

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

Form 10-Q

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

For quarterly period ended March 31, 2001

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 (IRS Employer Identification No.)
incorporation or organization)

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

(Address of Principal Executive Offices) (Zip Code)

(212) 332-3600

(Registrant's telephone number, including area code)

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

Yes No

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

Class	Outstanding at May 4, 2001
-----	-----
Common Stock, \$0.01 par value per share	9,064,231 shares

Harris & Harris Group, Inc.
Form 10-Q, March 31, 2001

TABLE OF CONTENTS

	Page Number
PART I. FINANCIAL INFORMATION	
Item 1. Consolidated Financial Statements	1
Consolidated Statements of Assets and Liabilities	2
Consolidated Statements of Operations	3
Consolidated Statements of Cash Flows	4
Consolidated Statements of Changes in Net Assets	5
Consolidated Schedule of Investments	6

Notes to Consolidated Financial Statements	14
--	----

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	21
---	----

Financial Condition	21
-------------------------------	----

Results of Operations	23
---------------------------------	----

Liquidity and Capital Resources	24
---	----

Risk Factors	25
------------------------	----

Item 3. Quantitative and Qualitative Disclosures About Market Risk	29
--	----

PART II OTHER INFORMATION

Item 1. Legal Proceedings	30
-------------------------------------	----

Item 2. Changes in Securities and Use of Proceeds	30
---	----

Item 3. Defaults Upon Senior Securities	30
---	----

Item 4. Submission of Matters to a Vote of Security Holders	30
---	----

Item 5. Other Information	30
-------------------------------------	----

Item 6. Exhibits and Reports on Form 8-K	30
--	----

Exhibit Index	32
-------------------------	----

Signature	32
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Harris & Harris Group, Inc.
Form 10-Q, March 31, 2001

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 amended Investment Company Act of 1940. The Company made such election on July 26, 1995. Certain information and disclosures normally included in the consolidated 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 consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2000 contained in the Company's 2000 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"). In order to qualify as a RIC, the Company must, in general (1) annually derive at least 90 percent of its gross income from dividends, interest and gains from the sale of securities; (2) quarterly meet certain investment diversification requirements; and (3) annually distribute at least 90 percent of its investment company taxable income as a dividend. In addition to the requirement that the Company must annually distribute at least 90 percent of its investment company taxable income, the Company may either distribute or retain its taxable net capital gains from investments, but any net capital gains not distributed could be

subject to corporate level tax. Further, the Company could be subject to a four percent excise tax if it fails to distribute 98 percent of its annual taxable income and would be subject to income tax if it fails to distribute 100 percent of its taxable income.

Because of the specialized nature of its investment portfolio, the Company could satisfy the diversification requirements under Sub-Chapter M of the Code only if it received a certification from the SEC that it is "principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available."

On March 8, 2001, the Company received SEC certification and qualified for RIC treatment for 2000 (as it had for 1999). Although the SEC certification for 2000 was issued, there can be no assurance that the Company will receive such certification for subsequent years (to the extent it needs additional certification as a result of changes in its portfolio) or that it will actually qualify for Sub-Chapter M treatment in subsequent years. In addition, under certain circumstances, even if the Company qualified for Sub-Chapter M treatment in a given 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.

1

CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES

ASSETS

	March 31, 2001 (Unaudited)	December 31, 2000 (Audited)
Investments, at value (See accompanying schedule of investments and notes)	\$ 30,145,270	\$ 42,568,559
Cash and cash equivalents	118,444	253,324
Restricted funds (Note 5)	331,102	265,183
Interest receivable	82	30,082
Note receivable	10,888	10,888
Prepaid expenses	62,244	82,615
Other assets	146,300	132,772
Total assets	<u>\$ 30,814,330</u>	<u>\$ 43,343,423</u>

LIABILITIES & NET ASSETS

Accounts payable and accrued liabilities	\$ 778,433	\$ 771,763
Payable to broker for unsettled trade	0	115,005
Accrued profit sharing (Note 3)	544,386	3,483,241
Deferred rent	21,590	23,903
Current income tax liability (Note 6)	69,316	5,751,566
Deferred income tax liability (Note 6)	1,364,470	1,364,470
Total liabilities	<u>2,778,195</u>	<u>11,509,948</u>
Commitments and contingencies (Note 7)		
Net assets	<u>\$ 28,036,135</u>	<u>\$ 31,833,475</u>

Net assets are comprised of:
Preferred stock, \$0.10 par value,
2,000,000 shares authorized;

none issued	\$	0	\$	0
Common stock, \$0.01 par value, 25,000,000 shares authorized; 10,692,971 issued at 3/31/01 and 12/31/00.		106,930		106,930
Additional paid in capital (Note 4).		26,724,595		26,724,595
Additional paid in capital - common stock warrants		109,641		109,641
Accumulated net realized gain (loss).		(71,991)		642,418
Accumulated unrealized appreciation of investments, net of deferred tax liability of \$1,630,506 at 3/31/01 and \$1,630,506 at 12/31/00.		4,234,491		7,317,422
Treasury stock at cost (1,628,740 shares at 3/31/01 and at 12/31/00).		(3,067,531)		(3,067,531)
Net assets.	\$	28,036,135	\$	31,833,475
Shares outstanding.		9,064,231		9,064,231
Net asset value per outstanding share	\$	3.09	\$	3.51

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

CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended March 31, 2001	Three Months Ended March 31, 2000
Investment income:		
Interest from:		
Fixed-income securities.	\$ 152,530	\$ 83,954
Affiliated companies	9,617	21,682
Other income	29,812	15,812
Total investment income.	191,959	121,448
Expenses:		
Profit sharing reversal (Note 3).	(846,290)	(1,651,336)
Salaries and benefits	299,704	277,546
Administration and operations	93,256	92,574
Professional fees	59,203	85,307
Rent.	42,073	41,475
Directors' fees and expenses.	22,990	21,132
Depreciation.	7,500	10,000
Custodian fees.	3,646	3,536
Interest expense (Note 4)	0	146,141
Total expenses.	(317,918)	(973,625)
Operating income before income taxes	509,877	1,095,073
Income tax provision (Note 6)	0	0
Net operating income.	509,877	1,095,073
Net realized (loss) gain on investments:		
Realized (loss) gain on sale of investments.	(1,194,652)	3,763,272
Total realized (loss) gain	(1,194,652)	3,763,272
Income tax provision (Note 6)	(29,634)	(1,183,618)
Net realized (loss) gain on		

investments	(1,224,286)	2,579,654
Net realized (loss) income. . . .	(714,409)	3,674,727
Net decrease in unrealized appreciation on investments:		
Decrease as a result of		
investment sales.	0	(3,204,990)
Increase as a result of		
investment sales.	1,528,082	0
Increase on investments held. . .	0	14,338,573
Decrease on investments held. . .	(4,611,013)	(21,733,839)
Change in unrealized		
appreciation on		
investments.	(3,082,931)	(10,600,256)
Income tax benefit (Note 6) . . .	0	53,304
Net decrease in unrealized		
appreciation on investments . . .	(3,082,931)	(10,446,952)
Net decrease in net assets resulting from operations:		
Total	\$ (3,797,340)	\$ (6,772,225)
Per outstanding share	\$ (0.42)	\$ (0.73)

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

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31, 2001	Three Months Ended March 31, 2000
Cash flows from operating activities:		
Net decrease in net assets resulting from operations.	\$ (3,797,340)	\$ (6,772,225)
Adjustments to reconcile net decrease in net assets resulting from operations to net cash used in operating activities:		
Net realized and unrealized		
loss on investments	4,277,583	6,836,984
Deferred income taxes.	0	1,030,314
Depreciation	7,500	10,000
Other.	0	105,040
Changes in assets and liabilities:		
Restricted funds	(65,919)	(76,698)
Interest receivable.	30,000	33,661
Prepaid expenses	20,371	8,604
Funds in escrow.	0	1,327,748
Other assets	(18,417)	16,189
Accounts payable and accrued liabilities.	6,670	(136,454)
Payable to broker for unsettled trade.	(115,005)	0
Accrued profit sharing	(2,938,855)	(2,676,032)
Current income tax liability . . .	(5,682,250)	0
Deferred rent.	(2,313)	(2,312)
Net cash used in operating activities	(8,277,975)	(295,181)
Cash flows from investing activities:		
Net purchase (sale) of short-term investments and marketable securities.	8,895,704	(1,977,303)

Proceeds from sale of investments.	0	5,014,702
Investment in private placements and loans	(750,000)	(2,640,000)
Purchase of fixed assets	(2,609)	(4,476)
	-----	-----
Net cash provided by investing activities	8,143,095	392,923
Cash flows from financing activities:		
Proceeds from note payable	0	3,000,000
Payment of note payable.	0	(3,000,000)
	-----	-----
Net cash used in financing activities	0	0
	-----	-----
Net (decrease) increase in cash and cash equivalents:		
Cash and cash equivalents at beginning of the period.	253,324	133,256
Cash and cash equivalents at end of the period.	118,444	230,998
	-----	-----
Net (decrease) increase in cash and cash equivalents	\$ (134,880)	\$ 97,742
	=====	=====

Supplemental disclosures of cash flow information:

Income taxes paid.	\$5,711,884	\$ 1,450
Interest paid.	\$ 0	\$ 36,500

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

4

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
(Unaudited)

	Three Months Ended March 31, 2001	Three Months Ended March 31, 2000
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Changes in net assets from operations:

Net operating income.	\$ 509,877	\$ 1,095,073
Net realized (loss) gain on investments	(1,224,286)	2,579,654
Net increase (decrease) in unrealized appreciation on investments as a result of sales	1,528,082	(3,051,686)
Net decrease in unrealized appreciation on investments held.	(4,611,013)	(7,395,266)
	-----	-----

Net decrease in net assets resulting from operations	(3,797,340)	(6,772,225)
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Changes in net assets from capital stock transactions:

Additional paid in capital on Common Stock Warrants issued.	0	109,641
	-----	-----
Net increase in net assets resulting from capital stock transactions.	0	109,641
	-----	-----

Net decrease in net assets.	0	(6,662,584)
	-----	-----

Net assets:

Beginning of the period	31,833,475	53,634,805
End of the period	\$ 28,036,135	\$ 46,972,221

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

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2001
(Unaudited)

Method of Valuation (3)	Shares/ Principal	Value
Investments in Unaffiliated Companies (16)(17)(18) -- 15.2% of total investments		
Publicly Traded Portfolio (Common stock unless noted otherwise) -- 10.0% of total investments		
Genomica Corporation (1)(6)(7) -- Develops software that enables the study of complex genetic diseases -- 2.95% of fully diluted equity		
Common Stock	(C) 731,111	\$3,015,833
Kana Communications, Inc. (1)(8) -- Provides customer-centric e-business applications and systems		
	(C) 6,782	13,175
Total Publicly Traded Portfolio (cost: \$1,550,360). . . . \$3,029,008		
Private Placement Portfolio (Illiquid) (16)(17)(18) -- 5.2% of total investments		
Essential.com, Inc. (1)(2)(9) -- Online energy and communications marketplace -- 0.97% of fully diluted equity		
Common stock	(D) 253,271	\$16,587
Exponential Business Development Company (2)(5) -- Venture capital partnership focused on early stage companies		
Limited partnership interest.	(A) --	25,000
Informio, Inc. (1)(2)(5)(6)(10) -- Developing audio web portal technology -- 0.81% of fully diluted equity		
Series A Voting Convertible Preferred Stock	(A) --	504,601
Kriton Medical, Inc. (1)(2)(5)(6) -- Research and development of medical devices -- 1.86% of fully diluted equity		
Series B Convertible Preferred Stock	(A) 476,191	1,000,001
MedLogic Global Corporation (1)(2)(5)(6) -- Medical cyanoacrylate adhesive -- 0.23% of fully diluted equity		
Series B Convertible Preferred Stock	(D) 54,287	
Common Stock	(D) 25,798	--
Total Private Placement Portfolio (cost: \$3,912,910). . . . \$1,546,189		

 Total Investments in Unaffiliated Companies
 (cost: \$5,463,270). \$4,575,197

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

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2001
 (Unaudited)

Method of Shares/
 Valuation (3) Principal Value

Investments in Non-Controlled Affiliated Companies (16)(18) --
 53.4% of total investments

Publicly Traded Portfolio -- 14.5% of total investments

Nanophase Technologies Corporation
 (1)(11) -- Manufactures and markets
 inorganic crystals of nanometric
 dimensions -- 4.46% of fully diluted
 equity. (C) 672,916 \$4,373,954

Total Publicly Traded Portfolio (cost: \$1,162,204). \$4,373,954

Private Placement Portfolio (Illiquid) (16)(18) --
 38.9% of total investments

Experion Systems, Inc. (1)(2)(5)(6)(12) --
 Provides e-business software selling
 platforms based on trust-based marketing --
 14.13% of fully diluted equity
 Convertible Preferred Stock. . . . (A) 187,500 \$1,500,000

NeuroMetrix, Inc. (1)(2)(5)(6) --
 Medical devices for monitoring
 neuromuscular disorders -- 13.40% of
 fully diluted equity
 Series A Convertible
 Preferred Stock. (D) 175,000
 Series B Convertible
 Preferred Stock. (D) 125,000
 Series C-2 Convertible
 Preferred Stock. (D) 229,620
 Series E Convertible
 Preferred Stock. (D) 53,333 6,708,225

PHZ Capital Partners Limited Partnership
 (2)(13) -- Organizes and manages
 investment partnerships -- 20.0% of
 fully diluted equity
 Limited partnership interest . . . (D) -- 1,806,279

Questech Corporation (1)(2)(5)(6) --
 Manufactures and markets proprietary
 decorative tiles and signs -- 9.88% of
 fully diluted equity
 Common Stock (B) 646,954
 Warrants at \$5.00 expiring
 11/15/04 (B) 1,965
 Warrants at \$4.00 expiring
 11/28/01 (B) 152,422
 Warrants at \$1.50 expiring
 11/16/05 (B) 1,250 970,598

Schwoo, Inc. (1)(2)(4)(14) -- Developing
 software that automatically manages
 e-commerce security infrastructure --

11.68% of fully diluted equity Series B Convertible Preferred Stock. (A)	1,946,535	750,000

Total Private Placement Portfolio (cost: \$8,192,550).		\$11,735,102

Total Investments in Non-Controlled Affiliated Companies (cost: \$9,354,754).		\$16,109,056

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

7

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2001
(Unaudited)

Method of Valuation (3)	Shares/ Principal	Value
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Private Placement Portfolio in Controlled Affiliates (16)(18) --
6.6% of total investments

Harris Newco, Inc. (1)(2)(5)(6)(15) -- 100% of fully diluted equity Series 1 Convertible Preferred Stock. (A)	100	\$ 2,000,000

Total Private Placement Portfolio in Controlled Affiliates (cost: \$2,000,000).		\$ 2,000,000

U.S. Government and Agency Obligations -- 24.8% of total investments

Federal Home Loan Bank Discount Notes - due date 4/06/01. (K)	\$1,900,000	\$ 1,898,414
Federal Home Loan Bank Discount Notes - due date 6/1/01 (K)	\$1,850,000	1,834,608
U.S. Treasury Bill dated 10/19/00 -- due date 4/19/01 -- 4.4% yield. . . (K)	\$1,750,000	1,745,975
Federal Home Loan Bank Discount Notes - due date 6/6/01 (K)	\$2,000,000	1,982,020

Total Investments in U.S. Government and Agency Obligations (cost: \$7,462,249).		\$ 7,461,017

Total Investments -- 100% (cost: \$24,280,273)		<u>\$30,145,270</u>
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The accompanying notes are an integral part of this consolidated schedule.

8

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2001
(Unaudited)

Notes to Consolidated Schedule of Investments

- (1) Represents a non-income producing security. Equity investments that have not paid dividends within the last 12 months are considered to be non-income producing.
- (2) Legal restrictions on sale of investment.
- (3) See Footnote to Schedule of Investments for a description of the Methods of Valuation A to L.
- (4) These investments were made during 2001. Accordingly, the amounts shown on the schedule represent the gross additions in 2001.

- (5) No changes in valuation occurred in these investments during the three months ended March 31, 2001.
- (6) These investments are development stage companies. A development stage company is defined as a company that is devoting substantially all of its efforts to establishing a new business, and either it has not yet commenced its planned principal operations or it has commenced such operations but has not realized significant revenue from them.
- (7) 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 Chief Financial Officer of CSHL. In late 1998, Charles E. Harris, Chairman and CEO of Harris & Harris Group, became a trustee of CSHL. On September 29, 2000, Genomica Corporation (National Market Symbol: GNOM) commenced trading on Nasdaq. On April 30, 2001 the market price per share of Genomica Corporation was \$4.11.
- (8) On October 5, 1999, Silknet Software, Inc. acquired InSite Marketing Technology, Inc. On April 19, 2000, Kana Communications, Inc. (National Market Symbol: KANA) and Silknet Software completed a merger, in which each share of Silknet Software was exchanged tax free for 1.66 Kana Communications shares. Upon the completion of the merger, 90 percent of the Kana Communications shares became freely tradable, and the Company was subject to a lock-up agreement on the remaining 10 percent of the stock that expired on December 31, 2000. During 2000, the Company sold 90 percent of the Kana Communications shares for proceeds of \$1,504,762. On April 30, 2001, the market price per share of Kana Communications was \$1.26.
- (9) On June 29, 2000, Sundial Marketplace Corporation was acquired in a tax-free merger by Essential.com, Inc.
- (10) Previously named iPacer Corporation.

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

- (11) On April 30, 2001, the market price per share of Nanophase Technologies Corporation (National Market Symbol: NANX) was \$10.00.
- (12) Previously named MyPersonalAdvocate.com, Inc.
- (13) 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.
- (14) As part of the investment, the Company acquired the right to purchase an additional 359,659 shares of Series B Convertible Preferred Stock. The Company acquired these shares on April 12, 2001 for a total of \$138,577.
- (15) Currently the Company owns 100 percent of Harris Newco, Inc.
- (16) Investments in unaffiliated companies consist of investments in which the Company owns less than five percent of the investee company. Investments in non-controlled affiliated companies consist of investments in which the Company owns more than five percent but less than 25 percent of the investee company. Investments in controlled affiliated companies consist of investments in which the Company owns

more than 25 percent of the investee company.

- (17) The aggregate cost for federal income tax purposes of investments in unaffiliated companies is \$5,463,270. The gross unrealized appreciation based on the tax cost for these securities is \$1,515,529. The gross unrealized depreciation based on the tax cost for these securities is \$2,403,602.
- (18) 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.

10

FOOTNOTE TO CONSOLIDATED SCHEDULE OF INVESTMENTS

ASSET VALUATION POLICY GUIDELINES

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

- 1) EQUITY-RELATED SECURITIES
- 2) INVESTMENTS IN INTELLECTUAL PROPERTY OR PATENTS OR RESEARCH AND DEVELOPMENT IN TECHNOLOGY OR PRODUCT DEVELOPMENT
- 3) LONG-TERM FIXED-INCOME SECURITIES
- 4) SHORT-TERM FIXED-INCOME INVESTMENTS
- 5) ALL OTHER INVESTMENTS

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

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

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

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

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

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

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

11

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 company's securities held by the Company. The Company discounts market value for securities that are subject to significant legal and contractual or restrictions. Other securities, for which market quotations are readily available, are carried at market value as of the time of valuation. In accordance with recently published SEC guidelines, the Company changed its policy, effective March 31, 2001, and no longer discounts the market value of securities for liquidity considerations. Management's estimate of the effect on NAV of not discounting the March 31, 2001 publicly held securities was an increase of \$0.08.

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

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

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

INVESTMENTS IN INTELLECTUAL PROPERTY OR PATENTS OR RESEARCH AND

DEVELOPMENT IN TECHNOLOGY OR PRODUCT DEVELOPMENT

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

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

F. Private Market: The private market method uses actual third-party investments in intellectual property or patents or research and development in technology or product development as

12

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

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

LONG-TERM FIXED-INCOME SECURITIES

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

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

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

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

SHORT-TERM FIXED-INCOME INVESTMENTS

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

ALL OTHER INVESTMENTS

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

The reported values of securities for which market

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

13

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.

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.

Harris & Harris Enterprises, Inc. ("Enterprises") is a 100 percent wholly owned subsidiary of the Company. Enterprises holds the lease for the office space, which it subleases to the Company and an unaffiliated party; operates a financial relations and consulting firm; is a partner in Harris Partners I, L.P. and is taxed as a C corporation. Harris Partners I L.P. is a limited partnership and owns a 20 percent limited partnership interest in PHZ Capital Partners, L.P. The partners of Harris Partners I L.P. are Enterprises (sole general partner) and the Company (sole limited partner).

The Company qualified for 2000 as a Regulated Investment Company ("RIC") under Sub-Chapter M of the Internal Revenue Code of 1986 (the "Code"). There can be no assurance that the Company will qualify as a RIC in 2001 or that, if it does qualify, it will continue to qualify for subsequent years. In addition, even if the Company were to qualify as a RIC for a given 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. As a RIC, the Company must, among other things, distribute at least 90 percent of its taxable net income and may either distribute or retain its taxable net realized capital gains on investments.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Principles of Consolidation. The consolidated financial

statements have been prepared in accordance with accounting principles generally accepted in the United States for investment companies and include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

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

14

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 specific identification basis for financial reporting and tax reporting.

Income Taxes. Prior to January 1, 1999, the Company recorded income taxes using the liability method in accordance with the provision of Statement of Financial Accounting Standards No. 109. Accordingly, deferred tax liabilities had been established to reflect temporary differences between the recognition of income and expenses for financial reporting and tax purposes, the most significant difference of which related to the Company's unrealized appreciation on investments.

The March 31, 2001 consolidated financial statements include a liability for deferred taxes on the remaining net built-in gains as of December 31, 1998, net of the unutilized operating and capital loss carryforwards incurred by the Company through December 31, 1998.

The March 31, 2000 and December 31, 2000 consolidated financial statements also reflect a tax provision on net realized long-term capital gains which the Company retained for liquidity and to fund investment opportunities, rather than distribute to shareholders as a cash distribution. Accordingly, the Company declared a designated undistributed capital gain dividend for the year. (See "Note 6. Income Taxes" and Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operation -- Sub-Chapter M Status -- Recent Developments.")

The Company pays federal, state and local income taxes on behalf of its wholly owned subsidiary, Harris & Harris Enterprises, which is a C corporation. (See Note 6. Income Taxes.)

Reclassifications. Certain reclassifications have been made to the March 31, 2000 financial statements to conform to the March 31, 2001 presentation.

Estimates by Management. The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of March 31, 2001 and December 31, 2000, and the reported amounts of revenues and expenses for the three months ended March 31, 2001 and March 31, 2000. Actual results could differ from these estimates.

NOTE 3. EMPLOYEE PROFIT-SHARING PLAN

On August 3, 1989, the shareholders of the Company approved the 1988 Long Term Incentive Compensation Plan (the "1988 Plan"). The Company's 1988 Plan was cancelled as of December 31, 1997, canceling all outstanding stock options and eliminating all potential stock option grants. As a substitution for the 1988 Plan, the Company adopted an employee profit-sharing plan.

15

As of January 1, 1998, the Company began implementing the Harris & Harris Group, Inc. Employee Profit Sharing Plan (the "1998 Plan") that provides for profit sharing equal to 20 percent of the net realized income of the Company as reflected on the Consolidated Statements of Operations for such year, less the nonqualifying gain, if any. The 1998 Plan was terminated by the Company as of December 31, 1999. All the amounts owed on the 1999 realized gains were paid during 2000. In March 2000, the Company paid out 90 percent of the profit sharing in the amount of \$1,024,696 on the 1999 realized gains; the remaining 10 percent or \$113,855 was paid out in September 2000, upon the completion and filing of the Company's 1999 federal tax return.

As of January 1, 2000, the Company implemented the Harris & Harris Group, Inc. Employee Profit Sharing Plan (the "Plan") that provides for profit sharing equal to 20 percent of the net realized income of the Company as reflected on the 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 is calculated without regard to dividends paid or distributions made to shareholders, payments under the Plan, unrealized gains and losses, and loss carryovers from other years ("Qualifying Income"). The portion of net after-tax realized gains attributable to asset values as of September 30, 1997 is considered nonqualifying gain, which reduces 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. Currently, the distribution amounts for each officer and employee are as follows: Charles E. Harris, 13.790 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 may subsequently be paid to such participant.

Notwithstanding any provisions of the Plan, in no event may the aggregate amount of all awards payable for any Plan year during which the Company remains a "business development company" within the meaning of 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 with the stipulation that no such modification, amendment or termination may adversely affect any participant that has not consented to such modification, amendment or termination. Nothing in this Plan shall preclude the Board of Directors from, for any Plan Year subsequent to the current Plan Year, naming additional Participants in the Plan or changing the Award Percentage of

any Full Participant or New Participant (subject to the overall percentage limitations contained herein).

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. During the first quarter of

16

2001, the Company paid out 90 percent of the 2000 profit sharing in the amount of \$2,092,565 and reduced the profit-sharing accrual by \$846,290 as a result of the realized losses and a decrease in the net unrealized appreciation. Accordingly, the cumulative accrual under the Plan decreased to \$544,386 at March 31, 2001. The remaining 10 percent of the 2000 profit sharing, approximately \$232,507, will be paid out upon the completion and filing of the Company's 2000 federal tax return.

NOTE 4. CAPITAL TRANSACTIONS

In 1998, the Board of Directors voted that, effective January 1, 1998, 50 percent of all directors' fees be used to purchase Company common stock from the Company. Subsequently, the directors approved purchases of the Company's common stock in the market, rather than from the Company, effective March 1, 1999.

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. The Company purchased a total of 401,878 shares in the open market for a total of \$795,506. On July 14, 1999, the Board of Directors announced a tender 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.

On January 27, 2000, the Company placed privately, with an unaffiliated investor, for \$3 million in cash, a one-year 12 percent note with one-year warrants to purchase 25,263 shares of the Company's common stock at \$11.8750 per share. During March 2000, with part of the proceeds from the sale of SciQuest.com stock, the Company prepaid the Note. The Company incurred total interest costs of \$146,141; \$36,500 in interest paid on the note and \$109,641 on the warrants, which expired on January 26, 2001.

On October 12, 2000, the Company announced that the Board of Directors had authorized a repurchase program in the open market of up to \$2 million of the Company's stock, at the discretion of management. As of December 31, 2000, the Company had repurchased a total of 176,600 shares in the open market at approximately \$3.00 per share for a total of \$530,051. The Company did not purchase any additional shares in the first quarter of 2001.

Since 1998, Company has repurchased a total of 1,659,047 shares for a total of \$3,158,388, including commissions and expenses, at an average price of \$1.90 per share. These treasury shares were reduced by the purchases made by the Directors.

On December 14, 2000, the Company declared a deemed dividend of \$1.78 per share for a total of \$16,253,987 and in 2001 paid federal income taxes on behalf of shareholders of \$0.62 per share for a total of \$5,688,896. The Company paid the tax at the corporate rate on the distribution, and the shareholders received a tax credit equal to their proportionate share of the tax paid. The net of the total deemed dividend declared (\$16,253,987) and the taxes paid on behalf of shareholders (\$5,688,896) is

considered to be reinvested by the shareholders; therefore, during 2000 additional paid in capital increased by \$10,565,091.

NOTE 5. EMPLOYEE BENEFITS

On October 19, 1999, Charles E. Harris signed an Employment Agreement with the Company (disclosed in a Form 8-K filed on October 27, 1999) (the "Employment Agreement"), which superseded an employment agreement that was about to expire on December 31, 1999. The Employment Agreement shall terminate on December 31, 2004 ("Term") subject to either an earlier

17

termination or an extension in accordance with the terms; on January 1, 2000 and on each day thereafter, the Term extends automatically by one day unless at any time the Company or Mr. Harris, by written notice, decides not to extend the Term, in which case the Term will expire five years from the date of the written notice.

During the period of employment, Mr. Harris shall serve as the Chairman and Chief Executive Officer of the Company. He shall be responsible for the general management of the affairs of the Company and all its subsidiaries, reporting directly to the Board of Directors of the Company. He shall serve as a member of the Board for the period of which he is elected and shall from time to time be reelected. If elected, he shall serve as President of the Company and as an officer and director of any subsidiary or affiliate of the Company.

Mr. Harris is to receive compensation under his Employment Agreement in the form of base salary of \$215,508 for 2001, with automatic yearly adjustments to reflect inflation. In addition, the Board may increase such salary, and consequently decrease it, but not below the level provided for by the automatic adjustments described above. Mr. Harris is also entitled to participate in the Company's Profit-Sharing Plan as well as in all compensation or employee benefit plans or programs, and to receive all benefits, perquisites, and emoluments for which salaried employees are eligible. Under the Employment Agreement, the Company is to furnish Mr. Harris with certain perquisites which include a company car, membership in certain clubs and up to a \$5,000 annual reimbursement for personal, financial or tax advice.

The Employment Agreement provides Mr. Harris with life insurance for the benefit of his designated beneficiaries in the amount of \$2,000,000; provides reimbursement for uninsured medical expenses (not to exceed \$10,000 per annum, adjusted for inflation, over the period of the contract); disability insurance in the amount of 100 percent of his base salary; and provides Mr. Harris and his spouse with long-term care insurance. These benefits are for the term of the Employment Agreement.

The Employment Agreement provides for the Company to adopt a supplemental executive retirement plan (the "SERP") for the benefit of Mr. Harris. Under the SERP, the Company will cause an amount equal to one-twelfth of the Mr. Harris's current base salary to be credited each month (a "Monthly Credit") to a special account maintained for this purpose on the books of the Company for the benefit of Mr. Harris (the "SERP Account"). The amounts credited to the SERP Account will be deemed invested or reinvested in such mutual funds or U.S. Government securities as determined by Mr. Harris. The SERP Account will be credited and debited to reflect the deemed investment returns, losses and expenses attributed to such deemed investments and reinvestments. Mr. Harris' benefit under the SERP will equal the balance in the SERP Account and such benefit will always be 100 percent vested (i.e., not forfeitable). Mr. Harris will determine the form and timing of the distribution of the balance in the SERP Account; provided,

however, in the event of the termination, the balance in the SERP Account will be distributed to Mr. Harris or his beneficiary, as the case may be, in a lump-sum payment within 30 days of such termination. The Company established a rabbi trust for the purpose of accumulating funds to satisfy the obligations incurred by the Company under the SERP. The restricted funds for the SERP Plan total \$331,102 as of March 31, 2001. Mr. Harris' rights to benefits pursuant to this SERP will be no greater than those of a general creditor of the Company.

The Employment Agreement provides severance pay in the event of termination without cause or by constructive discharge and also provides for certain death benefits payable to the surviving spouse equal to the executive's base salary for a period of two years.

18

In addition, Mr. Harris is entitled to receive severance pay pursuant to the severance compensation agreement that he entered into with the Company, effective August 15, 1990. The severance compensation agreement provides that if, following a change in control of the Company, as defined in the agreement, such individual's employment is terminated by the Company without cause or by the executive within one year of such change in control, the individual shall be entitled to receive compensation in a lump sum payment equal to 2.99 times the individual's average annualized compensation and payment of other welfare benefits. If Mr. Harris's termination is without cause or is a constructive discharge, the amount payable under the Employment Agreement will be reduced by the amounts paid pursuant to the severance compensation agreement.

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. As of January 1, 1999, the Company adopted the Harris & Harris Pension Plan and Trust, a money purchase plan which would allow the Company to stay compliant with the 401(k) top-heavy regulations and deduction limitation regulations. Contributions to the plan are at the discretion of the Company.

On June 30, 1994, the Company adopted a plan to provide medical and health insurance for retirees, their spouses and dependents who, at the time of their retirement, have ten years of service with the Company and have attained 50 years of age or have attained 45 years of age and have 15 years of service with the Company. On February 10, 1997, the Company amended this plan to include employees who "have seven full years of service and have attained 58 years of age." The coverage is secondary to any government provided or subsequent employer provided health insurance plans. Based upon actuarial estimates, as of March 31, 2001, the Company had a reserve of \$354,840 for the plan.

NOTE 6. INCOME TAXES

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. The Company qualified as a RIC under Sub-Chapter M of the Code for the year ended December 31, 2000.

As a RIC, to the extent that the Company retains capital gains, and declares a deemed dividend of those gains to shareholders, the dividend is taxable to the shareholders as capital gains. The Company would pay tax, at the corporate rate, on the distribution, and the shareholders would receive a tax credit equal to their proportionate share of the tax paid. The Company took advantage of this rule for 2000. During the three

months ended March 31, 2000, the Company accrued a net tax provision of \$1,030,314 on the gains realized on the sale of the 43,400 shares of SciQuest.com. The Company's December 31, 2000 financial statements include a tax liability of \$5,709,884. The taxes paid by the Company as a result of its deemed dividend declaration (\$5,688,896) are reflected as a deduction to the additional paid in capital in the Company's Consolidated Statement of Assets and Liabilities rather than as an expense in the Consolidated Statement of Operations.

A corporation that qualifies and elects treatment as a RIC continues to be taxable as a C Corporation on any gains realized within 10 years of its election 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"). In 1999, the Company received a ruling from the IRS concluding that the Company can carry forward its C Corporation losses to offset any Built-In Gains resulting from sales of its C Corporation Assets. That ruling may enable the Company to retain some or all of the proceeds from such sales without disqualifying itself as a RIC or incurring corporate level income tax, depending on whether the

19

Company's sale of C Corporation Assets with Built-In Gains will generate C Corporation E&P. In general, a RIC is not permitted to have, as of the close of any RIC taxable year, E&P accumulated during any C Corporation taxable year. However, because the realization of Built-In Gains will occur while the Company is a RIC, the Company believes that, under current law and IRS pronouncements, the sale of C Corporation Assets with Built-In Gains during RIC taxable years will not generate C Corporation E&P. The Company had accumulated net ordinary and capital losses of approximately \$7.0 million (resulting in a potential tax credit of approximately \$2.5 million) during its C Corporation taxable years, of which \$0.8 million still remains available for use. The Company intends to use the remaining \$0.8 million loss carryforward (resulting in a potential tax credit of approximately \$0.3 million) to reduce its taxes that are the result of Built-In Gains.

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. There can be no assurance that the Company will qualify or will elect to qualify as a RIC for 2001 or subsequent years.

During the three months ended March 31, 2001, the Company accrued a net tax provision of \$29,634. The Company pays federal, state and local taxes on behalf of its wholly owned subsidiary, Harris & Harris Enterprises, Inc., which is taxed as a C Corporation.

For the three months ended March 31, 2001 and 2000, the Company's income tax provision was allocated as follows:

	Three Months Ended March 31, 2001	Three Months Ended March 31, 2000
Net operating income	\$ 0	\$ 0
Net realized (loss) gain on investments	29,634	1,183,618
Net decrease in unrealized appreciation on investments	0	(153,304)
Total income tax provision	<u>\$ 29,634</u>	<u>\$ 1,030,314</u>

The above tax provision consists of the following:

Current	\$	29,634	\$	1,183,618
Deferred -- Federal		0		(153,304)
		-----		-----
Total income tax provision	\$	29,634	\$	1,030,314
		=====		=====

The Company's net deferred tax liability at March 31, 2001 and December 31, 2000 consists of the following:

	March 31, 2001	December 31, 2000
Tax on unrealized appreciation on investments	\$ 1,630,506	\$ 1,630,506
Net operating loss and capital carryforward	(266,036)	(266,036)
	-----	-----
Net deferred income tax liability	\$ 1,364,470	\$ 1,364,470
	=====	=====

20

NOTE 7. COMMITMENTS AND CONTINGENCIES

During 1993, the Company signed a ten-year lease with sublet provisions for office space. In 1995, this lease was amended to include additional office space. During 1999, the Company sublet this space to an unaffiliated party. Rent expense under this lease for the three months ended March 31, 2001 and March 31, 2000, was \$42,073 and \$41,475, respectively. Future minimum lease payments in each of the following years are: 2002 -- \$178,561; 2003 -- \$101,946.

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

The Company accounts for its operations utilizing accounting principles generally accepted in the United States for investment companies. On this basis, the principal measure of its financial performance is captioned "Net increase (decrease) in net assets resulting from operations," which is the sum of three elements. The first element is "Net operating income (loss)," which is the difference between the Company's income from interest, dividends, and fees and its operating expenses. The second element is "Net realized (loss) gain on investments," which is the difference between the proceeds received from dispositions of portfolio securities and their stated cost, net of applicable income tax provisions (benefits). These two elements are combined in the Company's financial statements and reported as "Net realized (loss) income." The third element, "Net increase (decrease) in unrealized appreciation on investments," is the net change in the fair value of the Company's investment portfolio.

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

Financial Condition

The Company's total assets and net assets were, respectively, \$30,814,330 and \$28,036,135 at March 31, 2001, compared with \$43,343,423 and \$31,833,475 at December 31, 2000.

Among the significant changes in the first quarter of 2001 were: (1) the payment of \$5,709,884 in federal income taxes as a result of the Company's deemed dividend distribution; (2) declines in the values of the Company's holdings in Nanophase Technologies Corporation and Essential.com of approximately \$2,287,914 and \$2,187,413, respectively; (3) the payment of the 2000 realized gain profit sharing of \$2,092,565; (4) a decrease in the Company's profit-sharing plan accrual of approximately

\$846,290, which contributed to operating income for the quarter of \$509,877.

In accordance with recently published SEC guidelines, this quarter reflects the change in the Company's valuation policy to no longer discount publicly held securities for liquidity considerations. (See "Asset Valuation Policy Guidelines" in the "Footnote to Consolidated Schedule of Investments" contained in "Item 1. Consolidated Financial Statements.")

Net asset value per share ("NAV") was \$3.09 at March 31, 2001, versus \$3.51 at December 31, 2000.

The Company's shares outstanding remained unchanged during the three months ended March 31, 2001.

21

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 and have little or no history of operations. At March 31, 2001, \$7,402,962 or 24.0 percent of the Company's total assets consisted of investments at fair value in publicly traded securities (these investments were private equities at the time the Company made the investments), of which net unrealized appreciation was \$4,690,398; \$15,281,291 or 49.6 percent of the Company's total assets consisted of non-publicly traded securities at fair value in private businesses, of which net unrealized appreciation was \$1,175,831.

At December 31, 2000, \$10,240,018 or 23.6 percent of the Company's total assets consisted of investments at fair value in four publicly traded securities (three of which were private businesses at the time the Company made the investments), of which net unrealized appreciation was \$5,539,997; \$16,782,438 or 38.7 percent of the Company's total assets consisted of non-publicly traded securities at fair value in private businesses, of which net unrealized appreciation was \$3,406,915.

The decrease in the value of publicly traded securities from \$10,240,018 at December 31, 2000 to \$7,402,962 at March 31, 2001 is primarily owing to the sale of shares of SciQuest.com and the decrease in the value of Nanophase Technologies Corporation. The value of the Company's investments may vary significantly on a quarterly basis (see "Risk Factors").

The decrease in the value of the non-publicly traded securities from \$16,782,438 at December 31, 2000 to \$15,281,291 at March 31, 2001 resulted primarily from the decrease in the Company's valuation of its holdings in Essential.com. This decrease was partially offset by the Company's new investment in Schwoor, Inc.

The changes in the values of SciQuest.com, Nanophase Technologies and Essential.com reflect the extreme volatility of private and publicly traded, small capitalization, high technology stocks in the past 18 month period as well as the inherent risks at all times of such investments (see "Risk Factors").

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

	March 31, 2001	December 31, 2000
Investments, at cost	\$24,280,273	\$33,620,631
Unrealized appreciation	5,864,997	8,947,928
	-----	-----
Investments, at fair value	\$30,145,270	\$42,568,559
	=====	=====

The accumulated unrealized appreciation on investments net of deferred taxes is \$4,234,491 at March 31, 2001, versus \$7,317,422 at December 31, 2000.

Following an initial investment in a private company, the Company may make additional investments in such investee in order to: (1) increase its ownership percentage; (2) exercise warrants, options or convertible securities that were acquired in the original or subsequent financing; (3) preserve the Company's proportionate ownership in a subsequent financing; or (4) attempt to preserve or enhance the value of the Company's investment. There can be no assurance that the Company will make follow-on investments or have sufficient funds to make additional investments. The Company has the discretion to make follow-on investments as it determines, subject to the availability of capital resources. The failure to make such follow-on investments may, in certain circumstances, jeopardize the continued viability of the investee company and the Company's initial investment or may result in a missed opportunity for the

22

Company to increase its participation in a successful operation. Even if the Company has sufficient capital to make a desired follow-on investment, it may elect not to make a follow-on investment either because it does not want to increase its concentration of risk, because it prefers other opportunities, or because it is inhibited by compliance with BDC or RIC requirements, even though the follow-on investment opportunity appears attractive.

The following table is a summary of the cash investments made by the Company in its private placement portfolio during the three months ended March 31, 2001:

New Investments:	Amount
Schwoo, Inc.	\$750,000

Total	\$750,000
	=====

Results of Operations

Investment Income and Expenses:

The Company realized a net operating income of \$509,877 and \$1,095,073 for the three months ended March 31, 2001 and March 31, 2000, respectively. The Company's net operating income in the three months ended March 31, 2001 and March 31, 2000 reflected decreases in the employee profit-sharing accrual that resulted in credits to expenses of \$846,290 and \$1,651,336, respectively. When unrealized appreciation as of a certain date subsequently decreases the profit-sharing accrual will be decreased accordingly, resulting in a credit to expenses.

The Company's principal objective is to achieve capital appreciation. Therefore, a significant portion of the investment portfolio is structured to maximize the potential for capital appreciation and provides little or no current yield in the form of dividends or interest. The Company does earn interest income from fixed-income securities, including U.S. Government and Agency Obligations. The amount of interest income earned varies with 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 \$152,530 and \$83,954 for the three months ended March 31, 2001 and March 31, 2000, respectively. The increase of \$68,576 or 81.7 percent is the result of an increase in the balance of the Company's fixed income portfolio during the three months ended March 31, 2001 versus the three months ended March 31, 2000.

The Company had interest income from affiliated companies of \$9,617 and \$21,682 for the three months ended March 31, 2001 and March 31, 2000, respectively. The decrease of \$12,065 is owing to the decrease in the outstanding loans to investee companies since the first quarter of 2000. The amount of outstanding loans to investee companies varies.

The Company had other income of \$29,812 and \$15,812 for the three months ended March 31, 2001 and March 31, 2000, respectively. Other income represents rental income from subletting office space to an unaffiliated party and, in 2001 a gain on the sale of Company property.

Operating expenses were (\$317,918) and (\$973,625) for the three months ended March 31, 2001 and March 31, 2000, respectively. The operating expenses of the first quarter of 2001 and 2000 reflect decreases in the employee profit-sharing accrual of \$846,290 and \$1,651,336, respectively, owing to decreases in the unrealized appreciation for the respective three

23

month periods. Salaries and benefits increased \$22,158 or 8.0 percent primarily as the result of interquarter variances. Professional fees decreased \$26,104 or 30.6 percent. The remaining expenses are related to office and rent expenses and director compensation.

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, the Company attempts to maintain adequate working capital to provide for fiscal periods when there are no such sales.

Realized Gains and Losses on Sales of Portfolio Securities:

During the three months ended March 31, 2001 and 2000, the Company realized (losses) gains of (\$1,194,652) and \$3,763,272, respectively. During the three months ended March 31, 2001, the Company realized losses of \$1,194,652 consisting primarily on the sale of 350,000 shares of SciQuest.com stock.

During the three months ended March 31, 2000, the Company realized a total gain of \$3,763,272, consisting primarily of \$3,264,989 on the sale of SciQuest.com shares, \$241,025 on the sale of Nanophase Technologies Corporation shares and \$147,528 on the realization of the reserve on the NBX/3Com escrow (the Company received the full escrowed funds in March 2000).

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 decreased by \$3,082,931 or 34.4 percent during the three months ended March 31, 2001, from \$8,947,928 to \$5,864,997, primarily as a result of the decline in the value of the Company's holdings of Nanophase Technologies Corporation and Essential.com, Inc. of \$2,287,914 and \$2,187,413, respectively.

Net unrealized appreciation on investments decreased by \$10,600,256 or 22.6 percent during the three months ended March 31, 2000, from \$46,882,521 to \$36,282,265, primarily as a result of declines in the value of the Company's holdings of SciQuest.com and Silknet Software of \$19,723,854 and \$1,861,499, respectively, offset by increases in the value of the Company's holdings of Nanophase Technologies Corporation, Alliance

Pharmaceutical Corp. and Genomica Corporation of \$7,191,790, \$5,813,900 and \$1,330,520, respectively.

The changes in the values of SciQuest.com, Silknet Software, Nanophase Technologies, Essential.com and Alliance Pharmaceutical reflect the extreme volatility of private and publicly traded, small capitalization, high technology stocks in the past 18 month period, as well as the inherent risks at all times of such investments (see "Risk Factors").

Liquidity and Capital Resources

The Company's primary sources of liquidity are cash, receivables and freely tradable marketable securities. The Company's secondary sources of liquidity are restricted securities of companies that are publicly traded. At March 31, 2001 and December 31, 2000, respectively, the Company's total primary liquidity was \$14,993,393 and \$23,039,736. On the

24

corresponding dates, the Company's total secondary liquidity was \$0 and \$3,040,679, respectively. The Company's tertiary source of liquidity is its holding of PHZ Capital Partners, L.P., from which the Company received net after-tax distributions in the first quarter of 2001 of \$62,861.

The decrease in the Company's primary source of liquidity from December 31, 2000 to March 31, 2001 is primarily owing to the (1) payment of federal income taxes of \$5,709,884; (2) payment of the 2000 employee profit sharing of approximately \$2,092,565; (3) decrease in the value of the Company's holdings in Nanophase Technologies Corporation of \$2,287,914; (4) investment of \$750,000 in Schwoo, Inc.; and (5) the use of funds for operating expenses.

The decrease in the Company's secondary source of liquidity from December 31, 2000 to March 31, 2001 is owing to the expiration of the lock-up period on Genomica Corporation; which increased the Company's primary source of liquidity.

From December 31, 2000 to March 31, 2001, the Company's liabilities for accrued employee profit sharing and deferred income tax liability decreased significantly. Accrued profit sharing decreased by \$2,938,855 or 84.4 percent to \$544,386 as a result of payment of \$2,092,565 of the 2000 profit sharing and the reversal of a prior expense accrual of \$846,290 owing to the decrease in the unrealized appreciation and the realized losses for the three months ended March 31, 2001. The remaining 2000 profit sharing accrual, approximately \$232,507, will be paid upon the completion and filing of the Company's 2000 federal tax return.

The Company's total income tax liability decreased by \$5,682,250 or 79.8 percent to \$1,433,786 primarily as a result of the payment of taxes in connection with the deemed dividend distribution.

Sub-Chapter M Status -- Recent Developments

On March 8, 2001, the Company received SEC certification and qualified for RIC treatment for 2000 (as it had for 1999). Although the SEC certification for 2000 was issued, there can be no assurance that the Company will receive such certification for subsequent years (to the extent it needs additional certification as a result of changes in its portfolio) or that it will actually qualify as a RIC for subsequent years. In addition, under certain circumstances, even if the Company qualified for Sub-Chapter M treatment in a given 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.

On December 14, 2000, the Company announced that its Board

of Directors, in accordance with rules governing a RIC under Sub-Chapter M of the Code, declared a designated undistributed capital gain dividend (also known as a deemed dividend) of \$1.78 per share, for a total of \$16,253,987 and paid corporate taxes on behalf of shareholders of \$0.62 per share, for a total of \$5,688,896.

Risk Factors

Investing in the Company's Stock is Highly Speculative and the Investor Could Lose Some or All of the Amount Invested

The value of the Company's common stock may decline and may be affected by numerous market conditions, which could result in the loss of some or all of the amount invested in the Company's shares. The securities markets frequently experience extreme price and volume fluctuations which affect market prices for securities of companies generally, and technology and very small capitalization companies in particular. Because of the Company's focus on the technology and very small capitalization sectors,

25

its stock price is likely to be impacted by these market conditions. General economic conditions, and general conditions in the Internet and information technology, life sciences, material sciences and other high technology industries, will also affect the Company's stock price.

Investing in the Company's Shares May be Inappropriate for the Investor's Risk Tolerance

The Company's investments, in accordance with its investment objective and principal strategies, result in a far above average amount of risk and volatility and may well result in loss of principal. The Company's investments in portfolio companies are highly speculative and aggressive and, therefore, an investment in its shares may not be suitable for all investors.

The Market for Venture Capital Investments is Highly Competitive. In Some Cases, the Company's Status as a Regulated Business Development Company May Hinder its Ability to Participate in Investment Opportunities.

The Company faces substantial competition in its investing activities from private venture capital funds, investment affiliates of large industrial, technology, service and financial companies, small business investment companies, wealthy individuals and foreign investors. As a regulated business development company, the Company is required to disclose quarterly the name and business description of portfolio companies and value of any portfolio securities. Most of the Company's competitors are not subject to this disclosure requirement. The Company's obligation to disclose this information could hinder its ability to invest in certain portfolio companies. Additionally, other regulations, current and future, may make the Company less attractive as a potential investor to a given portfolio company than a private venture capital fund not subject to the same regulations.

The Company Operates in a Regulated Environment

The Company is subject to substantive SEC regulations as a BDC. Securities and tax laws and regulations governing the Company's activities may change in ways adverse to the Company's and its shareholders' interests and interpretations of such laws and regulations may change with unpredictable consequences. Any change in the law or regulations that govern the Company's business could have an adverse impact on the Company or its operations.

The Company is Dependent Upon Key Management Personnel for Future Success

The Company is dependent for the selection, structuring, closing and monitoring of its investments on the diligence and skill of its senior management and other management members. The future success of the Company depends to a significant extent on the continued service and coordination of its senior management team, and particularly on the Chairman and Chief Executive Officer. The departure of any of the executive officers or key employees could materially adversely affect the Company's ability to implement its business strategy. The Company does not maintain key man life insurance on any of its officers or employees.

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 with risky technologies 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

26

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.

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.

Volatility and Illiquidity of Publicly Traded Holdings

When companies in which the Company has invested as private entities complete initial public offerings, they are by definition unseasoned issues. Typically, they have relatively small capitalizations. Thus, they can be expected to be highly volatile and of uncertain liquidity. If they are perceived as suffering from adverse news or developments and/or the capital markets are in a negative phase, not only their market prices, but also their liquidity can be expected to be impacted negatively. Historically, the Company has also invested in unseasoned publicly traded companies with similar characteristics and thus with similar exposure to potential negative volatility and illiquidity.

The Inability of the Company's Portfolio Companies to Successfully Market Their Products Would Have a Negative Impact on its Investment Returns

Even if the Company's portfolio companies are able to develop commercially viable products, the market for new products and services is highly competitive and rapidly changing. Commercial success is difficult to predict and the marketing

efforts of the Company's portfolio companies may not be successful.

Valuation of Portfolio Investments

There is typically no public market of equity securities of the small privately held companies in which the Company invests.

As a result, the valuation of the equity securities in the Company's portfolio is subject to the good faith estimate of the Company's Board of Directors. (See "Asset Valuation Policy Guidelines" in "Footnote to Consolidated Schedule of Investments.") In the absence of a readily ascertainable market value, the estimated value of the Company's portfolio of equity securities may differ significantly from the values that would be placed on the portfolio if a ready market for the equity securities existed. Any changes in estimated net asset value are recorded in the Company's statement of operations as "Change in unrealized appreciation on investments." (See "Management's Discussion and Analysis of Financial Condition and Results of Operations.")

27

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. 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 tax would result in a corresponding reduction in the Company's net assets and the amount of income available for distribution to the Company's stockholders.

Because the Company Must Distribute Income, the Company Will Continue to Need Additional Capital

The Company will continue to need capital to fund investments and to pay for operating expenses. The Company must distribute at least 90 percent of its net operating income other than net realized long-term capital gains to its stockholders to maintain its RIC status. As a result such earnings will not be available to fund investments. If the Company fails to generate net realized long-term capital gains or to obtain funds from outside sources, it could have a material adverse effect on the Company's financial condition and results. The Company does not normally establish reserves for taxes on unrealized capital gains. To the extent that the Company retains capital gains, either as a C corporation or as a Sub-Chapter M corporation, it will have to make provisions for federal taxes and possibly state and local taxes. In addition, as a BDC, the Company is generally required to maintain a ratio of at least 200 percent of total assets to total borrowings, which may restrict its ability to

borrow in certain circumstances.

Reserves for Taxes

As a Sub-Chapter M corporation, the Company does not have to pay federal income taxes on realized capital gains to the extent that such gains are distributed to shareholders. Accordingly, it does not establish reserves for taxes on its unrealized capital gains. If the Company were not to qualify for Sub-Chapter M tax status, it would have to establish such reserves for taxes, which would reduce its net asset value, net of a reduction in the reserve for employee profit sharing, accordingly. To the extent that the Company as a Sub-Chapter M corporation were to decide to make a deemed distribution of net realized capital gains and were to retain such net realized capital gains, it would have to establish appropriate reserves for taxes upon making such a decision.

28

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 a 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 Policy Guidelines" in the "Footnote to Consolidated Schedule of Investments contained in "Item 1. Consolidated Financial Statements.")

Neither the Company's investments nor an investment in the Company is intended to constitute a balanced investment program. The Company has exposure to public-market price fluctuations to the extent of its publicly traded portfolio, which portfolio may be composed primarily or entirely of highly risky, volatile securities.

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.

Because there is typically no public market for the equity interests of the small privately held 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."

29

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

On Tuesday, April 24th, 2001, the Company held its Annual Meeting of Shareholders for the following purposes: (1) to elect directors of the Company; and (2) to ratify, confirm and approve the Board of Directors' selection of Arthur Andersen LLP as the Company's independent public accountant for its fiscal year ending December 31, 2001. At the close of business on the record date (March 15, 2001), an aggregate of 9,064,231 shares of common stock were issued and outstanding.

All of the nominees at the April 24, 2001 Annual Meeting were elected directors:

Nominees	For	Withheld
Dr. C. Wayne Bardin	8,280,535	62,627
Dr. Phillip A. Bauman	8,280,130	63,032
G. Morgan Browne	8,291,630	51,532
Harry E. Ekblom	8,264,165	78,997
Dugald A. Fletcher	8,253,035	90,127
Charles E. Harris	8,290,915	52,247
Glenn E. Mayer	8,287,370	55,792
James E. Roberts	8,268,755	74,407

With respect to proposal number two, described as a proposal "to ratify, confirm and approve the Board of Directors' selection of Arthur Andersen LLP" as the Company's independent public accountant for its fiscal year ending December 31, 2001, the affirmative votes cast were 8,317,222, the negative votes cast were 19,929 and those abstaining were 8,011.

Item 5. Other Information
Recent Sales of Unregistered Securities
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.

30

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.

10.22 Harris & Harris Group, Inc. Employee Profit-Sharing Plan, incorporated by reference as Exhibit 10.22 to the Company's Form 10K for the year ended December 31, 1999.

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

(b) The Company did not file any reports on Form 8-K during the first quarter of 2001.

31

EXHIBIT INDEX

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

SIGNATURE

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

Harris & Harris Group, Inc.

By: /s/ Rachel M. Pernia

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

Date: May 14, 2001

32