

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 September 30, 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
incorporation or organization)

(I.R.S. Employer Identification No.)

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

(Address of Principal Executive Offices) (Zip Code)

212/332-3600

(Registrant's telephone number, including area code)

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

Yes 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 October 18, 1999 |
|--|---------------------------------|
| ----- | ----- |
| Common Stock, \$0.01 par value per share | 9,240,831 shares |

Harris & Harris Group, Inc.
Form 10-Q, September 30, 1999

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Harris & Harris Group, Inc.
Form 10-Q, September 30, 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 1997. Although the SEC certification for 1997 was issued, there can be no assurance that the Company will receive such certification for 1999 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.

Pursuant to the Company's receipt of the section 851(e) certification and its intention to qualify as a RIC, in 1998 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 it did not

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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 approximately \$7 million. The Company intends to use the \$7 million tax loss carryforward to offset the long-term capital gain realized when the Company sold its interest in NBX Corporation in 1999. 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 (under the RIC regulations) 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 1999, 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> September 30, 1999 (Unaudited) | <C> December 31, 1998 (Audited) |
|--|--|---------------------------------------|
| Investments, at value (See accompanying schedule of investments and notes) | \$ 26,578,612 | \$ 24,532,191 |
| Cash and cash equivalents | 216,054 | 164,143 |
| Funds in escrow (Note 7) | 1,327,748 | 0 |
| Receivable from brokers | 0 | 380,707 |
| Interest receivable | 63,176 | 666 |
| Note receivable | 32,663 | 32,663 |
| Prepaid expenses | 31,622 | 90,649 |
| Other assets | 146,419 | 157,840 |
| | ----- | ----- |
| Total assets | \$ 28,396,294 | \$ 25,358,859 |
| | ===== | ===== |

LIABILITIES & NET ASSETS

| | | |
|--|------------|------------|
| Accounts payable and accrued liabilities | \$ 433,910 | \$ 505,118 |
| Accrued profit sharing (Note 5) | 2,747,383 | 1,323,559 |
| Deferred rent | 35,469 | 42,409 |
| Deferred income tax liability (Note 6) | 1,705,509 | 931,064 |
| | ----- | ----- |

| | | |
|--|---------------|---------------|
| Total liabilities | 4,922,271 | 2,802,150 |
| ----- | | |
| Commitments and contingencies (Note 7) | | |
| Net assets. | \$ 23,474,023 | \$ 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 9/30/99 and 12/31/98. | 106,930 | 106,930 |
| Additional paid in capital. | 16,159,504 | 16,158,381 |
| Accumulated net realized income (deficit) | 1,897,300 | (525,177) |
| Accumulated unrealized appreciation of investments, net of deferred tax liability of \$1,705,509 at 9/30/99 and \$3,410,884 at 12/31/98. | 7,847,769 | 6,996,664 |
| Treasury stock at cost, 1,452,140 shares at 9/30/99 and 101,739 shares at 12/31/98 (Note 4) | (2,537,480) | (180,089) |
| Net assets. | \$ 23,474,023 | \$ 22,556,709 |
| ----- | | |
| Total net assets and liabilities. \$ | 28,396,294 | \$ 25,358,859 |
| ===== | | |
| Shares outstanding. | 9,240,831 | 10,591,232 |
| ----- | | |
| Net asset value per outstanding share | \$ 2.54 | \$ 2.13 |
| ===== | | |

</TABLE>

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

<TABLE>

<CAPTION>

CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

| <S> | Three Months Ended | | Nine Months Ended | |
|---|--------------------|-------------------|-------------------|-------------------|
| | <C> | <C> | <C> | <C> |
| | Sept. 30, 1999 | Sept. 30, 1998 | Sept. 30, 1999 | Sept. 30, 1998 |
| Investment income: | | | | |
| Interest from: | | | | |
| Fixed-income securities. | \$ 64,349 | \$ 46,571 | \$ 185,557 | \$ 314,237 |
| Affiliated companies . . . | 19,196 | 22,649 | 28,513 | 109,133 |
| Other income | 3,722 | 135,680 | 4,022 | 143,028 |
| Total investment income. | 87,267 | 204,900 | 218,092 | 566,398 |
| Expenses: | | | | |
| Salaries and benefits. . . | 182,130 | 182,136 | 574,463 | 646,284 |
| Profit-sharing accrual (reversal) (Note 5) . . . | 5,254 | 0 | 1,423,824 | (423,808) |
| Administration and operations. | 53,542 | 74,346 | 241,421 | 272,294 |
| Professional fees. | 95,013 | 66,767 | 219,003 | 246,866 |
| Rent | 39,799 | 40,522 | 122,555 | 118,137 |
| Directors' fees and expenses. | 19,500 | 31,252 | 82,616 | 101,385 |
| Depreciation | 12,500 | 12,500 | 37,500 | 37,500 |
| Custodian fees | 3,713 | 2,253 | 6,996 | 8,451 |
| Interest expense (Note 7). | 0 | 11,963 | 0 | 85,378 |
| Total expenses | 411,451 | 421,739 | 2,708,378 | 1,092,487 |

| | | | | |
|---|-------------|---------------|-------------|---------------|
| Operating loss before income taxes | (324,184) | (216,839) | (2,490,286) | (526,089) |
| Income tax (provision) (Note 6) | 0 | (743,949) | 0 | (1,137,192) |
| Net operating loss | (324,184) | (960,788) | (2,490,286) | (1,663,281) |
| Net realized (loss) gain on sale of investments: | | | | |
| Realized (loss) gain on investments | (86,217) | (787,873) | 11,039,600 | (200,696) |
| Total realized (loss) gain | (86,217) | (787,873) | 11,039,600 | (200,696) |
| Income tax (provision) (Note 6) | 0 | 0 | (2,479,820) | 0 |
| Net realized (loss) gain on sale of investments . | (86,217) | (787,873) | 8,559,780 | (200,696) |
| Net realized (loss) income . | (410,401) | (1,748,661) | 6,069,494 | (1,863,977) |
| Net increase (decrease) in unrealized appreciation on investments: | | | | |
| Increase as a result of investment sales | 73,446 | 554,687 | 559,352 | 665,312 |
| Decrease as a result of investment sales | (98,895) | (170,468) | (4,939,595) | (963,680) |
| Increase on investments held | 1,803,900 | 2,262 | 4,859,080 | 3,779,954 |
| Decrease on investments held | (357,853) | (2,271,010) | (1,333,107) | (8,687,643) |
| Change in unrealized appreciation on investments | 1,420,598 | (1,884,529) | (854,270) | (5,206,057) |
| Income tax benefit (Note 6) | 29,096 | 743,949 | 1,705,375 | 1,704,889 |
| Net increase (decrease) in unrealized appreciation on investments | 1,449,694 | (1,140,580) | 851,105 | (3,501,168) |
| Net increase (decrease) in net assets from operations: | | | | |
| Total | \$1,039,293 | \$(2,889,241) | \$6,920,599 | \$(5,365,145) |
| Per outstanding share . . . \$ | 0.11 | \$ (0.27) | \$ 0.75 | \$ (0.51) |

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

</TABLE>

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<TABLE>

<CAPTION>

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| <S> | <C> | <C> |
|-----|---|---|
| | Nine Months Ended September 30, 1999 | Nine Months Ended September 30, 1998 |

| | | |
|---|--------------|----------------|
| Cash flows from operating activities: | | |
| Net increase (decrease) in net assets resulting from operations. | \$ 6,920,599 | \$ (5,365,145) |
| 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 . . . | (10,185,330) | 5,406,753 |
| Deferred income taxes | 774,445 | (667,697) |
| Depreciation | 37,500 | 37,500 |
| Changes in assets and liabilities: | | |
| Funds in escrow (Note 7) | (1,327,748) | 0 |

| | | |
|---|-------------|--------------|
| Receivable from brokers. | 380,707 | 0 |
| Interest receivable. | (62,510) | 78,457 |
| Collection on notes receivable . . | 10,000 | 0 |
| Prepaid expenses | 59,027 | 35,702 |
| Other assets | (18,326) | (4,855) |
| Accounts payable and accrued liabilities. | (71,208) | (316,227) |
| Accrued profit sharing (Note 5). . | 1,423,824 | 0 |
| Deferred rent. | (6,940) | (6,940) |
| Purchase of fixed assets | (7,754) | (8,300) |
| | ----- | ----- |
| Net cash used in operating activities. | (2,073,714) | (810,752) |
| Cash flows from investing activities: | | |
| Net (purchase) sale of short-term investments and marketable securities | (1,368,720) | 13,934,302 |
| Proceeds from sale of private placement investment | 12,274,631 | 0 |
| Investment in private placements and loans. | (2,777,001) | (960,308) |
| | ----- | ----- |
| Net cash provided by investing activities. | 8,128,910 | 12,973,994 |
| Cash flows from financing activities: | | |
| Payment of dividend | (3,647,017) | (8,019,728) |
| Payment of note payable (Note 7). . | 0 | (4,000,000) |
| Proceeds from sale of treasury stock (Note 4). | 17,283 | 40,604 |
| Purchase of treasury stock (Note 4). | (2,373,551) | (199,802) |
| | ----- | ----- |
| Net cash used in financing activities | (6,003,285) | (12,178,926) |
| Net increase (decrease) 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 | 216,054 | 129,904 |
| | ----- | ----- |
| Net increase (decrease) in cash and cash equivalents | \$ 51,911 | \$ (15,684) |
| | ===== | ===== |
| Supplemental disclosures of cash flow information: | | |
| Income taxes paid | \$ 1,407 | \$ 372 |
| Interest paid | \$ 0 | \$ 85,378 |

</TABLE>

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

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<TABLE>

<CAPTION>

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
(Unaudited)

| <S> | <C> | <C> | <C> | <C> |
|-----|--------------------|--------------------|-------------------|-------------------|
| | Three Months Ended | Three Months Ended | Nine Months Ended | Nine Months Ended |
| | Sept. 30, 1999 | Sept. 30, 1998 | Sept. 30, 1999 | Sept. 30, 1998 |

Changes in net assets from operations:

| | | | | |
|--|--------------|--------------|----------------|----------------|
| Net operating loss. | \$ (324,184) | \$ (960,788) | \$ (2,490,286) | \$ (1,663,281) |
| Net realized (loss) gain on investments | (86,217) | (787,873) | 8,559,780 | (200,696) |
| Net (decrease) increase in unrealized appreciation | | | | |

| | | | | |
|---|-----------|-------------|-------------|-------------|
| on investments as a result of sales | (25,449) | 384,219 | (4,380,243) | (298,368) |
| Net increase (decrease) in unrealized appreciation on investments held. . . | 1,475,143 | (1,524,799) | 5,231,348 | (3,202,800) |
| ----- | | | | |
| Net increase (decrease) in net assets resulting from operations | 1,039,293 | (2,889,241) | 6,920,599 | (5,365,145) |

Changes in net assets from capital
stock transactions:

| | | | | |
|--|-------------|----------|-------------|-------------|
| Payment of dividends. . . | 0 | 0 | (3,647,017) | (8,019,728) |
| Proceeds from sale of treasury stock (Note 4). | 0 | 10,877 | 17,283 | 40,604 |
| Purchase of treasury stock (Note 4) | (1,832,831) | (34,088) | (2,373,551) | (199,802) |
| ----- | | | | |
| Net decrease in net assets resulting from capital stock transactions . . | (1,832,831) | (23,211) | (6,003,285) | (8,178,926) |
| ----- | | | | |

| | | | | |
|---|-----------|-------------|---------|--------------|
| Net (decrease) increase in net assets. | (793,538) | (2,912,452) | 917,314 | (13,544,071) |
|---|-----------|-------------|---------|--------------|

Net assets:

| | | | | |
|--------------------------|--------------|--------------|--------------|--------------|
| Beginning of the period. | 24,267,561 | 23,023,315 | 22,556,709 | 33,654,934 |
| ----- | | | | |
| End of the period. . . | \$23,474,023 | \$20,110,863 | \$23,474,023 | \$20,110,863 |
| ===== | | | | |

</TABLE>

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

<TABLE>
<CAPTION>

CONSOLIDATED SCHEDULE OF INVESTMENTS SEPTEMBER 30, 1999
(Unaudited)

| <S> | <C> Method of Valuation (3) | <C> Shares/ Principal | <C> Value |
|--|-----------------------------------|-----------------------------|--------------|
| Investments in Unaffiliated Companies (11)(12) -- 41.4% of total investments | | | |
| Publicly Traded Portfolio (Common stock unless noted otherwise) -- 6.3% of total investments | | | |
| ATG, Inc. (1)(4) -- Radioactive and hazardous waste management services . . . (C) | | 20,000 | \$ 100,000 |
| Nanophase Technologies Corporation (1)(6)(13) -- Manufactures and markets inorganic crystals of nanometric dimensions -- 4.60% of fully diluted equity. (C) | | 672,916 | 1,059,870 |
| Somnus Medical Technology, Inc. (1) -- Biotechnology and healthcare related(C) | | 200,000 | 512,500 |
| ----- | | | |

Total Publicly Traded Portfolio (cost: \$1,920,153). . . \$1,672,370

</TABLE>

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

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<TABLE>

<CAPTION>

CONSOLIDATED SCHEDULE OF INVESTMENTS SEPTEMBER 30, 1999
(Unaudited)

| <S> | <C> Method of Valuation (3) | <C> Shares/ Principal | <C> Value |
|---|-----------------------------------|-----------------------------|--------------|
| Private Placement Portfolio (Illiquid) (11)(12)(13) -- 35.1% of total investments | | | |
| Alliance Pharmaceutical Corp.(1)(2)(4) -- Research and development of pharmaceutical products -- \$1,200,000 subordinated 6% notes due 5/20/02 convertible into 600,000 common shares @ \$2.00 per share (C) | \$1,200,000 | | |
| Warrants convertible into 200,000 common shares @ \$2.45 expiring 5/20/04. (C) | 200,000 | \$ 3,329,750 | |
| Exponential Business Development Company (1)(2)(5) -- Venture capital partnership focused on early stage companies Limited partnership interest. . . (A) | -- | 25,000 | |
| Genomica Corporation (1)(2)(5)(6)(8) -- Develops software that enables the study of complex genetic diseases -- 4.97% of fully diluted equity Common Stock. (B) | 199,800 | | |
| Series A Voting Convertible Preferred Stock . . . (B) | 1,660,200 | 1,209,730 | |
| Kriton Medical, Inc. (1)(2)(4)(5) -- Research and development of medical devices -- 1.88% of fully diluted equity Series B Convertible Preferred Stock (A) | 476,191 | 1,000,001 | |
| MedLogic Global Corporation (1)(2)(5) -- 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)(7) -- Internet e-commerce source for scientific products -- 2.30% of fully diluted equity Series C Convertible Preferred Stock (B) | 277,163 | | |
| Common Stock. (B) | 26,822 | 3,200,962 | |
| Total Private Placement Portfolio (cost: \$5,111,080) | | \$ 9,331,420 | |
| Total Investments in Unaffiliated Companies (cost: \$7,031,233) | | \$11,003,790 | |

</TABLE>

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

<TABLE>
<CAPTION>

CONSOLIDATED SCHEDULE OF INVESTMENTS SEPTEMBER 30, 1999
(Unaudited)

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

Private Placement Portfolio in
Non-Controlled Affiliates (11)(13) (Illiquid)
-- 40.9% of total investments

InSite Marketing Technology, Inc. (1)(2)(5)(9)
-- Integrates marketing science and
sales strategy into e-commerce
-- 6.92% of fully diluted equity
Common Stock (A) 1,351,351 \$ 500,000

NeuroMetrix, Inc. (1)(2)(6)
-- Medical devices for monitoring
neuromuscular disorders -- 16.23%
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)(10) -- Organizes
and manages investment partnerships
-- 20.0% of fully diluted equity
Limited partnership interest . . (D) -- 1,637,112

Questech Corporation (1)(2)(5)(6)
-- Manufactures and markets
proprietary decorative tiles
and signs -- 12.38% of fully diluted
equity
Common Stock (D) 565,792 2,263,168
Warrants at \$4.00
expiring 11/28/01 (A) 166,667 167

Sundial Marketplace Corporation
(1)(2)(4)(5)(6) -- Internet retailer
offering telecommunications products
and services -- 20% of fully diluted equity
Series A Convertible
Preferred Stock (A) 2,000,000 500,000

Total Private Placement Portfolio
in Non-Controlled Affiliates (cost: \$5,278,102). . . . \$10,858,672

</TABLE>
The accompanying notes are an integral part of this consolidated schedule.

<TABLE>
<CAPTION>

CONSOLIDATED SCHEDULE OF INVESTMENTS SEPTEMBER 30, 1999
(Unaudited)

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

U.S. Government Obligations -- 17.7% of total investments

| | | |
|---|--------------|------------|
| U.S. Treasury Bill dated 2/25/99 due date 10/7/99 -- 4.6% yield (K) | \$ 550,000 | \$ 549,582 |
| U.S. Treasury Bill dated 3/4/99 due date 11/12/99 -- 4.5% yield (K) | \$ 1,000,000 | 994,800 |
| U.S. Treasury Bill dated 3/11/99 due date 11/26/99 -- 4.5% yield (K) | \$ 1,000,000 | 992,940 |
| U.S. Treasury Bill dated 3/25/99 due date 12/30/99 -- 4.7% yield (K) | \$ 600,000 | 592,908 |
| U.S. Treasury Bill dated 12/10/98 due date 12/9/99 -- 4.8% yield (K) | \$ 1,600,000 | 1,585,920 |

Total U.S. Government

Obligations (cost: \$4,715,999) \$ 4,716,150

Total Investments -- 100% (cost: \$17,025,334). \$26,578,612

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

</TABLE>

CONSOLIDATED SCHEDULE OF INVESTMENTS SEPTEMBER 30, 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-incomeproducing securities.
- (2) Legal restrictions on sale of investment.
- (3) See Footnote to Consolidated Schedule of Investments for a description of the Method of Valuation A to L under Asset Valuation Policy Guidelines set forth below.
- (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 nine months ended September 30, 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) In September 1998, SciQuest.com, Inc. acquired BioSupplyNet, Inc. On September 20, 1999, SciQuest.com, Inc. filed a Form S-1 Registration Statement. See Note 8 of Notes to Consolidated Financial Statements.
- (8) In 1996, Genomica Corporation was cofounded by the Company, Cold Spring Harbor Laboratory ("CSHL"), a not-for-profit institution, 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 CEO of Harris & Harris Group became a trustee of CSHL.
- (9) On October 5, 1999, Silknet Software, Inc. acquired InSite Marketing Technology, Inc. See Note 8 of Notes to Consolidated Financial Statements.
- (10) Harris Partners I L.P. owns a 20 percent 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 percent owned subsidiary of Harris & Harris Group, Inc.
- (11) Investments in unaffiliated companies consist of investments in which Harris & Harris Group, Inc. (the "Company") owns less than five percent of the investee company. Investments in non-controlled affiliated companies consist of investments where the Company owns more than five 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.
- (12) The aggregate cost for federal income tax purposes of investments in unaffiliated companies is \$7,031,233. The gross unrealized appreciation based on the tax cost for these securities is \$4,688,138. The gross unrealized depreciation based on the tax cost for these securities is \$715,581.

(13) The percentage ownership of each investee company disclosed in the Consolidated Schedule of Investments expresses the potential common equity interest in each such investee. The calculated percentage represents the amount of the issuer's common stock the Company owns or can acquire as a percentage of the issuer's total outstanding common stock plus common shares reserved for issued and outstanding warrants, convertible securities and stock options.

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

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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 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; and 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 portfolio 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

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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, and terms 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 net investment company taxable income and may either distribute or retain its taxable net 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 during a year, 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 as 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 and include the accounts of the Company and its wholly owned subsidiary. 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 Consolidated 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. The September 30, 1999 consolidated financial statements include a provision for deferred taxes on the net unrealized gains as of December 31, 1998. (See Note 6. Income Taxes.) The consolidated financial statements do not include a provision for deferred income taxes on the increase in the unrealized appreciation during 1999.

Reclassifications. Certain reclassifications have been made to the September 30, 1998 financial statements to conform to the September 30, 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 September 30, 1999 and December 31, 1998, and the reported amounts of revenues and expenses for the three and nine months ended September 30, 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 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

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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. (See Note 5. Employee Benefits.)

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 directly from the Company.

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 September 30, 1999, the Company had purchased a total of 401,878 shares for a total of \$795,509 at 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.

On July 14, 1999, the Company announced an offer to purchase up to 1,100,000 shares of its common stock for cash at a price equal to \$1.63 per share. A total of 1,080,569 shares were tendered for a total cost, including related expenses of approximately \$71,500, of \$1,832,831. Of these shares, 1,075,269 were tendered by one shareholder, which tendered all of its holdings.

In total, as a result of the shares purchased in the open market and through the tender offer, the Company has purchased 1,482,447 shares for a total of \$2,628,340, including commissions and expenses, at an average price of \$1.77.

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 this contract was to expire on December 31, 1999. Base salary was to be increased annually to reflect inflation and in addition could be increased by such amount as the Compensation Committee of the Board of Directors of the Company deems appropriate. In addition, Mr. Harris would have been entitled, under certain circumstances, to receive severance pay under the employment and severance contracts. On October 19, 1999, Mr. Harris signed an Employment Agreement with the Company, disclosed in a Form 8-K filed on October 27, 1999, replacing the employment agreement which was to expire on December 31, 1999.

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As of January 1, 1998, the Company cancelled its stock option plan and 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 consolidated 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, 13.79 percent; Mel P. Melsheimer, 4.233 percent; Rachel M. Pernia, 1.524 percent; and Jacqueline M. Matthews, 0.453 percent. 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 BDC within the meaning of 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 who 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 third quarter of 1999, the Company accrued profit-sharing expense of \$5,254, bringing the cumulative accrual under the Plan to \$2,747,383 at September 30, 1999.

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 10 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 September 30, 1999, 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 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' losses against 1998 income. Following that offset, the Company had approximately a \$7 million loss carryforward. The Company intends to use the approximate \$7 million loss carryforward (which it anticipates will 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 and nine months ended September 30, 1999 and 1998, the

Company's income tax (provision) benefit was allocated as follows:

<TABLE>

| <S> | <C> | <C> | <C> | <C> |
|--------------------------------|--------------|--------------|----------------|-----------------|
| | Three Months | Three Months | Nine Months | Nine Months |
| | Ended | Ended | Ended | Ended |
| | Sept. | Sept. | Sept. | Sept. |
| | 30, 1999 | 30, 1998 | 30, 1999 | 30, 1998 |
| Investment operations . . . \$ | 0 | \$ (743,949) | \$ | 0 \$(1,137,192) |
| Realized (loss) gain | | | | |
| on investments | 0 | 0 | (2,479,820) | 0 |
| Net increase (decrease) in | | | | |
| unrealized appreciation | | | | |
| on investments | 29,096 | 743,949 | 1,705,375 | 1,704,889 |
| Total income tax | | | | |
| (provision) benefit . . \$ | 29,096 | \$ | 0 \$ (774,445) | \$ 567,697 |

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

| | | | | | | | |
|----------------------------|--------|--------|----|--------------|----|-----------|-------------|
| Current -- Federal | \$ | 0 | \$ | 0 | \$ | 0 | \$(100,000) |
| Deferred -- Federal | | 29,096 | | 0 | | (774,445) | 667,697 |
| Total deferred income | | | | | | | |
| tax (provision) benefit \$ | 29,096 | \$ | 0 | \$ (774,445) | \$ | 567,697 | |

</TABLE>

The Company's net deferred income tax liability at September 30, 1999 and December 31, 1998 consists of the following:

<TABLE>

| <S> | <C> | <C> |
|-----------------------------------|--------------------|-------------------|
| | September 30, 1999 | December 31, 1998 |
| Tax on unrealized appreciation | | |
| on investments | \$ 1,705,509 | \$ 3,410,885 |
| Net operating loss and capital | | |
| loss 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. Any capital gains not distributed could be subject to corporate level tax. 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.

The Company incurred net ordinary and capital losses during the C Corporation taxable years, of which approximately \$7 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 approximate \$7 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 has announced an intention to issue formal guidance in 1999 concerning conversions of C Corporations to RIC's. 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 10-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 September 30, 1999 and 1998, was \$39,799 and \$40,522 respectively and \$122,555 and \$118,137 for the nine months ended September 30, 1999 and 1998, 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

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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 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 September 20, 1999, SciQuest.com, Inc. filed a Form S-1 Registration Statement. The Company anticipates receiving 461,036 (as adjusted for stock split) shares for its investment in SciQuest.com, Inc.

On October 5, 1999, the Company's interest in InSite Marketing Technology, Inc. was acquired by merger in a tax-free exchange by Silknet Software, Inc. (NASDAQ: SILK). The Company received 40,864 restricted shares of Silknet.

On October 19, 1999, Mr. Charles E. Harris signed an Employment Agreement with the Company, disclosed in a Form 8-K filed on October 27, 1999, replacing the Employment Agreement which was to expire on December 31, 1999.

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, and the reversal of previously recorded unrealized gain (loss) on investments sold or realized during the period, 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.

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Financial Condition

The Company's total assets and net assets were, respectively, \$28,396,294 and \$23,474,023 at September 30, 1999, compared with \$25,358,859 and \$22,556,709 at December 31, 1998.

Net asset value per share ("NAV") was \$2.54 at September 30, 1999 versus \$2.13 at December 31, 1998.

Among the significant changes which affected total assets, net assets and NAV in the first nine months of 1999 were: 1) the acquisition of NBX Corporation by 3Com Corporation, that increased Harris & Harris Group's net assets by approximately \$5,868,568; 2) an increase in the value of the Company's holdings in SciQuest.com, Inc., that increased net assets by approximately \$2,350,962; 3) an increase in the value of the Company's holdings in Alliance Pharmaceutical that increased net assets by approximately \$2,127,750; 4) the payment of a cash dividend of \$0.35 per share, that reduced net assets by approximately \$3,647,017; 5) the addition to a deferred income tax liability, that reduced net assets by \$774,445; 6) the purchase of 275,648 treasury shares in the open market for a total of \$540,720; and the completion of the tender offer of 1,080,569 shares for a total of \$1,832,831; and 7) the operating loss that reduced net assets by approximately \$2,490,286. (See "Consolidated Statements of Operations" contained in "Item 1. Consolidated Financial Statements.")

The Company's shares outstanding as of September 30, 1999 were 9,240,831 versus 10,591,232 at December 31, 1998. The Company's outstanding shares were reduced as a result of its purchase in the open market of 243,523 shares in the first quarter and 32,125 shares in the second quarter as well as the tender offer the Company completed in the third quarter for 1,080,569 shares. However, the treasury shares were then decreased by purchases of a total of 30,307 shares of treasury shares by directors. (See "Note 4 of Notes to Consolidated Financial Statements.")

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 September 30, 1999, \$20,190,092 or 71.1 percent of the Company's total assets consisted of investments at fair value in private businesses, of which net unrealized appreciation was \$9,800,910 before taxes. At December 31, 1998, \$19,562,386 or 77.1 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 77.1 percent at December 31, 1998 to 71.1 percent at September 30, 1999 is primarily owing to the acquisition of NBX Corporation by 3Com Corporation, offset by the additional investments in private businesses.

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

<TABLE>

| <S> | <C> | <C> |
|----------------------------|--------------------|-------------------|
| | September 30, 1999 | December 31, 1998 |
| Investments, at cost | \$ 17,025,334 | \$ 14,124,642 |
| Unrealized appreciation | 9,553,278 | 10,407,549 |
| | ----- | ----- |
| Investments, at fair value | \$ 26,578,612 | \$ 24,532,191 |
| | ===== | ===== |

</TABLE>

The accumulated unrealized appreciation on investments net of deferred taxes is \$7,847,769 at September 30, 1999, versus \$6,996,664 at December 31, 1998.

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 nine months ended September 30, 1999:

<TABLE>

| <S> | <C> |
|---------------------------------|-------------|
| New Investments: | Amount |
| Alliance Pharmaceutical Corp. | \$1,202,000 |
| Kriton Medical, Inc. | 1,000,001 |
| Sundial Marketplace Corporation | 500,000 |
| | ----- |
| Sub-Total | \$2,702,001 |
| Exercise of Warrants: | |
| SciQuest.com, Inc. | 75,000 |
| | ----- |
| Total | \$2,777,001 |
| | ===== |

</TABLE>

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Results of Operations

Investment Income and Expenses:

The Company realized a net operating loss of \$2,490,286 and \$1,663,281 for the nine months ended September 30, 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 \$185,557 and \$314,237 for the nine months ended September 30, 1999 and 1998, respectively. The decrease of \$128,680 or 40.9 percent is the result of a decline in the balance of the Company's fixed income portfolio during the

nine months ended September 30, 1999 versus the nine months ended September 30, 1998. The Company had borrowed funds against the JP Morgan line of credit during the nine months ended September 30, 1998, which were not outstanding during the nine months ended September 30, 1999. Accordingly, the Company had interest expense of \$85,378 during the nine months ended September 30, 1998 and did not have any interest expense for the nine months ended September 30, 1999.

The Company had interest income from affiliated companies of \$28,513 and \$109,133 for the nine months ended September 30, 1999 and 1998, respectively. The decrease of \$80,620 or 73.9 percent is owing to a reduced number of loans outstanding to investee companies during the fourth quarter of 1999 as compared to the fourth quarter of 1998. This reduction is primarily attributable to repayments or conversion of the loans to stock of investee companies during the fourth quarter of 1998.

The Company had other income of \$4,022 and \$143,028 for the nine months ended September 30, 1999 and 1998, respectively. The other income in 1998 represents dividend income, rental income and repayment of expenses paid by the Company on BioSupplyNet's behalf in 1996. The Company did not have any rental income in 1999.

Operating expenses were \$2,708,378 and \$1,092,487 for the nine months ended September 30, 1999 and 1998, respectively. The increase of \$1,615,891 or 147.9 percent is primarily owing to the increase in the accrual for the Company's profit-sharing plan of \$1,423,824 as a result of the realized gain on the sale of NBX Corporation and the increase in the unrealized appreciation on investments. Also, the first nine months of 1998 included a profit-sharing reversal of \$423,808, which reduced the total expenses for that period by such amount. 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).

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Ninety percent of the profit-sharing amounts resulting from the realized gains during 1999, net of operating expenses for the year, will be paid out as soon as practicable following the 1999 year-end audit. The remaining 10 percent will be paid out after the Company has filed its federal tax return for the year.

The Company had interest income from fixed-income securities of \$64,349 and \$46,571 for the three months ended September 30, 1999 and 1998, respectively. The increase of \$17,778 or 38.2 percent is a result of the Company having more funds available to invest in the third quarter of 1999 as a result of the funds received from the sale of NBX Corporation.

The Company had interest income from affiliated companies of \$19,196 and \$22,649 for the three months ended September 30, 1999 and 1998, respectively. The decrease of \$3,453 or 15.2 percent is owing to a lower amount of loans outstanding to investee companies.

Operating expenses were \$411,451 and \$421,739 for three months ended September 30, 1999 and 1998, respectively. The decrease of \$10,288 or 2.4 percent is primarily owing to interquarter variances and the interest expense the Company incurred in the third quarter of 1998 and not in 1999.

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:

"Net realized gain (loss) on investments" and "Net (decrease) increase in unrealized appreciation on investments" are directly related. When an investment is sold or realized, its previously recorded unrealized gain or loss is reversed completely. Therefore a reversal of a previously recorded loss would increase the unrealized appreciation on investments and a reversal of a previously recorded gain would decrease the unrealized appreciation on investments.

During the nine months ended September 30, 1999 and 1998, the Company realized gains and (losses) of \$11,039,600 and (\$200,696), respectively. During the nine months ended September 30, 1999, the Company realized a gain of approximately \$10,584,630 on the acquisition of NBX Corporation by 3Com Corporation; a gain of approximately \$160,918 on its sale of Princeton Video Image, Inc. stock; and received a cash distribution from PHZ Capital Partners L.P. of approximately \$612,170. The Company also incurred losses of approximately \$318,118 on the sale of various publicly traded investments. As a result of the gains and losses realized in the nine months ended September 30, 1999, unrealized appreciation decreased by \$4,380,243.

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During the nine months ended September 30, 1998, the Company sold various publicly traded securities, realizing a net loss of \$200,696. As a result of the gains and losses realized in the nine months ended September 30, 1998, unrealized appreciation decreased by \$298,368.

During the three months ended September 30, 1999 and 1998, the Company realized losses of \$86,217 and \$787,873, respectively. During the three months ended September 30, 1999, the Company sold various publicly traded securities realizing a net loss of \$112,077 and received a cash distribution from PHZ Capital Partners L.P. of \$25,860. As a result of the gains and losses realized in the three months ended September 30, 1999, unrealized appreciation decreased by \$25,449.

During the three months ended September 30, 1998, the Company sold various publicly traded securities realizing a net loss of \$787,873. As a result of the gains and losses realized in the three months ended September 30, 1998, unrealized appreciation increased by \$384,219.

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 \$854,270 or 8.2 percent during the nine months ended September 30, 1999, from \$10,407,549 to \$9,553,279, primarily as a result of the reclassification of the Company's holdings of NBX Corporation from unrealized to realized gain of approximately \$4,716,062, offset by the increase in value of the Company's holdings of SciQuest.com, Inc. of approximately \$2,350,962, and of Alliance Pharmaceutical Corp. of approximately \$2,127,750.

Net unrealized appreciation on investments before taxes decreased by \$5,206,057 or 63.8 percent during the nine months ended September 30, 1998, from \$8,158,732 to \$2,952,675, primarily as a result of decreased valuations in Nanophase Technologies Corporation, Princeton Video Image, Inc. and MedLogic Global Corporation. These decreases were offset primarily by an increased valuation in NeuroMetrix, Inc.

Net unrealized appreciation on investments before taxes increased by \$1,420,598 or 17.5 percent during the three months ended September 30, 1999, from \$8,132,681 to \$9,553,279, primarily as a result of the increase in the value of Alliance Pharmaceutical Corp. of approximately \$1,803,750.

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Net unrealized appreciation on investments before taxes decreased by \$1,884,529 or 39.0 percent during the three months ended September 30, 1998, from \$4,837,204 to \$2,952,675, owing primarily to decreases in Nanophase Technologies Corporation, MultiTarget, Inc., Somnus Corporation and Energy Research Corporation.

Liquidity and Capital Resources

The Company held cash, receivables and marketable securities (the primary measure of liquidity) at September 30, 1999 totaling \$8,028,161, versus \$5,547,984 at December 31, 1998.

The increase in cash, receivables and marketable securities from December 31, 1998 to September 30, 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., \$1,202,000 in Alliance Pharmaceutical Corp., and \$500,000 in Sundial Marketplace Corporation; and 3) the purchase of treasury shares in the open market for a total of \$540,720 and the purchase of 1,080,569 shares tendered in the Company's tender offer for a total of approximately \$1,832,831 including approximately \$71,500 of related fees.

From December 31, 1998 to September 30, 1999, the amounts receivable from brokers decreased by \$380,707 or 100 percent, owing to a transaction that settled in January 1999. Funds in escrow increased by \$1,327,748 or 100 percent, owing to the escrowed funds net of reserve 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 September 30, 1999. Accrued profit-sharing increased by \$1,423,824 or 107.5 percent to \$2,747,383 as a result of the gain on the sale of NBX Corporation and the increase in the unrealized appreciation on investments. Ninety percent of the profit-sharing amount attributable to 1999 net realized income will be paid out as soon as practicable following the year-end audit. The remaining 10 percent will be paid out after the Company has filed its federal tax return for the year. There was no profit-sharing paid out during the nine months ended September 30, 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 and capital loss carryforward to offset the long-term capital gain realized when the Company sold its interest in NBX Corporation.

As of September 30, 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.

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 the sum of its annual ordinary income and capital gain net 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 1999 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 Company anticipates filing a request for SEC certification for 1999 in the near future.

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 (under the RIC regulations) 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

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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 approximately \$7 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 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 approximate \$7 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 has announced an intention to issue formal guidance in 1999 concerning conversions of C Corporation to RIC's. 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 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.

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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 four 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. Accordingly, the inability to liquidate assets could have an adverse effect on the Company's ability to meet its operating expenses in the ordinary course.

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

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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 consolidated 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 has developed a plan focusing on achieving Year 2000 compliance. 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. The Company considers the principal type of market risk to be valuation 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 Guidelines in the Footnote to Consolidated Schedule of Investments.

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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 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 consolidated statements of operations as "Net increase (decrease) in unrealized appreciation on investments."

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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
None

Item 5. Other Information
None

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.

10.1 Employment Agreement Between Harris & Harris Group, Inc. and Charles E. Harris, dated October 19, 1999, incorporated by reference to Exhibit 99 to the Company's Form 8-K filed on October 27, 1999.

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 nine months ended September 30, 1999. On October 27, 1999, the Company filed a Form 8-K to disclose the Employment Agreement between Charles E. Harris, Chief Executive Officer of Harris & Harris Group, Inc. and Harris & Harris Group, Inc.

EXHIBIT INDEX

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

27. Financial Data Schedule

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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: November 15, 1999

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

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