Cash and cash equivalents at beginning of the period . .	164,143	145,588
Cash and cash equivalents at end of the period	70,808	163,534
	-----	-----
Net (decrease) increase in cash and cash equivalents. . . \$	(93,335)	\$ 17,946
	=====	=====

Supplemental disclosures of cash flow information:

Income taxes paid \$	797	\$ 300
Interest paid \$	0	\$ 44,180

</TABLE>

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

<TABLE>

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CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
(Unaudited)

<S>	<C>	<C>
	Three Months Ended	Three Months Ended
	March 31, 1999	March 31, 1998

Changes in net assets from operations:

Net operating loss. \$	(1,288,348)	\$ (526,591)
Net realized gain on investments.	8,265,727	51,130
Net decrease in unrealized appreciation on investments as a result of sales.	(3,079,426)	(87,898)
Net (decrease) increase in unrealized appreciation on investments held	(659,689)	559,828
	-----	-----
Net increase (decrease) in net assets resulting from operations . . .	3,238,264	(3,531)

Changes in net assets from capital stock transactions:

Payment of dividend	(3,647,017)	0
Purchase of treasury stock. . . .	(477,344)	0
Proceeds from sale of stock . . .	16,178	0
	-----	-----
Net (decrease) increase in net assets resulting from capital stock transactions.	(4,108,183)	0
	-----	-----

Net decrease in net assets (869,919) (3,531)

Net assets:

Beginning of the period	22,556,709	33,654,934
	-----	-----
End of the period \$	21,686,790	\$ 33,651,403
	=====	=====

</TABLE>

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

<TABLE>
<CAPTION>

CONSOLIDATED SCHEDULE OF INVESTMENTS MARCH 31, 1999
(Unaudited)

<S>	<C>	<C>	<C>
	Method of Valuation (3)	Shares/ Principal	Value
	-----	-----	-----
Investments in Unaffiliated Companies (10)(11)(12) -- 30.5% of total investments			
Publicly Traded Portfolio (Common stock unless noted otherwise) -- 20.8% of total investments			
ATG, Inc. (1)(4) -- Radioactive and hazardous waste management services (C) 20,000 \$ 128,750			
3Com Corporation (1)(4) -- Computer network technology related. (C) 80,000 1,865,000			
Fuisz Corporation (1)(4) -- Biotechnology and drug related . . (C) 35,000 229,688			
Monsanto Corporation (1)(4) -- Life sciences and drug related . . (C) 10,000 459,375			
Nanophase Technologies Corporation (1)(6) -- Manufactures and markets inorganic crystals of nanometric dimensions -- 4.59% of fully diluted equity (C) 672,916 1,093,354			
Network Event Theatre (1)(4) -- Internet and other services to colleges (C) 10,000 126,250			
Somnus Medical Technology, Inc. (1) -- Biotechnology and healthcare related. (C) 130,000 341,250			
Sterling Commerce (1)(4) -- Software technology for business-to-business e-commerce . (C) 25,000 768,750			
Voice Control Systems, Inc. (1)(2) -- Supplier of speech recognition and related speech input technology. . (C) 22,964 73,198			
Total Publicly Traded Portfolio (cost: \$5,664,623)			\$5,085,615

</TABLE>

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

<TABLE>
<CAPTION>

CONSOLIDATED SCHEDULE OF INVESTMENTS MARCH 31, 1999
(Unaudited)

<S>	<C>	<C>	<C>
	Method of Valuation (3)	Shares/ Principal	Value
	-----	-----	-----
Private Placement Portfolio (Illiquid) (10)(11)(12) -- 9.7% of total investments			
Exponential Business Development Company (1)(2)(5) -- Venture capital partnership focused			

on early stage companies			
Limited partnership interest (A)	--	\$ 25,000	
Kriton Medical, Inc. (1)(2)(4) -- Research and development of medical devices			
Series B Convertible Preferred Stock . . (A)	--	1,000,001	
MedLogic Global Corporation (1)(2) -- Medical cyanoacrylate adhesive -- 0.37% of fully diluted equity			
Series B Convertible Preferred Stock . . (B)		54,287	
Common Stock (B)		25,798	565,977
SciQuest.com, Inc. (1)(2)(8) -- Internet e-commerce source for scientific products -- 3.48% 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: \$2,833,776)			\$ 2,365,978

Total Investments in Unaffiliated Companies (cost: \$8,498,399) \$ 7,451,593			

</TABLE>
The accompanying notes are an integral part of this consolidated schedule.
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<TABLE>
<CAPTION>
CONSOLIDATED SCHEDULE OF INVESTMENTS MARCH 31, 1999
(Unaudited)

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

Private Placement Portfolio in Non-Controlled Affiliates (10)(12) (Illiquid) -- 48.2% of total investments			
Genomica Corporation (1)(2)(5)(6)(7) -- Develops software that enables the study of complex genetic diseases -- 5.01% 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)(5)(6) -- Integrates marketing science and sales strategy into e-commerce -- 6.97% of fully diluted equity			
Common Stock (A)		1,351,351	500,000

NeuroMetrix, Inc. (1)(2)(6) -- Medical devices for monitoring neuromuscular disorders -- 16.41% 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

PHZ Capital Partners Limited Partnership (2)(9) -- Organizes and manages investment partnerships -- 20.0% of fully diluted equity			
Limited partnership interest (D)	--		1,857,353

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

Total Private Placement Portfolio in Non-Controlled Affiliates (cost: \$5,778,406).	\$11,788,643	

U.S. Government Obligations -- 21.3% of total investments		
U.S. Treasury Bill dated 10/22/98 due date		
4/22/99 -- 4.5% yield(K)	\$ 250,000	\$ 249,298
U.S. Treasury Bill dated 11/12/98 due date		
5/13/99 -- 4.5% yield(K)	\$ 4,400,000	4,376,988
U.S. Treasury Bill dated 11/19/98 due date		
5/20/99 -- 4.5% yield(K)	\$ 575,000	571,514

Total Investments in		
U.S. Government Obligations (cost: \$5,198,174).	\$ 5,197,800	

Total Investments -- 100% (cost: \$19,474,979)	\$ 24,438,036	
=====		

</TABLE>

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

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CONSOLIDATED SCHEDULE OF INVESTMENTS MARCH 31, 1999
(Unaudited)

Notes to Consolidated 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 1999. Accordingly, the amounts shown on the schedule represent the gross additions in 1999.
- (5) No changes in valuation occurred in these investments during the three months ended March 31, 1999.
- (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 ("CSHL") and Falcon Technology Partners, LP. Mr. G. Morgan Browne serves on the Board of Directors of the Company and is Administrative Director of CSHL. In late 1998, Mr. Charles E. Harris, Chairman and C.E.O. of Harris & Harris Group became a trustee of CSHL.
- (8) SciQuest.com, Inc. acquired BioSupplyNet, Inc.
- (9) Harris Partners I L.P. owns a 20% limited partnership interest in PHZ Capital Partners L.P. The partners of Harris Partners I L.P. are Harris & Harris Enterprises, Inc. (sole general partner) and Harris & Harris Group, Inc. (sole limited partner). Harris & Harris Enterprises, Inc. is a 100% owned subsidiary of Harris & Harris Group, Inc.
- (10) Investments in unaffiliated companies consist of investments in which Harris & Harris Group, Inc. (the "Company") owns less than 5 percent of the investee company. Investments in non-controlled affiliated companies consist of investments where the Company owns more than 5 percent but less than 25 percent of the investee company. Investments in controlled affiliated companies consist of investments where the Company owns more than 25 percent of the investee company.
- (11) The aggregate cost for federal income tax purposes of investments in unaffiliated companies is \$8,498,399. The gross unrealized appreciation based on the tax cost for these securities is \$55,897. The gross unrealized depreciation based on the tax cost for these securities is \$1,102,703.
- (12) The percentage ownership of each investee company disclosed in the Schedule of Investments expresses the potential common equity interest in each such investee. The calculated percentage represents

the amount of the issuer's common stock the Company owns or can acquire as a percentage of the issuer's total outstanding common stock plus common shares reserved for issued and outstanding warrants, convertible securities and stock options.

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FOOTNOTE TO CONSOLIDATED 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:

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EQUITY-RELATED SECURITIES

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

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

B. Private Market: The private market method uses actual third-party transactions in the company's securities as a basis for valuation, using actual, executed, historical transactions in the company's securities by

responsible third parties. The private market method may also use, where applicable, unconditional firm offers by responsible third parties as a basis for valuation.

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

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

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

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

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

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

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

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

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

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

LONG-TERM FIXED-INCOME SECURITIES

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

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

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

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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 CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

NOTE 1. THE COMPANY

Harris & Harris Group, Inc. (the "Company") is a venture capital investment company operating as a business development company ("BDC") under the Investment Company Act of 1940 ("1940 Act"). 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.

Harris & Harris Enterprises, Inc. is a 100 percent owned subsidiary of the Company. Harris Partners I L.P. is a limited partnership. The partners of Harris Partners I L.P. are Harris & Harris Enterprises, Inc. (sole general partner) and Harris & Harris Group, Inc. (sole limited partner).

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 2. Management's Discussion and Analysis of Financial Condition and Results of Operations - Sub-Chapter M Tax Status.") 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 consolidated financial statements:

Principles of Consolidation. The consolidated financial statements have been prepared in accordance with Generally Accepted Accounting Principles for investment companies. All significant intercompany accounts and transactions have been eliminated in consolidation.

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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 or specific identification basis for financial reporting and tax reporting.

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 related to the Company's unrealized appreciation on investments.

The March 31, 1999 financial statements include a provision for deferred taxes on the net unrealized gains as of December 31, 1998. (See Note 6. Income Taxes.)

Reclassifications. Certain reclassifications have been made to the March 31, 1998 financial statements to conform to the March 31, 1999 presentation.

Estimates by Management. The preparation of the consolidated 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 March 31, 1999 and December 31, 1998, and the reported amounts of revenues and expenses for the three months ended March 31, 1999 and 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

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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.

As of January 1, 1998, the Company implemented 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 the year-end audit, 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.

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 realized and unrealized gains at that date, net of operating expenses for the year. Any adjustments to the Plan accrual are then reflected in the Consolidated Statements of Operations for the quarter. The Plan accrual is not paid out until the gains are realized. The Plan profit-sharing resulting from the realized gains during 1999 net of operating expenses for the year, will be paid out as soon as practicable following year end. During the first quarter of 1999, the Company accrued profit-sharing expense of \$901,341, bringing the cumulative accrual under the Plan to \$2,224,900 at March 31, 1999.

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NOTE 4. CAPITAL TRANSACTIONS

In 1998, the Board of Directors approved that effective January 1, 1998, 50 percent of all Directors' 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 open market, rather than directly from the Company. During 1998 and 1999, the directors bought a total of 30,307 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 March 31, 1999, the Company had purchased a total of 369,753 shares for a total of \$732,131 or an average of \$1.98 per share. However, the treasury shares purchased were decreased by the directors' purchases of a total of 30,307 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' Employment Contract was amended to reduce his salary to \$200,000 and to allow him to participate in other business opportunities and investments. The term of the contract expires on December 31, 1999. Base salary is to be increased annually to reflect inflation and in addition may be increased by such amount as the Compensation Committee of the Board of Directors of the Company deems appropriate. In addition, Mr. Harris would be entitled, under certain circumstances, to receive severance pay under the employment and severance contracts.

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

On June 30, 1994, the Company adopted a plan to provide medical and health coverage for retirees, their spouses and dependents who, at the time of their retirement, have ten years of service with the Company and have attained 50 years of age or have attained 45 years of age and have 15 years of service with the Company. On February 10, 1997, the Company amended this plan to include employees who "have seven full years of service and have attained 58 years of age." The coverage is secondary to any government provided or subsequent employer provided health insurance plans. Based upon actuarial estimates, the Company provided an original reserve of \$176,520 that was charged to operations for the period ending June 30, 1994. As of March 31, 1999, the Company had a reserve of \$283,305 for the plan.

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NOTE 6. INCOME TAXES

As of December 31, 1998, the Company had not elected tax treatment available to a RIC under Sub-Chapter M of the Code. Accordingly, for federal and state income tax purposes, the Company was taxed at statutory corporate rates on its income, which enabled the Company to offset any prior years' net income against future net operating losses. The Company intends to use the \$7.1 million loss carryforward (which should result in a tax credit of approximately \$2.5 million) to offset the long-term capital gain realized when the Company sold its interest in NBX Corporation.

For the three months ended March 31, 1999 and 1998, the Company's income tax provision (benefit) was allocated as follows:

<TABLE>

<S>	<C>	<C>
	Three Months Ended	Three Months Ended
	March 31, 1999	March 31, 1998
Investment operations	\$ 0	\$ 365,712
Realized (loss) gain on investments	2,479,821	27,531

Decrease in unrealized appreciation on investments	(1,705,376)	(808,957)
Total income tax provision (benefit)	\$ 774,445	\$ (415,714)

The above tax benefit consists of the following:

Current -- Federal	\$ 0	\$ 100,000
Deferred -- Federal	774,445	(515,714)
Total income tax provision (benefit)	\$ 774,445	\$ (415,714)

</TABLE>

The Company's net deferred tax liability at March 31, 1999 and December 31, 1998 consists of the following:

<TABLE>

	<C> March 31, 1999	<C> December 31, 1998
Tax on unrealized appreciation on investments	\$ 1,705,509	\$ 3,410,885
Net operating loss and capital carryforward	0	(2,479,821)
Net deferred income tax liability	\$ 1,705,509	\$ 931,064

</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 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - Sub-Chapter M Status.")

The Company incurred net ordinary and capital losses during the C Corporation taxable years, of which \$7.1 million will be eligible to be carried forward to the Company's 1999 taxable year. 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 in certain cases may use ordinary and capital loss carryforwards to reduce net capital gains. In addition, a 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"). The Company intends to use its \$7.1 million loss carryforward to offset the long term capital gain realized when the Company sold its interest in NBX Corporation. The Company anticipates realizing a tax benefit of approximately \$2.5 million as a result of such offset.

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 certain issues relevant to the conversion of the Company from a C Corporation to a RIC.

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 three months ended March 31, 1999 and 1998, was \$41,378 and \$38,808 respectively. Future minimum lease payments in each of the following years are: 2000 -- \$178,561; 2001 -- \$178,561; 2002 -- \$178,561; 2003 -- \$101,946.

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 (7.3125 percent). In March 1998, the Company paid down \$2,500,000; in April 1998, the Company paid the remaining balance.

The Company has a total of \$1,475,276 of funds in escrow as a result of the acquisition of NBX Corporation by 3Com Corporation. The funds are in a one year interest bearing escrow account for the benefit of the

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Company, subject to any 3Com Corporation warranty claims associated with its acquisition of NBX Corporation. The Company set up a reserve of 10 percent for any potential claims, therefore the funds in escrow reflect \$1,327,748 net of the reserve of \$147,528. At this time, the Company does not anticipate any claims against the escrowed funds and expects to receive these proceeds by March 8, 2000.

NOTE 8. SUBSEQUENT EVENTS

On April 19, 1999, Harris Partners I L.P. received a cash distribution from its investment in PHZ Capital Partners, L.P. of \$546,360. This distribution was included in unrealized appreciation as of March 31, 1999 and will be included in realized gain for the three months ended June 30, 1999.

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

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

"Net realized gain (loss) on investments" and "Net (decrease) 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, respectively, \$26,134,071 and \$21,686,790 at March 31, 1999, compared with \$25,358,859 and \$22,556,709 at December 31, 1998.

Among significant changes in the first quarter of 1999 were: 1) the acquisition of NBX Corporation by 3Com Corporation, which increased Harris & Harris Group's net assets by approximately \$5,868,568; 2) the payment of a cash dividend of \$0.35 per share, which reduced net assets by approximately \$3,647,017; 3) the addition to a deferred income tax liability, which reduced net assets by \$774,445 and 4) the operating loss and decrease in value in investments held which decreased net assets by approximately \$1,288,348 and \$659,689, respectively. (See "Consolidated Statements of Operations" contained in "Item 1. Consolidated Financial Statements.")

Net asset value per share ("NAV") was \$2.09 at March 31, 1999 versus \$2.13 at December 31, 1998. NAV was reduced by the \$0.35 dividend declared and paid in the first quarter of 1999.

The Company's shares outstanding as of March 31, 1999 were 10,353,525 versus 10,591,232 at December 31, 1998. The Company's outstanding shares were reduced as a result of its repurchase in the open market of a total of 369,753 shares as of March 31, 1999. However, the treasury shares were then decreased by purchases of Company stock by directors with 50% of their director compensation. (See "Note 4 of Notes to Consolidated Financial Statements.")

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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 March 31, 1999, \$14,154,621 or 54 percent of the Company's total assets consisted of investments at fair value in private businesses, of which net unrealized appreciation was \$5,542,439 before taxes. 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. The decrease in the percentage of private investments from 77 percent at December 31, 1998 to 54 percent at March 31, 1999 is primarily owing to the acquisition of NBX Corporation by 3Com Corporation.

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

<TABLE>

<S>	<C> March 31, 1999	<C> December 31, 1998
Investments, at cost	\$ 19,474,979	\$ 14,124,643
Unrealized appreciation	4,963,057	10,407,548
	-----	-----
Investments, at fair value	\$ 24,438,036	\$ 24,532,191
	=====	=====

The accumulated unrealized appreciation on investments net of deferred taxes is \$3,257,549 at March 31, 1999, versus \$6,996,664 at December 31, 1998.

</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) to exercise warrants or options that were acquired in a prior financing; (3) to preserve the Company's proportionate ownership in a subsequent financing; or (4) attempt to preserve or enhance the value of the Company's investment. Such additional investments are referred to as "follow-on" investments. There can be no assurance that the Company will make follow-on investments or have sufficient funds to make additional investments. The failure to make such follow-on investments could jeopardize the viability of the investee company and the Company's investment or could result in a missed opportunity for the Company to participate to a greater extent in an investee's successful operations. The Company attempts to maintain adequate liquid capital to make

follow-on investments in its private investee portfolio companies. The Company may elect not to make a follow-on investment either because it does not want to increase its concentration of risk or because it prefers other opportunities, even though the follow-on investment opportunity appears attractive.

The following table is a summary of the cash investments made by the Company in its private placement portfolio during the three months ended March 31, 1999:

<S>	<C>
New Investments:	Amount
Kriton Medical, Inc.	\$ 1,000,001
Total	----- \$ 1,000,001 =====

</TABLE>

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Results of Operations

Investment Income and Expenses:

The Company realized a net operating loss of \$1,288,348 and \$526,591 for the three months ended March 31, 1999 and 1998 respectively. The Company's principal objective is to achieve capital appreciation. Therefore, a significant portion of the investment portfolio is structured to maximize the potential for capital appreciation and provides little or no current yield in the form of dividends or interest. The Company does earn interest income from fixed-income securities, including U.S. Government Obligations. The amount of interest income earned varies based upon the average balance of the Company's fixed-income portfolio and the average yield on this portfolio.

The Company had interest income from fixed-income securities of \$45,209 and \$192,291 for the three months ended March 31, 1999 and 1998, respectively. The decrease of \$147,082 or 76.5 percent is the result of a decline in the balance of the Company's fixed income portfolio during the three months ended March 31, 1999 versus the three months ended March 31, 1998. The Company had borrowed funds against the JP Morgan line of credit during the three months ended March 31, 1998, which were not outstanding during the three months ended March 31, 1999. Accordingly, the Company had interest expense of \$73,415 during the three months ended March 31, 1998 and did not have any interest expense for the three months ended March 31, 1999.

The Company had interest income from affiliated companies of \$628 and \$10,932 for the three months ended March 31, 1999 and 1998, respectively. The decrease of \$10,304 or 94.3 percent is owing to the repayment of the majority of the outstanding loans by the investee companies during the fourth quarter of 1998.

The Company had other income of \$0 and \$7,348 for the three months ended March 31, 1999 and 1998, respectively. The other income in 1998 represents rental income, the Company did not have any rental income in 1999.

Operating expenses were \$1,334,185 and \$371,450 for the three months ended March 31, 1999 and 1998, respectively. The increase of \$962,735 or 259.2 percent is primarily owing to the increase in the accrual for the Company's profit-sharing plan of \$901,341 as a result of the realized gain on the sale of NBX Corporation. Also, the first quarter of 1998 included a profit-sharing reversal of \$198,763, which reduced the total expenses for that period by \$198,763. Most of the Company's operating expenses are related to employee and director compensation, office and rent expenses and consulting and professional fees (primarily legal and accounting fees).

The profit-sharing resulting from the realized gains during 1999, net of operating expenses for the year, will be paid out as soon as practicable following the year-end audit.

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 months ended March 31, 1999 and 1998, the Company realized gains of \$10,745,548 and \$78,661, respectively. During the three months ended March 31, 1999, the Company realized a gain of approximately \$10,584,630 on the acquisition of NBX Corporation by 3Com Corporation. The Company also realized a gain of \$160,918 on its sale of Princeton Video Image, Inc. stock.

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 Consolidated Schedule of Investments" contained in "Item 1. Consolidated Financial Statements".)

Net unrealized appreciation on investments before taxes decreased by \$5,444,491 or 52.3 percent during the three months ended March 31, 1999, from \$10,407,548 to \$4,963,057, primarily as a result of the reclassification of the NBX Corporation unrealized gain of \$4,716,062 to realized and the decrease in value of publicly-held stocks that the Company acquired during the three months ended March 31, 1999.

Net unrealized appreciation on investments before taxes decreased by \$337,027 or 4.1 percent during the three months ended March 31, 1998, from \$8,158,732 to \$7,821,705, primarily as a result of increased valuations on NeuroMetrix, Inc.; PureSpeech, Inc.; Energy Research Corporation and Fuisz Technologies Corporation. These gains were offset primarily by decreased valuations in Nanophase Technologies Corporation, Princeton Video Image, Inc. and MedLogic Global Corporation.

Liquidity and Capital Resources

The Company reported total cash, receivables and marketable securities (the primary measure of liquidity) at March 31, 1999 of \$11,715,146 versus \$5,547,984 at December 31, 1998.

As of March 31, 1999, the Company had a \$6,000,000 line of credit in place with J.P. Morgan, of 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.

The increase in cash, receivables and marketable securities from December 31, 1998 to March 31, 1999 is primarily owing to the receipt of total proceeds of \$12,422,159 in cash and funds in escrow (\$1,475,276, against which the Company recorded a 10 percent reserve); offset by the 1) payment of a dividend of \$0.35 per share for a total of \$3,647,017; 2) the investment of \$1,000,001 in Kriton Medical, Inc.; and 3) the purchase of treasury shares for a total of \$477,344.

From December 31, 1998 to March 31, 1999, receivables from broker decreased by \$380,707 or 100 percent, owing to transactions that settled in January 1999. Funds in escrow increased by \$1,327,748 or 100 percent, owing to the escrowed funds received by the Company on the sale of NBX Corporation. The Company's liabilities of accrued profit-sharing and deferred income tax liability increased significantly from December 31, 1998 to March 31, 1999. Accrued profit-sharing increased by \$901,341 or 68.1 percent to \$2,224,900 as a result of the gain on the sale of NBX Corporation. The accrued profit-sharing attributable to 1999 net realized income will be paid out as soon as practicable following the year-end audit. There was no profit-sharing paid out during the three months ended March 31, 1999.

The deferred income tax liability increased by \$774,445 or 83.2 percent to \$1,705,509. The increase in the deferred tax liability reflects the utilization of all of the Company's net operating loss carryforward to offset the long-term capital gain realized when the Company sold its interest in NBX Corporation.

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. (Any undistributed investment company taxable income would also be taxed.) Further, the Company could be subject to a four percent excise tax if it fails to distribute at least 98 percent of its annual ordinary income and net capital gain 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 Consolidated Financial Statements" contained in "Item 1. Consolidated Financial Statements".) 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.

The Company incurred ordinary and capital losses during its C Corporation taxable years, of which \$7.1 million will be eligible to be carried forward to the Company's 1999 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 ordinary and 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").

The Company intends to use its \$7.1 million loss carryforward to offset the long term capital gain realized when the Company sold its interest in NBX Corporation. The Company anticipates realizing a tax benefit of approximately \$2.5 million as a result of such offset.

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 certain issues relevant to the conversion of the Company from a C Corporation to a RIC.

If necessary for liquidity purposes or to fund investment opportunities, in lieu of distributing its taxable net capital gains, the Company may

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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:

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.

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 Consolidated 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 and Results of Operations -- 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.

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 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's business activities contain elements of risk. 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.

The Company considers the principal type of market risk to be valuation risk. The Company considers the management of risk essential to conducting its businesses and to maintaining profitability. Accordingly, the Company's risk management systems and procedures are designed to identify and analyze the Company's risks, to set appropriate policies and limits and to continually monitor these risks and limits by means of reliable administrative and information systems and other policies and programs.

The Company manages its market risk by maintaining a portfolio of equity interests that is diverse by industry, geographic area, property

type, size of individual investment and borrower. However, neither the Company's investments nor an investment in the Company is intended to constitute a balanced investment program. The Company does have exposure to public market price fluctuations to the extent of its publicly traded portfolio.

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.

Since there is typically no public market for the equity interests of the small companies in which the Company invests, the valuation of the equity interests in the Company's portfolio is subject to the estimate of the Company's Board of Directors in accordance with the Company's Asset Valuation Policy Guidelines. In the absence of a readily ascertainable market value, the estimated value of the Company's portfolio of equity interests may differ significantly from the values that would be placed on the portfolio if a ready market for the equity interests existed. Any changes in valuation are recorded in the Company's statement of operations as "Net (decrease) increase in unrealized appreciation on investments."

PART II. OTHER INFORMATION

Item 1. Legal Proceedings
Not Applicable

Item 2. Changes in Securities and Use of Proceeds
Not Applicable

Item 3. Defaults Upon Senior Securities
Not Applicable

Item 4. Submission of Matters to a Vote of Security Holders
Not Applicable

Item 5. Other Information
Recent Sales of Unregistered Securities
During three months ended March 31, 1999, the Directors purchased a total of 5,816 shares of restricted common shares as part of their compensation program.

Item 6. Exhibits and Reports on Form 8-K

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

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

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

11.0* Computation of per share earnings. See Consolidated Statements of Operations.

27.0* Financial Data Schedule.

(b) The Company did not file any reports on Form 8-K during the first quarter of 1999.

EXHIBIT INDEX

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

27. Financial Data Schedule

SIGNATURE

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

Harris & Harris Group, Inc.

By: /s/ Rachel M. Pernia

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

Date: May 14, 1999

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

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