

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 June 30, 2003

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)

111 West 57th Street, New York, New York 10019
(Address of Principal Executive Offices) (Zip Code)

(212) 582-0900
(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 by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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

<u>Class</u>	<u>Outstanding at August 6, 2003</u>
Common Stock, \$0.01 par value per share	11,498,845 shares

Harris & Harris Group, Inc.
Form 10-Q, June 30, 2003

	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	13
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	22
Background and Overview	22
Results of Operations	24
Financial Condition	27
Cash Flow	30
Liquidity and Capital Resources	31
Risk Factors	33
Item 3. Quantitative and Qualitative Disclosures About Market Risk	40
Item 4. Controls and Procedures	41
PART II OTHER INFORMATION	
Item 1. Legal Proceedings	42
Item 2. Changes in Securities and Use of Proceeds	42
Item 3. Defaults Upon Senior Securities	42
Item 4. Submission of Matters to a Vote of Security Holders	42
Item 5. Other Information	42
Item 6. Exhibits and Reports on Form 8-K	43
Signature	44

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

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

Harris & Harris Group, Inc. (the "Company") is an internally managed, closed-end investment company that has elected to be treated as a business development company under the Investment Company Act of 1940. 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, 2002, contained in the Company's 2002 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, gains from the sale of securities and similar sources; (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 to the extent it fails to distribute at least 98 percent of its annual taxable income and would be subject to income tax to the extent it fails to distribute 100 percent of its investment company 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 Securities and Exchange Commission ("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 2, 2003, the Company received SEC certification for 2002, permitting it to qualify for RIC treatment for 2002 (as it had for 1999-2001). Although the SEC certification for 2002 was issued, there can be no assurance that the Company will qualify for or 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.

CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES

	<u>ASSETS</u>	
	June 30, 2003 (Unaudited)	December 31, 2002 (Audited)
Investments, at value (Cost: \$37,534,201 at 6/30/03, \$30,206,935 at 12/31/02).....	\$ 34,354,451	\$ 27,486,822
Cash and cash equivalents.....	192,977	5,967,356
Restricted funds (Note 5).....	1,002,303	756,944
Funds in escrow.....	0	750,000
Receivable from portfolio company.....	0	786,492
Interest receivable.....	18	189
Income tax receivable.....	78,289	0
Prepaid expenses.....	61,876	96,631
Other assets.....	213,298	107,535
Total assets	<u>\$ 35,903,212</u>	<u>\$ 35,951,969</u>
 <u>LIABILITIES & NET ASSETS</u>		
Accounts payable and accrued liabilities.....	\$ 1,725,095	\$ 1,451,568
Payable to broker for unsettled trade.....	0	5,696,725
Bank loan payable (Note 8).....	7,983,520	0
Accrued profit sharing (Note 3).....	1,523	15,233
Deferred rent.....	27,520	5,397
Current income tax liability.....	0	857,656
Deferred income tax liability (Note 6).....	669,344	669,344
Total liabilities	<u>10,407,002</u>	<u>8,695,923</u>
Commitments and contingencies (Note 7)		
Net assets	<u>\$ 25,496,210</u>	<u>\$27,256,046</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; 13,327,585 issued at 6/30/03 and 12/31/02.....	133,276	133,276
Additional paid in capital (Note 4).....	32,845,872	32,845,872
Additional paid in capital - common stock warrants.....	109,641	109,641
Accumulated net realized gain.....	(162,379)	1,137,820
Accumulated unrealized appreciation of investments, net of deferred tax liability of \$844,918 at 6/30/03 and 12/31/02 ...	(4,024,669)	(3,565,032)
Treasury stock, at cost (1,828,740 shares at 6/30/03 and 12/31/02).....	<u>(3,405,531)</u>	<u>(3,405,531)</u>
Net assets	<u>\$ 25,496,210</u>	<u>\$27,256,046</u>
Shares outstanding.....	<u>11,498,845</u>	<u>11,498,845</u>
Net asset value per outstanding share	<u>\$ 2.22</u>	<u>\$ 2.37</u>

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

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
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	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Investment income:				
Interest from:				
Fixed-income securities	\$ 32,009	\$ 40,135	\$ 78,255	\$ 94,271
Other income	<u>18,555</u>	<u>20,233</u>	<u>36,985</u>	<u>25,559</u>
Total investment income	50,564	60,368	115,240	119,830
Expenses:				
Profit-sharing accrual (Note 3)	0	121,326	0	249,285
Salaries and benefits	361,703	264,589	723,899	519,965
Administration and operations	143,590	137,166	238,702	225,068
Professional fees	150,136	100,566	217,294	143,661
Rent	71,441	43,856	119,318	86,580
Directors' fees and expenses	33,680	36,102	90,045	77,178
Depreciation	10,150	6,737	20,130	12,685
Bank custody fees	2,222	1,744	4,409	5,583
Interest expense	<u>4,631</u>	<u>3,000</u>	<u>12,892</u>	<u>10,776</u>
Total expenses	<u>777,553</u>	<u>715,086</u>	<u>1,426,689</u>	<u>1,330,781</u>
Operating loss before income taxes	(726,989)	(654,718)	(1,311,449)	(1,210,951)
Income tax provision (Note 6)	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Net operating loss	(726,989)	(654,718)	(1,311,449)	(1,210,951)
Net realized gain on investments:				
Realized gain on investments	<u>28,140</u>	<u>688,681</u>	<u>28,572</u>	<u>799,360</u>
Total realized gain	28,140	688,681	28,572	799,360
Income tax (provision) benefit (Note 6)	<u>(14,349)</u>	<u>47,087</u>	<u>(17,322)</u>	<u>12,864</u>
Net realized gain (loss) on investments	<u>13,791</u>	<u>735,768</u>	<u>11,250</u>	<u>812,224</u>
Net realized (loss) income	(713,198)	81,050	(1,300,199)	(398,727)
Net increase (decrease) in unrealized appreciation on investments:				
Increase as a result of investment gain	0	353,221	0	353,221
Decrease as a result of investment gain	(18,031)	0	(18,031)	0
Increase on investments held	462,021	71	689,859	45,077
Decrease on investments held	<u>(275,501)</u>	<u>(53)</u>	<u>(1,131,465)</u>	<u>(602,216)</u>
Net change in unrealized appreciation on investments	168,489	353,239	(459,637)	(203,918)
Income tax benefit (Note 6)	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Net increase (decrease) in unrealized appreciation on investments	<u>168,489</u>	<u>353,239</u>	<u>(459,637)</u>	<u>(203,918)</u>
Net (decrease) increase in net assets resulting from operations:				
Total	<u>\$ (544,709)</u>	<u>\$ 434,289</u>	<u>\$ (1,759,836)</u>	<u>\$ (602,645)</u>
Per outstanding share	<u>\$ (0.05)</u>	<u>\$ 0.05</u>	<u>\$ (0.15)</u>	<u>\$ (0.07)</u>

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

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
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	Six Months Ended June 30, 2003	Six Months Ended June 30, 2002
Cash flows from operating activities:		
Net decrease in net assets resulting from operations	\$ (1,759,836)	\$ (602,645)
Adjustments to reconcile net decrease in net assets resulting from operations to net cash used in operating activities:		
Realized and unrealized gain (loss) on investments	431,065	(595,442)
Depreciation	20,130	12,685
Changes in assets and liabilities:		
Restricted funds.....	(245,359)	(172,819)
Receivable from investment company.....	786,492	0
Funds in escrow	750,000	0
Interest receivable	171	82
Income tax receivable.....	(78,289)	0
Note receivable.....	0	10,487
Prepaid expenses	34,755	(36,436)
Other assets	(105,763)	(173,770)
Accounts payable and accrued liabilities.....	273,527	293,465
Payable to broker for unsettled trade	(5,696,725)	0
Accrued profit sharing.....	(13,710)	249,285
Current income tax liability	(857,656)	(290,796)
Deferred income tax liability	0	(12,864)
Deferred rent	<u>22,123</u>	<u>(4,627)</u>
Net cash used in operating activities	(6,439,075)	(1,323,395)
Cash flows from investing activities:		
Net (purchase) sale of short-term investments and marketable securities	(4,385,459)	18,472,315
Proceeds from investments	15,709	780,605
Investment in private placements and loans	(2,945,618)	(4,675,000)
Purchase of fixed assets	<u>(3,456)</u>	<u>(22,602)</u>
Net cash (used in) provided by investing activities.....	(7,318,824)	14,555,318
Cash flows from financing activities:		
Proceeds from note payable.....	7,983,520	0
Payment of bank loan payable	0	(12,495,777)
Collection on notes receivable	<u>0</u>	<u>3,500</u>
Net cash provided by (used in) financing activities	<u>7,983,510</u>	<u>(12,492,277)</u>
Net increase (decrease) in cash and cash equivalents:		
Cash and cash equivalents at beginning of the period.....	5,967,356	135,135
Cash and cash equivalents at end of the period.	<u>192,977</u>	<u>874,781</u>
Net increase (decrease) in cash and cash equivalents	<u>\$ (5,774,379)</u>	<u>\$ 739,646</u>
Supplemental disclosures of cash flow information:		
Income taxes paid	\$ 575,100	\$ 290,748
Interest paid.....	\$ 10,784	\$ 19,106

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

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS (Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Changes in net assets from operations:				
Net operating loss.....	\$ (726,989)	\$ (654,718)	\$(1,311,449)	\$(1,210,951)
Net realized gain on investments	13,791	735,768	11,250	812,224
Net (decrease) increase in unrealized appreciation on investments as a result of gain	(18,031)	353,221	(18,031)	353,221
Net increase (decrease) in unrealized appreciation on investments held.....	<u>186,520</u>	<u>18</u>	<u>(441,606)</u>	<u>(557,139)</u>
Net (decrease) increase in net assets resulting from operations.....	(544,709)	434,289	(1,759,836)	(602,645)
Net (decrease) increase in net assets	(544,709)	434,289	(1,759,836)	(602,645)
Net assets:				
Beginning of the period.....	<u>26,040,919</u>	<u>23,297,836</u>	<u>27,256,046</u>	<u>24,334,770</u>
End of the period	<u>\$25,496,210</u>	<u>\$23,732,125</u>	<u>\$25,496,210</u>	<u>\$23,732,125</u>

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

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF JUNE 30, 2003 (Unaudited)

	<u>Method of Valuation (3)</u>	<u>Shares/ Principal</u>	<u>Value</u>
Investments in Unaffiliated Companies (8)(9)(10) -- 10.8% of total investments			
Private Placement Portfolio (Illiquid) -- 10.8% of total investments			
AlphaSimplex Group, LLC (2)(12) -- Investment advisory firm headed by Dr. Andrew W. Lo, holder of the Harris & Harris Group Chair at MIT Limited Liability Company interest	(B)	--	\$ 106,250
Continuum Photonics, Inc. (1)(2)(6) -- Develops optical networking components by merging cutting-edge materials, MEMS and electronics technologies -- 3.73% of fully diluted equity Series B Convertible Preferred Stock	(D)	2,000,000	86,380
Exponential Business Development Company (1)(2)(5)(12) -- Venture capital partnership focused on early stage companies Limited Partnership interest	(A)	--	25,000
Kriton Medical, Inc. (1)(2)(5)(6) -- Develops ventricular assist devices -- 1.73% of fully diluted equity Series B Convertible Preferred Stock	(D)	476,191	0
NanoGram Corporation (1)(2)(4)(6)(13) -- Develops a broad suite of intellectual property utilizing nanotechnology -- 1.81% of fully diluted equity Series 1 Preferred Stock	(A)	63,210	21,672
NanoOpto Corporation (1)(2)(6) -- Develops high performance, integrated optical communications sub-components on a chip by utilizing patented nano-manufacturing technology -- 1.45% of fully diluted equity Series A-1 Convertible Preferred Stock	(D)	267,857	128,292
Nanosys, Inc. (1)(2)(4)(5)(6) -- Develops nanotechnology-enabled systems incorporating novel and patent-protected zero and one-dimensional nanometer-scale materials -- 1.72% of fully diluted equity Series C Convertible Preferred Stock	(A)	803,428	1,500,000
Nantero, Inc. (1)(2)(5)(6) -- Develops a high density nonvolatile random access memory chip using nanotechnology -- 4.15% of fully diluted equity Series A Convertible Preferred Stock	(A)	345,070	489,999
NeoPhotonics Corporation (1)(2)(6)(13)(14) -- Develops and manufactures planar optical devices and components using nanomaterials deposition technology -- 1.54% of fully diluted equity Series D Convertible Preferred Stock	(D)	1,498,802	106,276
Optiva, Inc. (1)(2)(5)(6) -- Develops and commercializes nanomaterials for advanced applications -- 1.98% of fully diluted equity Series C Convertible Preferred Stock	(B)	1,249,999	<u>1,250,000</u>
Total Private Placement Portfolio (cost: \$6,829,869)			<u>\$3,713,869</u>
Total Investments in Unaffiliated Companies (cost: \$6,829,869)			<u>\$3,713,869</u>

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

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF JUNE 30, 2003 (Unaudited)

	<u>Method of Valuation (3)</u>	<u>Shares/ Principal</u>	<u>Value</u>
Investments in Non-Controlled Affiliated Companies (8)(9)(11) -- 31.5% of total investments			
Private Placement Portfolio (Illiquid) -- 31.5% of total investments			
Agile Materials & Technologies, Inc. (1)(2)(5)(6) -- Develops and sells variable integrated passive electronic equipment components -- 8.15% of fully diluted equity			
Series A Convertible Preferred Stock	(A)	3,732,736	\$1,000,000
Chlorogen, Inc. (1)(2)(4)(6) -- Develops patented chloroplast technology to produce plant-made proteins -- 6.76% of fully diluted equity			
Series A Convertible Preferred Stock	(A)	3,000,000	525,900
Experion Systems, Inc. (1)(2)(5)(7) -- Develops and sells software to credit unions -- 12.44% of fully diluted equity			
Series A Convertible Preferred Stock	(B)	294,118	
Series B Convertible Preferred Stock	(B)	35,294	
Series C Convertible Preferred Stock	(B)	222,184	1,037,000
NanoGram Devices Corporation (1)(2)(4)(6)(14) -- Develops power components for biomedical applications by utilizing a patented nanomaterial synthesis process -- 5.02% of fully diluted equity			
Series A-1 Convertible Preferred Stock	(A)	63,210	
Series A-2 Convertible Preferred Stock	(A)	750,000	813,210
Nanopharma Corp. (1)(2)(5)(6) -- Develops advanced nanoscopic drug delivery vehicles and systems -- 14.69% of fully diluted equity			
Series A Convertible Preferred Stock	(D)	684,516	350,000
Nanotechnologies, Inc. (1)(2)(6) -- Develops high-performance nanoscale materials for industry -- 6.48% of fully diluted equity			
Series B Convertible Preferred Stock	(B)	1,538,837	
Series C Convertible Preferred Stock	(B)	235,720	1,277,681
NeuroMetrix, Inc. (1)(2)(5) -- Develops and sells medical devices for monitoring neuromuscular disorders -- 12.10% of fully diluted equity			
Series A Convertible Preferred Stock	(B)	875,000	
Series B Convertible Preferred Stock	(B)	625,000	
Series C-2 Convertible Preferred Stock	(B)	1,148,100	
Series E Convertible Preferred Stock	(B)	499,996	
Series E-1 Convertible Preferred Stock	(B)	235,521	5,075,426
Questech Corporation (1)(2)(5) -- Manufactures and markets proprietary metal decorative tiles -- 6.68% of fully diluted equity			
Common Stock	(B)	646,954	
Warrants at \$5.00 expiring 11/15/04	(B)	1,966	
Warrants at \$1.50 expiring 11/16/05	(B)	1,250	
Warrants at \$1.50 expiring 12/14/06	(B)	8,500	
Warrants at \$1.50 expiring 11/21/07	(B)	3,750	<u>724,588</u>
Total Private Placement Portfolio (cost: \$10,868,128)			<u>\$10,803,805</u>
Total Investments in Non-Controlled Affiliated Companies (cost: \$10,868,128)			<u>\$10,803,805</u>

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

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF JUNE 30, 2003 (Unaudited)

	<u>Method of Valuation (3)</u>	<u>Shares/ Principal</u>	<u>Value</u>
U.S. Government and Agency Obligations – 57.7% of total investments			
U.S. Treasury Bills -- due date 07/10/03	(J)	\$3,223,000	\$3,222,323
U.S. Treasury Bills -- due date 07/17/03	(J)	2,000,000	1,999,260
U.S. Treasury Bills -- due date 08/14/03	(J)	3,040,000	3,036,990
U.S. Treasury Bills -- due date 08/21/03	(J)	2,000,000	1,997,660
U.S. Treasury Bills -- due date 09/18/03	(J)	1,600,000	1,596,944
U.S. Treasury Bills -- due date 09/25/05	(J)	8,000,000	<u>7,983,600</u>
Total Investments in U.S. Government (cost: \$19,836,204)			<u>\$19,836,777</u>
Total Investments -- 100% (cost: \$37,534,201)			<u>\$34,354,451</u>

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

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF JUNE 30, 2003 (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 Asset Valuation Policy Guidelines.
- (4) Initial investment was made during 2003.
- (5) No changes in valuation occurred in these investments during the three months ended June 30, 2003.
- (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) Previously named MyPersonalAdvocate.com, Inc.
- (8) Investments in unaffiliated companies consist of investments in which the Company owns less than five percent of the portfolio 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 portfolio company. Investments in controlled affiliated companies consist of investments in which the Company owns more than 25 percent of the portfolio company.
- (9) The percentage ownership of each portfolio company disclosed in the Consolidated Schedule of Investments expresses the potential equity interest in each such portfolio company. The calculated percentage represents the amount of the issuer's equity securities the Company owns or can acquire as a percentage of the issuer's total outstanding equity securities plus equity securities reserved for issued and outstanding warrants, convertible securities and all authorized stock options, both granted and ungranted.
- (10) The aggregate cost for federal income tax purposes of investments in unaffiliated companies is \$6,829,869. The gross unrealized appreciation based on the tax cost for these securities is \$103,171. The gross unrealized depreciation based on the tax cost for these securities is \$3,219,171.
- (11) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated companies is \$10,868,128. The gross unrealized appreciation based on the tax cost for these securities is \$2,772,007. The gross unrealized depreciation based on the tax cost for these securities is \$2,836,330.
- (12) Non-registered investment company.
- (13) On April 30, 2003, NeoPhotonics Corporation distributed its shares in NanoGram Corporation to shareholders of record on November 14, 2002. The Company received 63,210 shares of Series 1 Preferred Stock.
- (14) On April 30, 2003, NeoPhotonics Corporation distributed its shares in NanoGram Devices Corporation to shareholders of record on November 14, 2002. The Company received 63,210 shares of Series A-1 Convertible Preferred Stock.

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

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 Valuation Committee (formerly named the "Investment and Valuation Committee"), comprised of at least three or more independent 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.

The values assigned to these investments are based on available information and do not necessarily represent amounts that might ultimately be realized, as such amounts depend on future circumstances and cannot reasonably be determined until the individual investments are actually liquidated.

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 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 company's securities held by the Company. The Company discounts market value for securities that are subject to significant legal and contractual restrictions. 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 Valuation Committee members, based on the data available to them. The resulting valuation, although stated as a precise number, is necessarily within a range of values that vary depending upon the significance attributed to the various factors being considered. Some of the factors considered may include the financial condition and operating results of the company, the long-term potential of the business of the company, the values of similar securities issued by companies in similar businesses, the proportion of the company's securities owned by the Company and the nature of any rights to require the company to register restricted securities under applicable securities laws.

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

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

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

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

G. Analytical Method: The analytical method is used to value an investment after analysis of the best available outside information where the factual information available to the Company dictates that an investment should no longer be valued under either the cost or private market method. This valuation method is inherently imprecise and ultimately the result of reconciling the judgments of the Company's 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.

I. Fixed-Income 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:

Independent pricing services that provide quotations based primarily on quotations from dealers and brokers, market transactions, and other sources.

Fair value as determined in good faith by the Valuation Committee.

SHORT-TERM FIXED-INCOME INVESTMENTS

J. Short-Term Fixed-Income Investments are valued at market value at the time of valuation. Short-term debt with remaining maturity of 90 days or less is valued at amortized cost.

ALL OTHER INVESTMENTS

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

The reported values of securities for which market quotations are not readily available and for other assets reflect the 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. 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.

<p style="text-align: center;">NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)</p>

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 owned, until December 31, 2002, 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 Harris & Harris Group, Inc. (sole limited partner).

The Company filed for the 1999 tax year to elect treatment as a Regulated Investment Company ("RIC") under Sub-Chapter M of the Internal Revenue Code of 1986 (the "Code") and qualified for the same treatment for 2000-2002. There can be no assurance that the Company will qualify as a RIC for 2003 and subsequent years 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 as a RIC. As a RIC, the Company must, among other factors, distribute at least 90 percent of its investment company taxable income and may either distribute or retain its realized net 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.

Portfolio Investment Valuations. Investments are stated at "value" as defined in the 1940 Act and in the applicable regulations of the Securities and Exchange Commission. Value, as defined in Section 2(a)(41) of the 1940 Act, is (i) the market price for those securities for which a market quotation is readily available and (ii) for all other assets is as determined in good faith by, or under the direction of, the Board of Directors. (See "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 specific identification 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 relates to the Company's unrealized appreciation on investments.

The June 30, 2003 consolidated financial statements include a provision 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 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.")

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 June 30, 2003, and December 31, 2002, and the reported amounts of revenues and expenses for the three months ended June 30, 2003, and June 30, 2002. The most significant estimates relate to the fair valuations of investments for the three months ended June 30, 2003, and June 30, 2002. Actual results could differ from these estimates.

NOTE 3. EMPLOYEE PROFIT SHARING PLAN

As of January 1, 2000, the Company implemented the Harris & Harris Group, Inc. Employee Profit-Sharing Plan (the "Plan") that provides for profit sharing by its officers and employees equal to 20 percent of the net realized income of the Company as reflected on the consolidated statements 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 carry-overs 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 Compensation Committee (the "Committee") 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.

As of January 1, 2003, the Company implemented the Amended and Restated Harris & Harris Group, Inc. Employee Profit-Sharing Plan (the "2002 Plan"). The shareholders of the Company approved the performance goals under the 2002 Plan in accordance with Section 162(m) of the Internal Revenue Code of 1986 ("Code"). The Code generally provides that a public company such as the Company may not deduct compensation paid to its chief executive officer or to any of its four most highly compensated officers to the extent that the compensation paid to any such officer/employee exceeds \$1 million in any tax year, unless the payment is made upon the attainment of objective performance goals that are approved by the Company's shareholders.

Under the 2002 Plan, net realized income of the Company includes investment income, realized qualifying gains and losses, and operating expenses (including taxes paid or payable by the Company), but is calculated without regard to dividends paid or loss carry-overs from other years ("Qualifying Income").

Under the 2002 Plan, awards previously granted to the Plan's four current Participants (Messrs. Harris and Melsheimer and Mss. Shavin and Matthews, herein referred to as the "grandfathered participants") will be reduced by 10% with respect to "Non-Tiny Technology Investments" (as defined in the 2002 Plan) and by 25% with respect to "Tiny Technology Investments" (as defined in the 2002 Plan) and will become permanent. These reduced awards are herein referred to as "grandfathered participations." The amount by which such awards are reduced will be allocable and reallocable each year by the Compensation Committee ("Committee") among current and new participants as awards under the 2002 Plan. The grandfathered participations will be honored by the Company whether or not the grandfathered participant is still employed by the Company or is still alive (in the event of death, the grandfathered participations will be paid to the grandfathered participant's beneficiary), unless the grandfathered participant is dismissed for cause, in which case all awards, including the grandfathered participations, will be immediately cancelled and forfeited. With regard to new investments and follow-on investments made after the date on which the first new employee begins participating in the 2002 Plan, both current and new participants will be required to be employed by the Company at the end of a plan year in order to participate in profit sharing on such investments with respect to such year.

Notwithstanding any provisions of the 2002 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 as calculated exceed such amount, the awards will be reduced pro rata.

The 2002 Plan may be modified, amended or terminated by the Committee at any time. Notwithstanding the foregoing, the grandfathered participations may not be modified. Nothing in the 2002 Plan will preclude the Committee from naming additional participants in the 2002 Plan or, except for grandfathered participations, changing the Award Percentage of any Participant (subject to the overall percentage limitations contained in the 2002 Plan). Under the 2002 Plan, the distribution amounts for non-grandfathered investments for each officer and employee currently are as follows: Charles E. Harris, 10.790 percent; Mel P. Melsheimer, 4.233 percent; Douglas W. Jamison, 3.0 percent; Helene B. Shavin, 1.524 percent; and Jacqueline M. Matthews, 0.453 percent. In one case, for a former employee who left the Company for reason other than due to termination for cause, any amount earned will be accrued and may subsequently be paid to such participant.

The grandfathered participations are set forth below:

Officer/Employee	Grandfathered Participations	
	Non-Tiny Technology (%)	Tiny Technology (%)
Charles E. Harris	12.41100	10.34250
Mel P. Melsheimer	3.80970	3.17475
Helene B. Shavin	1.37160	1.14300
Jacqueline M. Matthews	.40770	.33975
Total	18.00000	15.00000

Accordingly, an additional 2.00% of Qualifying Income with respect to grandfathered Non-Tiny Technology Investments, 5.00% of Qualifying Income with respect to grandfathered Tiny Technology Investments and the full 20.00% of Qualifying Income with respect to new investments are available for allocation and reallocation from year to year. Currently, Douglas W. Jamison is allocated 0.80% of the Non-Tiny Technology Grandfathered Participations and 2.00% of the Tiny Technology Grandfathered Participations.

The Company calculates the profit-sharing 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 profit-sharing accrual are then reflected in the Consolidated Statements of Operations for the quarter. The profit-sharing accrual is not paid out until the gains are realized. During the first quarter of 2003, the Company, under the Harris & Harris Group, Inc. Employee Profit-Sharing Plan, paid out 90 percent of the 2002 profit sharing in the amount of \$13,710. The remaining 10 percent of the 2002 profit sharing, \$1,523, will be paid out upon the completion and filing of the Company's 2002 federal tax return.

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 March 1, 1999, the directors may purchase the Company's common stock in the open market, rather than from the Company.

Since 1998, the Company has repurchased a total of 1,859,047 of its shares for a total of \$3,496,388, including commissions and expenses, at an average price of \$1.88 per share. These treasury shares were reduced by the purchases made by the Directors. On July 23, 2002, because of the Company's strategic decision to invest in tiny technology, the Board of Directors reaffirmed its commitment not to authorize the purchase of additional shares of stock in the foreseeable future.

On July 8, 2002, the Company filed a final prospectus under Rule 497 of the Securities Act of 1933 with the SEC for the issuance of transferable rights to its shareholders. The rights allowed the shareholders to subscribe for a maximum of 2,954,743 new shares of the Company's common stock, of which 2,634,614 new shares were subscribed for pursuant to the rights offering. The actual amount of gross proceeds raised upon completion of the offer was \$5,927,882; net proceeds were \$5,643,470, after expenses of \$284,412. Since the completion of the offer, the Company has invested \$4,695,618 in accordance with its investment objectives and policies. The Company intends to invest the balance of the proceeds over the next several months depending on the available investment opportunities for the types of investments in which the Company principally invests.

As of December 31, 2002, there are no distributable earnings. The difference between the book basis and tax basis components of distributable earnings is primarily attributed to Built-In Gains generated at the time of the Company's qualification as a RIC (see Note 6. "Income Taxes") and nondeductible deferred compensation.

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 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; 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; serve as a member of the Board for the period of which he is and shall from time to time be elected or reelected; and serve, if elected, 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 \$208,315 for 2000, 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; provides Mr. Harris and his spouse with long-term care insurance; and disability insurance in the amount of 100 percent of his base salary. 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 Mr. Harris's current annual 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's 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 will establish 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 \$1,002,303 as of June 30, 2003. 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.

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' 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. In 2001, Congress enacted the Economic Growth and Tax Relief Reconciliation Act of 2001 which has increased the deduction limits for plans such as the 401(k) Plan. This Act eliminates the need for the Company to maintain two separate plans. Effective December 31, 2001, the Pension Plan merged into the 401(k) Plan, with the 401(k) Plan being the surviving plan. Contributions to the plan are at the discretion of the Company

On June 30, 1994, the Company adopted a plan to provide medical and dental 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. The annual premium cost to the Company with respect to the entitled retiree shall not exceed \$12,000, subject to an index for inflation. Based upon actuarial estimates, the Company provided an original reserve of \$176,520 that was charged to operations for the period ending June 30, 1994. As of June 30, 2003, the Company had a reserve of \$446,302 for the plan.

On March 20, 2003, in order to begin planning for eventual management succession, the Board of Directors voted to establish a mandatory retirement plan for individuals who are employed by the Company in a bona fide executive or high policy making position. There are currently two such individuals, the Chairman and CEO, and the President and COO. Under this plan, mandatory retirement will take place effective December 31 of the year in which the eligible individuals attain the age of 65. On an annual basis beginning in the year in which the designated individual attains the age of 65, a committee of the Board consisting of non-interested directors may determine to postpone the mandatory retirement date for that individual for one additional year for the benefit of the Company.

Under applicable law prohibiting discrimination in employment on the basis of age, the Company can impose a mandatory retirement age of 65 for its executives or employees in high policy-making positions only if each employee subject to the mandatory retirement age is entitled to an immediate retirement benefit at retirement age of at least \$44,000 per year. The benefits payable at retirement to Charles E. Harris, the Company's Chairman and Chief Executive Officer, and Mel P. Melsheimer, the Company's President, Chief Operating Officer and Chief Financial

Officer, under the Company's existing retirement plans do not equal this threshold. Mr. Harris has offered, for the benefit of the Company, to waive his right to exclude certain other benefits from this calculation, which makes it unlikely that any provision will have to be made for him in order for the Company to comply with this threshold requirement. For Mr. Melsheimer, however, a new plan must be established to provide him with the difference between the benefit required under the age discrimination laws and that provided under the Company's existing plans. The expense to the Company of providing the benefit under this new plan is currently estimated to be \$450,000. This benefit will be unfunded, and the expense is being amortized over the fiscal periods through the year ended December 31, 2004.

NOTE 6. INCOME TAXES

The Company elected Sub-Chapter M status for the year ended December 31, 1999. On February 23, 1999, the Company declared a cash dividend of \$0.35 per share (for a total of \$3,647,017), thereby distributing part of the long-term capital gain generated in 1999 by the sale of NBX Corporation to 3Com Corporation. Approximately \$143,261 of the long-term capital gain for 1999 was not distributed during 1999. Accordingly, on September 20, 2000, the Company declared a \$0.02 dividend (for a total of \$184,817). For the year ended December 31, 1999, the Company incurred approximately \$20,000 in excise taxes.

Provided that a proper election is made, a corporation taxable under Sub-Chapter C of the Internal Revenue Code (a "C Corporation") that elects to qualify as a RIC continues to be taxable as a C Corporation on any gains realized within 10 years of its qualification as a RIC (the "Inclusion Period") from sales of assets that were held by the corporation on the effective date of the RIC election ("C Corporation Assets") to the extent of any gain built into the assets on such date ("Built-In Gain"). (If the corporation fails to make a proper election, it is taxable on its Built-In Gain as of the effective date of its RIC election.) The Company had Built-In Gains at the time of its qualification as a RIC and made the election to be taxed on any Built-In Gain realized during the Inclusion Period. Prior to 1999, the Company incurred ordinary and capital losses from its operations. After the Company's election of RIC status, those losses remained available to be carried forward to subsequent taxable years. The Company has previously used loss carryforwards to offset Built-In Gains. As of January 1, 2003, the Company had \$501,640 of loss carryforwards remaining and \$4,663,457 of unrealized Built-In Gains remaining.

Continued qualification as a RIC requires the Company to satisfy certain investment asset 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 as a RIC in subsequent years.

To the extent that the Company retains capital gains, and declares a deemed dividend to shareholders, the dividend is taxable to the shareholders. 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 and 2001. The Company's financial statements for 2000 and 2001 include a tax liability of \$5,709,884 and \$290,748, respectively. The taxes paid by the Company's shareholders as a result of the Company's deemed dividend declaration for 2000 (\$5,688,896) and 2001 (\$271,467) are reflected as a deduction to the additional paid-in capital in the Company's Consolidated Statement of Assets and Liabilities rather than an expense in the Consolidated Statement of Operations.

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 and six months ended June 30, 2003, and 2002, the Company's income tax provision was allocated as follows:

	Three Months Ended June 30, 2003	Three Months Ended June 30, 2002	Six Months Ended June 30, 2003	Six Months Ended June 30,2002
Net operating loss	\$ 0	\$ 0	\$ 0	\$ 0
Net realized gain (loss) on investments.....	14,349	(47,087)	17,322	(12,864)
Net increase in unrealized appreciation on investments	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total income tax (benefit) provision	<u>\$ 14,349</u>	<u>\$ (47,087)</u>	<u>\$ 17,322</u>	<u>\$ (12,864)</u>

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

Current	\$ 14,349	\$ 0	\$ 17,322	\$ 0
Deferred -- Federal.....	<u>0</u>	<u>(47,087)</u>	<u>0</u>	<u>(12,864)</u>
Total income tax provision.....	<u>\$ 14,349</u>	<u>\$ (47,087)</u>	<u>\$ 17,322</u>	<u>\$ (12,864)</u>

The Company's net deferred tax liability at June 30, 2003, and December 31, 2002, consists of the following:

	June 30, 2003	December 31, 2002
Tax on unrealized appreciation on investments	\$ 844,918	\$ 844,918
Net operating loss and capital carryforward	<u>(175,574)</u>	<u>(175,574)</u>
Net deferred income tax liability	<u>\$ 669,344</u>	<u>\$ 669,344</u>

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. During 1999, the Company sublet this additional space to an unaffiliated party. Rent expense under this lease for the year ended December 31, 2002 was \$178,561. Minimum lease payments in 2003 are \$101,946.

On April 17, 2003, the Company signed a seven-year sublease for office space at 111 West 57th Street in New York City to replace its existing lease which expires on July 31, 2003. Minimum sublease payments in 2003 are \$49,626. Future minimum sublease payments in each of the following years are: 2004 -- \$134,816; 2005--\$138,187; 2006 -- \$141,641; 2007 -- \$145,182; 2008 - - \$148,811; and thereafter for the remaining term -- \$203,571.

NOTE 8. ASSET ACCOUNT LINE OF CREDIT

On November 19, 2001, the Company established an asset account line of credit of up to \$12,700,000. The asset account line of credit is secured by the Company's government and government agency securities. Under the asset account line of credit, the Company may borrow up to 95 percent of the current value of its government and government agency securities. The Company's outstanding balance under the asset line of credit at June 30, 2003 and June 30, 2002 was \$7,983,520 and \$0, respectively. The asset line of credit bears interest at a rate of the Broker Call Rate plus 50 basis points. At June 30, 2003, the asset account line of credit accrued interest at a rate of 3.5%.

NOTE 9. SUBSEQUENT EVENTS

On July 2, 2003, the Company sold its investment in \$8,000,000 of U.S. Treasury Bills due September 25, 2003. The proceeds of \$7,982,244 were used to repay the entire outstanding balance of \$7,983,520 under the asset line of credit.

On August 1, 2003, the Company made a follow-on investment of \$323,000 in the preferred stock of a privately held tiny-technology company.

NOTE 10. INTERIM FINANCIAL STATEMENTS

The interim financial statements of the Company have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulations S-X. Accordingly, they do not include all information and disclosures necessary for a presentation of the Company's financial position, results of operations and cash flows in conformity with generally accepted accounting principles in the United States of America. In the opinion of management, these financial statements reflect all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation of the Company's financial position, results of operations and cash flows for such periods. The results of operations for any interim period are not necessarily indicative of the results for the full year. These financial statements should be read in conjunction with the financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002.

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

The information contained in this section should be read in conjunction with the Company's June 30, 2003 Consolidated Financial Statements and the Company's year-end 2002 Consolidated Financial Statements and the Notes thereto.

Background and Overview

The Company incorporated under the laws of the state of New York in August 1981 as Sovereign Thoroughbreds, Inc. ("Sovereign") to own and manage thoroughbred-horse breeding stock. In 1983, Sovereign completed an initial public offering and invested \$406,936 in Otisville BioTech, Inc. ("Otisville"), which also completed an initial public offering. In 1984, Charles E. Harris purchased a controlling interest in Sovereign, which at the time held the controlling interest in Otisville. Under Mr. Harris's control, the Company divested its other assets and became a financial services company, with the investment in Otisville as the initial focus of its business activity. The Company hired new management for Otisville, and Otisville acquired new technology targeting the development of a human blood substitute.

In 1986, operating as a financial services company, the Company changed its name to The Lexington Group, Inc., and eventually, the Company operated two wholly-owned insurance brokerage subsidiaries and a wholly-owned trust company subsidiary. In 1988, in conjunction with the acquisition of one of these insurance brokerage operations, C.D. Harris (which was previously unrelated to Charles E. Harris or his family), the Company changed its name to Harris & Harris Group, Inc. In 1989, Otisville changed its name to Alliance Pharmaceutical Corporation ("Alliance"). By 1990, the Company had completed selling its \$406,936 investment in Alliance for total proceeds of \$3,923,559. In 1992, the Company sold its insurance brokerage and trust company subsidiaries to their respective managements and registered as an investment company under the 1940 Act. In 1992, the Company commenced operations as a closed-end, non-diversified investment company. In 1995, the Company elected to become a business development company subject to the provisions of Sections 55 through 65 of the 1940 Act. Throughout the Company's corporate history, it has made early-stage venture capital investments in a variety of industries. In 1994, the Company made its first nanotechnology investment. Since August 2001, it has made initial investments exclusively in tiny technology, including its last 12 initial 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, have little or no history of operations and are developing unproven technologies. At June 30, 2003, \$14,517,674 or 56.9 percent of the Company's net assets consisted of venture capital investments at fair value, net of unrealized depreciation of \$3,180,323. At December 31, 2002, \$12,036,077 or 44.2 percent of the Company's net assets consisted of venture capital investments at fair value, of which net unrealized depreciation was \$2,718,389. At December 31, 2001, \$13,120,978 or 53.9 percent of the Company's net assets consisted of venture capital investments at fair value, of which net unrealized appreciation was \$1,215,444.

Since the Company's investment in Otisville in 1983, it has made a total of 53 venture capital investments, including four private investments in public equities. The Company has sold 35 of these 53 investments, realizing total proceeds of \$105,659,158 on its invested capital of \$37,366,522. Sixteen of these 35 investments were profitable. The average and median holding periods for these 35 investments were 3.57 years and 3.20 years respectively. The Company

values the 18 venture capital investments currently in its portfolio at \$14,517,674, as compared with a cost to it of \$17,697,997. As of June 30, 2003, the average and median holding periods for its 18 current venture capital investments are 2.52 years and 1.31 years, respectively.

The Company has broad discretion in the investment of its capital. However, the Company invests primarily in illiquid equity securities of private companies. Generally, these investments take the form of preferred stock, are subject to restrictions on resale and have no established trading market. Its principal objective is to achieve long-term capital appreciation. Therefore, a significant portion of its investment portfolio 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 and is not expected to be material to the Company's results of operations.

The Company values its investments each quarter at fair value as determined in good faith by its Valuation Committee within guidelines established by its Board of Directors in accordance with the 1940 Act. (See "Footnote to Consolidated Schedule of Investments" contained in "Consolidated Financial Statements.")

General business and capital markets conditions in 2002 and 2003 have been adverse for the venture capital industry. There have been few opportunities to take venture capital-backed companies public or sell them to established companies. It has been difficult to finance venture capital-backed companies privately. And, it has been difficult in general for venture capital firms themselves to raise capital.

The Company presents the financial results of its operations utilizing accounting principles generally accepted in the United States for investment companies. On this basis, the principal measure of its financial performance during any period is the net increase/(decrease) in its net assets resulting from its operating activities, which is the sum of the following three elements:

- (1) Net Operating Income / (Loss) - the difference between the Company's income from interest, dividends, and fees and its operating expenses.
- (2) Net Realized Gain / (Loss) on Investments - the difference between the net proceeds of dispositions of portfolio securities and their stated cost.
- (3) Net Increase / (Decrease) in Unrealized Appreciation on Investments - the net change in the fair value of the Company's investment portfolio.

Because of the structure and objectives of its business, the Company generally expects to experience net operating losses and seeks to generate increases in its net assets from operations through the long term appreciation of its venture capital investments. The Company has in the past relied, and continues to rely, on proceeds from sales of investments, rather than on investment income, to defray a significant portion of its operating expenses. Because such sales are unpredictable, the Company attempts to maintain adequate working capital to provide for fiscal periods when there are no such sales.

Results of Operations

Three months ended June 30, 2003, as compared to the three months ended June 30, 2002

The Company had a net decrease in net assets resulting from operations of \$544,709 in the three months ended June 30, 2003, compared to a net increase in net assets resulting from operations of \$434,289 in the three months ended June 30, 2002.

Investment Income and Expenses:

The Company had net operating losses of \$726,989 and \$654,718 for the three months ended June 30, 2003, and June 30, 2002, respectively. In the three months ended June 30, 2003, the Company's net operating loss reflected an increase to expenses primarily related to increases in salaries and benefits, professional fees and rent expense.

Operating expenses were \$777,553 and \$715,086 for the three months ended June 30, 2003, and June 30, 2002, respectively. The operating expenses of the second quarter of 2003 reflect no expense for employee profit-sharing. In the three months ended June 30, 2003, versus the three months ended June 30, 2002, salaries and benefits increased by \$97,114 or 36.7 percent, primarily as a result of an additional employee and mandatory retirement plan pension expense. Professional fees increased primarily as a result of an increase in independent accounting and legal expenses associated with the preparation of the Company's proxy statement and legal and consulting expenses associated with the preparation of the mandatory retirement plan and revision of the retiree medical and health insurance plan.

Realized Gains and Losses on Portfolio Securities:

During the three months ended June 30, 2003, and June 30, 2002, the Company realized gains of \$28,140 and \$688,681, respectively.

During the three months ended June 30, 2002, the Company realized a net gain of \$688,681, consisting primarily of a gain of \$986,187 from its partnership interest in PHZ Capital Partners L.P., offset by a loss of \$350,583 on the dissolution of Informio, Inc.

Unrealized Appreciation and Depreciation of Portfolio Securities:

Net unrealized depreciation on investments decreased by \$168,489 or five percent during the three months ended June 30, 2003, from \$3,348,239 at March 31, 2003, to \$3,179,750 at June 30, 2003.

During the three months ended June 30, 2003, the Company recorded a net decrease of \$184,493 in unrealized depreciation of its venture capital investments.

Six Months ended June 30, 2003, as compared to the six months ended June 30, 2002

The Company had net decreases in net assets resulting from operations of \$1,759,836 and \$602,645 in the six months ended June 30, 2003, and June 30, 2002, respectively.

Investment Income and Expenses:

The Company had net operating losses of \$1,311,449 and \$1,210,951 for the six months ended June 30, 2003, and June 30, 2002, respectively. In the six months ended June 30, 2003, the Company's net operating loss reflected an increase to expenses primarily related to increases in salaries and benefits, professional fees and rent expense offset by a decrease in the employee profit-sharing accrual.

Operating expenses were \$1,426,689 and \$1,330,781 for the six months ended June 30, 2003, and June 30, 2002, respectively. Operating expenses in the six months ended June 30, 2003, versus the six months ended June 30, 2002, changed primarily for the following reasons:

- (1) Operating expenses for the six months ended June 30, 2003, included no expense for employee profit-sharing, versus \$249,285 in such expense for the six months ended June 30, 2002.
- (2) Salaries and benefits increased by \$203,934 or 39.2 percent, primarily as a result of the addition of an employee and mandatory retirement plan pension expense.
- (3) Professional fees increased, primarily as a result of an increase in independent accounting and legal expenses associated with the implementation of the Sarbanes-Oxley Act; legal expenses associated with the preparation of the Company's proxy statement; and legal and consulting expenses associated with the preparation of the mandatory retirement plan and revision of the retiree medical and health insurance plan.

Realized Gains and Losses on Portfolio Securities:

During the six months ended June 30, 2003, and June 30, 2002, the Company realized gains of \$28,572 and \$799,360, respectively.

During the six months ended June 30, 2003, the Company neither sold nor liquidated any venture capital investments.

During the six months ended June 30, 2002, the Company's realized net gains of \$799,360 consisted primarily of \$1,108,226 from its partnership interest in PHZ Capital Partners L.P., offset by a loss of \$350,583 on the dissolution of Informio, Inc.

Unrealized Appreciation and Depreciation of Portfolio Securities:

Net unrealized depreciation on investments increased by \$459,637 or 16.9 percent during the six months ended June 30, 2003, from \$2,720,113 at December 31, 2002, to \$3,179,750 at June 30, 2003.

During the six months ended June 30, 2003, the Company recorded a net decrease of \$461,934 in unrealized depreciation of its venture capital investments.

Year ended December 31, 2002, as compared to years ended December 31, 2001, and 2000

The Company had net decreases in net assets resulting from operations of \$2,722,194, \$6,889,238 and \$15,507,207 in the years ended December 31, 2002, December 31, 2001, and December 31, 2000, respectively.

Investment Income and Expenses:

The Company had net operating (loss) income of (\$1,871,088) in 2002, (\$524,560) in 2001 and \$3,310,250 in 2000. The net operating (loss) income for 2002, 2001 and 2000 reflected a decrease in the employee profit-sharing accrual that resulted in a reversal of expenses of \$163,049 in 2002, \$984,021 in 2001 and \$4,812,675 in 2000. When unrealized appreciation as of a certain date subsequently decreases or increases, the profit-sharing accrual decreases or increases accordingly, resulting in a decrease or increase to expenses.

Operating expenses in 2002 were \$2,124,549, reflecting an increase of \$1,089,328 from \$1,035,221 in 2001. Of this increase, \$820,972 was a reversal of the profit sharing accrual. Operating expenses for 2002 also reflect an increase in salaries and benefits, primarily owing to an increase in the retirement medical benefit expense and the expense of a new employee, starting in September 2002, and an increase in professional fees, primarily as a result of expenses associated with new investments and preparation of the Company's proxy statement.

Operating expenses in 2001 were \$1,035,221, reflecting an increase of \$3,658,421 from \$(2,623,200) in 2000. Of this increase, \$3,828,654 was a reversal of the profit sharing accrual, offset by a decrease in all other expenses of \$170,233.

Realized Gains and Losses on Sales of Portfolio Securities:

During the three years ended December 31, 2002, December 31, 2001, and December 31, 2000, the Company sold various investments and received distributions, resulting in net realized income from investments of \$3,284,737, \$1,394,781 and \$19,065,267, respectively.

During the year ended December 31, 2002, Informio, Inc. approved a plan of liquidation, the Company sold its interest in Schwoo, Inc. and the Company's partnership interest in PHZ Capital Partners, L.P. was liquidated. The Company recorded realized income from investments of \$3,284,737, consisting primarily of realized income of \$4,776,360 from the liquidation of its partnership interest in PHZ Capital Partners L.P. The Company recorded realized losses of \$350,583 and \$1,248,825 from the liquidation of Informio, Inc. and sale of the Company's previously written-off investment in Schwoo, Inc., respectively.

During 2001, the Company recorded realized income from investments of \$1,394,781, consisting primarily of realized income (losses) from sales of: Nanophase Technologies Corporation, \$2,762,696; Genomica Corporation, \$1,022,905; Essential.com, Inc., (\$1,349,512); shares of SciQuest.com, Inc. purchased in the open market, (\$1,258,679); and MedLogic Global Corporation, (\$1,033,765). The Company also recorded realized income of \$1,266,729 from its partnership interest in PHZ Capital Partners L.P. As a result of the income and losses realized during 2001, unrealized appreciation increased by \$3,948,271.

During 2000, the Company recorded realized income from investments of \$19,065,267, consisting primarily of realized income (losses) from sales of Alliance Pharmaceutical Corp., \$9,693,446, and the Company's private-equity investments in SciQuest.com, Inc., \$7,407,377.

Unrealized Appreciation and Depreciation of Portfolio Securities:

In 2002, net unrealized appreciation on investments decreased by \$3,936,533 or 323.6 percent, from \$1,216,420 at December 31, 2001, to (\$2,720,113) at December 31, 2002, primarily as a result of decreases in the valuations of the Company's venture capital investments, including a decrease in unrealized appreciation of NeuroMetrix, Inc. of \$1,986,081.

In 2001, net unrealized appreciation on investments decreased by \$7,731,508 or 86.4 percent, from \$8,947,928 at December 31, 2000, to \$1,216,420 at December 31, 2001, primarily as a result of decreases in the valuations of the Company's holdings of Nanophase Technologies Corporation, Genomica Corporation and Schwoob, Inc. of \$5,499,664, \$1,540,375 and \$1,248,827, respectively, offset by an increase in unrealized appreciation of \$1,528,082 and \$1,033,775 as a result of the realization of the loss on the sale of the Company's positions in SciQuest.com, Inc. and MedLogic Global Corporation.

In 2000, net unrealized appreciation on investments decreased by \$37,934,593 or 80.9 percent from \$46,882,521 at December 31, 1999, to \$8,947,928 at December 31, 2000, primarily as a result of decreases in the valuations of the Company's holdings in SciQuest.com, Inc. of \$26,102,456 (net of gain of \$7,407,377 realized on sale) and Kana Communications, Inc. of \$3,816,204 (net of gain of \$1,054,818 realized on sale), offset by an increase in the value of the Company's holding in Nanophase Technologies Corporation of \$3,709,449.

During the year ended December 31, 2002, we experienced a net decrease in unrealized depreciation of the Company's venture capital investments of \$3,933,834.

Financial Condition

Six Months ended June 30, 2003

The Company's total assets and net assets were \$35,903,212 and \$25,496,210, respectively, at June 30, 2003, compared with \$35,951,969 and \$27,256,046 at December 31, 2002.

Net asset value per share ("NAV") was \$2.22 at June 30, 2003, versus \$2.37 at December 31, 2002. The Company's shares outstanding remained unchanged during the six months ended June 30, 2003.

Significant developments in the six months ended June 30, 2003, were an increase in bank loan payable of \$7,983,520 and an increase in the value of the Company's investment in U.S. Treasury Bills of \$4,386,032.

The increase in the value of the venture capital investments, from \$12,036,077 at December 31, 2002, to \$14,517,674 at June 30, 2003, resulted primarily from the Company's three new venture capital investments and one follow-on investment, partially offset by a net decrease in the value of the Company's other venture capital investments.

The following table is a summary of additions to the Company's portfolio of venture capital investments during the six months ended June 30, 2003:

<u>New Investment</u>	<u>Amount</u>
Chlorogen, Inc.	\$ 525,900
NanoGram Devices Corporation	\$ 750,000
Nanosys, Inc.	\$1,500,000
<u>Follow-on Investment</u>	
Nanotechnologies, Inc.	<u>\$ 169,718</u>
Total	<u>\$2,945,618</u>

Year ended December 31, 2002

At December 31, 2002, as compared with December 31, 2001, the Company's total assets decreased by \$3,730,398 or 9.4 percent to \$35,951,969, and its net assets increased by \$2,921,276 or 12 percent to \$27,256,046.

NAV was \$2.37 on 11,498,845 shares outstanding at December 31, 2002, versus \$2.75 on 8,864,231 shares outstanding at December 31, 2001.

Among the significant developments during the year ended December 31, 2002, were: (1) payment of \$271,467 in federal income taxes as a result of the Company's deemed dividend distribution to shareholders; (2) net decrease in the unrealized appreciation of the Company's venture capital investments of \$3,933,834, including a decrease in the unrealized appreciation of NeuroMetrix, Inc. of \$1,986,081; (3) decrease in bank loan payable of \$12,495,777; (4) net proceeds of \$5,643,470 pursuant to the issuance and exercise of transferable rights for 2,634,614 new shares of the Company's common stock, bringing the Company's shares outstanding as of December 31, 2002, to 11,498,845 shares, versus 8,864,231 shares outstanding at December 31, 2001; and (5) receipt of \$5,700,000 in cash and a recorded receivable in the amount of \$786,492 related to the liquidation of the Company's partnership interest in PHZ Capital Partners L.P.

The value of the venture capital investments decreased by \$1,084,901, from \$13,120,978 at December 31, 2001, to \$12,036,077 at December 31, 2002, reflecting increases from new and additional investments offset by investment write-downs and the liquidation of investments. Increases from new and follow-on investments totaled \$7,195,988. Write-downs totaled \$5,213,959. The liquidations of Informio, Inc. and the Company's partnership interest in PHZ Capital Partners L.P. resulted in decreases in venture capital investments of a total of \$3,072,382, based on their respective values at December 31, 2001.

The following table is a summary of additions to our portfolio of venture capital investments for the year ended December 31, 2002:

<u>New Investment</u>	Amount
Agile Materials & Technologies, Inc.	\$1,000,000
Continuum Photonics, Inc.	\$1,000,000
Nanopharma Corp.	\$ 700,000
NanoOpto Corporation	\$ 625,000
Nanotechnologies, Inc.	\$ 750,000
Neo Photonics Corporation	\$1,000,000
Optiva, Inc.	\$1,250,000
<u>Follow-on Investment</u>	
Experion Systems, Inc.	\$ 517,706
NeuroMetrix, Inc.	<u>\$ 353,282</u>
Total	<u>\$7,195,988</u>

Year Ended December 31, 2001

At December 31, 2001, as compared with December 31, 2000, the Company's total assets decreased by \$3,661,056 or 8.4 percent to \$39,682,367, and its net assets decreased by \$7,498,705 or 23.6 percent to \$24,334,770.

NAV was \$2.75 at December 31, 2001, versus \$3.51 at December 31, 2000. NAV was reduced by \$0.02 in 2000 by the cash dividend paid by the Company to shareholders.

Among the significant developments during the year ended December 31, 2001, were: (1) payment of \$5,709,884 in federal income taxes as a result of the Company's deemed dividend distribution; (2) net decrease in the unrealized appreciation of the Company's venture capital investments of \$7,731,465, including a write-off for book purposes of the value of the Company's holdings in Schwoo, Inc. of \$1,248,827; (3) sales of the Company's holdings in Nanophase Technologies Corporation, Genomica Corporation, SciQuest.com, Inc., Essential.com and MedLogic Global Corporation; and (4) change in the Company's valuation policy as of March 31, 2001, in accordance with newly promulgated SEC guidelines. The Company changed its valuation policy by no longer discounting publicly held securities for liquidity considerations. (See "Asset Valuation Policy Guidelines" in the "Footnote to Consolidated Schedule of Investments.")

The following table is a summary of additions to our portfolio of venture capital investments for the year ended December 31, 2001:

<u>New Investment</u>	Amount
Schwoo, Inc.	\$ 888,577
Nantero, Inc.	\$ 489,999
<u>Follow-on Investment</u>	
Experion Systems, Inc.	\$ 80,000
<u>Loan</u>	
Schwoo, Inc.	<u>\$ 360,250</u>
Total	<u>\$1,818,826</u>

The following table summarizes fair value of our entire investment portfolio, as compared with its cost, at June 30, 2003, and December 31, 2002, and December 31, 2001:

	<u>June 30, 2003</u>	<u>December 31, 2002</u>	<u>December 31, 2001</u>
Investments, at Cost	\$37,534,201	\$30,206,935	\$37,714,285
Unrealized depreciation ...	<u>(3,179,750)</u>	<u>(2,720,113)</u>	<u>1,216,420</u>
Investments, at fair value .	<u>\$34,354,451</u>	<u>\$27,486,822</u>	<u>\$38,930,705</u>

The accumulated unrealized (depreciation) appreciation on investments net of deferred taxes was (\$3,389,458) at December 31, 2002, versus (\$148,049) at December 31, 2001. The accumulated unrealized (depreciation) on investments net of deferred taxes was \$3,849,094 at June 30, 2003, versus (\$3,389,458) at December 31, 2002.

The following table summarizes the composition of our venture capital portfolio at June 30, 2003, and at December 31, 2002, and December 31, 2001:

<u>Category</u>	<u>June 30, 2003</u>	<u>December 31, 2002</u>	<u>December 31, 2001</u>
Tiny Technology	57.0%	49.0%	9.3%
Other Venture Capital Investments	<u>43.0%</u>	<u>51.0%</u>	<u>90.7%</u>
Total Venture Capital Investments	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

Cash Flow

Year ended December 31, 2002

Cash flow provided by operating activities for the year ended December 31, 2002, was \$1,923,048, primarily as a result of the following changes from December 31, 2001, to December 31, 2002: payable to broker for unsettled trade increased by \$5,969,725; funds held in escrow increased by \$750,000; and receivable from a partnership liquidation increased by \$786,492. In addition, net realized and unrealized loss on investments was \$651,797, and the net decrease in net assets resulting from operations was \$2,722,194.

Cash provided by investing activities for the year ended December 31, 2002, was \$10,751,980, reflecting the decrease in the Company's investment in U.S. Treasury Bills of \$10,358,006 and the proceeds from the liquidation of investments of \$7,631,100, offset by investments in private placements of \$7,195,988.

Cash used in financing activities for the year ended December 31, 2002, was \$6,842,807, reflecting the payment of the outstanding balance on the asset line of credit of \$12,495,777, offset by the net proceeds from a rights offering of \$5,643,470. The Company intended to invest in tiny technology, under normal circumstances, directly or indirectly, the net proceeds of the rights offering in accordance with its investment objectives and policies, within the 12 months following the receipt of the net proceeds of the rights offering, depending on the available investment opportunities.

Liquidity and Capital Resources

The Company's primary sources of liquidity are cash, receivables and freely marketable securities, net of short-term indebtedness. The Company's secondary sources of liquidity are restricted securities of companies that are publicly traded.

Six Months ended June 30, 2003

At June 30, 2003, and December 31, 2002, the Company's total net primary liquidity was \$12,134,541 and \$16,508,057, respectively. On both of the corresponding dates, the Company's secondary liquidity was \$0, as the Company had no restricted securities of companies that are publicly traded. The Company's tertiary source of liquidity was its partnership interest in PHZ Capital Partners L.P., which was liquidated effective December 31, 2002. The Company received the final distribution of \$786,492 from PHZ Capital Partners L.P. in the first quarter of 2003.

The decrease in the Company's net primary sources of liquidity from December 31, 2002, to June 30, 2003, is primarily owing to: (1) payment of federal, state and local taxes; (2) investment in Chlorogen, Inc.; (3) investment in Nanotechnologies, Inc.; (4) investment in Nanosys, Inc.; and (5) use of funds for net operating expenses.

From December 31, 2002, to June 30, 2003, the Company's liability for accrued employee profit sharing decreased by \$13,710 to \$1,523, or 90 percent as a result of the payment of \$13,710 for the 2002 profit sharing. The remaining 2002 profit sharing accrual of \$1,523 will be paid upon the completion and filing of the Company's 2002 federal tax return.

The Company's total net income tax liability decreased by \$935,945, from \$1,527,000 at December 31, 2002 to \$591,055 at June 30, 2003, primarily as a result of federal, state and local payments made for income earned in 2002.

Year ended December 31, 2002

At December 31, 2002, December 31, 2001, and December 31, 2000, the Company's net primary liquidity was \$16,508,057, \$13,459,654 and \$23,039,736, respectively. On the corresponding dates, the Company's secondary liquidity was \$0, \$0 and \$3,040,679. The Company's tertiary source of liquidity was its partnership interest in PHZ Capital Partners L.P., from which the Company received cash distributions in 2002, 2001 and 2000 of \$6,588,661, \$172,068 and \$280,326, respectively. Effective December 31, 2002, the Company liquidated its 20 percent partnership interest in PHZ, for \$5,700,000 on December 31, 2002, and a final distribution of \$786,492 on January 16, 2003. At December 31, 2002, the final distribution of \$786,492 is included in net primary liquidity as a receivable.

The increase in the Company's net primary liquidity from December 31, 2001, to December 31, 2002, is the net result of: (1) payment of federal income taxes; (2) investment in Nanopharma Corp.; (3) investment in NanoOpto Corporation; (4) investment in NeoPhotonics Corporation; (5) investment in Experion Systems, Inc.; (6) investment in Continuum Photonics, Inc.; (7) investment in Nanotechnologies, Inc.; (8) investment in Optiva, Inc.; (9) investment in Agile Materials & Technologies, Inc.; (10) investment in NeuroMetrix, Inc.; (11) funds held in escrow for a pending venture capital investment; and (12) use of funds for operating expenses; offset by raising \$5,643,470, net of expenses, from a rights offering of common stock by the Company that closed July 31, 2002.

From December 31, 2001, to December 31, 2002, restricted funds increased by \$274,924 or 57.0 percent, owing to the Company's 2002 contribution of \$147,478 to the Supplemental Executive Retirement Plan, or SERP account, and net changes in the account from income earned and changes in investments valuations.

From December 31, 2001, to December 31, 2002, the Company's liability for accrued profit sharing decreased by \$163,049 to \$15,233, to reflect the estimated amount to be paid out under the profit-sharing plan. Current income tax liability increased by \$602,588 to \$857,656, owing primarily to income recorded in association with the liquidation of the Company's partnership interest in PHZ Capital Partners L.P.

On November 19, 2001, the Company established an asset account line of credit of up to \$12,700,000. The asset account line of credit is secured by the Company's Government Agency securities. Under the asset account line of credit, the Company may borrow up to 95 percent of the current value of its Government Agency securities. The Company's outstanding balance under the asset line of credit at December 31, 2002, and December 31, 2001, was \$0 and \$12,495,777, respectively. The asset line of credit bears interest at a rate of the Broker Call Rate plus 50 basis points.

The Company's net primary sources of liquidity are more than adequate to cover the Company's gross cash operating expenses over the next 12 months. Such gross cash operating expenses totaled \$2,256,991, \$1,992,341 and \$2,051,086 in 2002, 2001 and 2000, respectively.

Critical Accounting Policies

Critical accounting policies are those that are both important to the presentation of the Company's financial condition and results of operations and those that require management's most difficult, complex or subjective judgments. The Company's critical accounting policies are those applicable to the valuation of investments.

Valuation of Portfolio Investments

As a business development company, the Company invests primarily in illiquid securities including debt and equity securities of private companies. The investments are generally subject to restrictions on resale and generally have no established trading market. The Company values substantially all of its equity investments at fair value as determined in good faith by the Company's Valuation Committee. The Valuation Committee, comprised of at least three or more independent Board members, reviews and approves the valuation of the Company's investments 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.

Recent Developments — Portfolio Companies

On January 16, 2003, the Company received \$786,492 as final payment in the liquidation of the Company's partnership interest in PHZ Capital Partners L.P.

On February 3, 2003, the Company announced that it had invested \$750,000 in a convertible preferred security of NanoGram Devices Corporation. NanoGram Devices has developed and is commercializing specialized power sources for medical devices and other medical equipment based on its patented, laser-based nanomaterials synthesis technology.

On August 1, 2003, the Company made a follow-on investment of \$323,000 in preferred stock of one of our privately held tiny-technology companies that has not yet announced this financing.

Recent Developments — Other

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. On April 2, 2003, the Company received SEC certification and qualified for RIC treatment for 2002. Although the SEC certification for 1999-2002 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.

RISK FACTORS

Investing in our common stock involves a number of significant risks relating to our business and investment objective. You should carefully consider the risks and uncertainties described below before you purchase any of our common stock. These risks and uncertainties are not the only ones we face. Unknown additional risks and uncertainties, or ones that we currently consider immaterial, may also impair our business. If any of these risks or uncertainties materialize, our business, financial condition or results of operations could be materially adversely affected. In this event, the trading price of our common stock could decline, and you could lose all or part of your investment.

Risks related to the companies in our portfolio.

Investing in small, private companies involves a high degree of risk and is highly speculative.

We have invested a substantial portion of our assets in privately held development stage or start-up companies. These businesses tend to lack management depth, to have limited or no history of operations and to have not attained profitability. Tiny technology companies are especially risky, involving scientific, technological and commercialization risks. Because of the speculative nature of these investments, these securities have a significantly greater risk of loss than traditional investment securities. Some of our venture capital investments are likely to be complete losses or unprofitable and some will never realize their potential. We have been risk seeking rather than risk averse in our approach to venture capital and other investments. Neither our investments nor an investment in our common stock is intended to constitute a balanced investment program.

We may invest in companies working with technologies or intellectual property which currently have few or no proven commercial applications.

Nanotechnology, in particular, is a developing area of technology, of which much of the future commercial value is unknown, difficult to estimate and subject to widely varying interpretations. There are relatively few nanotechnology products currently commercially available. The timing of additional future commercially available nanotechnology products is highly uncertain.

Our portfolio companies working with tiny technology may be particularly susceptible to intellectual property disputes.

Research and commercialization efforts in tiny technology are being undertaken by a wide variety of government, academic and private corporate entities. As additional commercially viable applications of tiny technology begin to emerge, ownership of the intellectual property on which these products are based may be contested in some cases. Any dispute over the basic ownership of our portfolio companies' technologies or products would have a material adverse affect on that company's value.

Our portfolio companies may not be able to market their products successfully.

Even if our portfolio companies are able to develop commercially viable products, the market for new products and services is highly competitive, rapidly changing and especially sensitive to adverse general economic conditions. Commercial success is difficult to predict, and the marketing efforts of our portfolio companies may not be successful.

Unfavorable economic conditions could result in financial losses in our portfolio.

Most of the companies in which we have made or will make investments are susceptible to economic slowdowns or recessions. An economic slowdown, capital markets conditions or credit squeeze may affect the ability of a company in our portfolio to raise additional capital from venture capital or other private equity sources or to engage in a liquidity event such as an initial public offering or merger. These conditions can be expected to lead to financial losses in our portfolio.

Risks related to the illiquidity of our investments.

We invest in illiquid securities and may not be able to dispose of them when it is advantageous to do so, or ever.

Most of our investments are or will be equity securities acquired directly from small companies. These equity securities are generally subject to restrictions on resale or otherwise have no established trading market. The illiquidity of most of our portfolio of equity securities may adversely affect our ability to dispose of these securities at times when it may be advantageous for us to liquidate these investments. We may never be able to dispose of these securities.

Unfavorable economic conditions could impair our ability to engage in liquidity events or to find additional capital required by our portfolio companies.

Our business of making private equity investments and positioning them for liquidity events may be adversely affected by current and future capital markets and economic conditions. The public equity markets currently provide little opportunity for liquidity events, even for more mature technology companies than the ones in which we typically invest. The potential for public market liquidity could further decrease and could lead to an inability to realize potential gain or could lead to

financial losses in our portfolio and a decrease in our revenues, net income and assets. Recent regulatory changes have made the process of completing an initial public offering of equity securities more difficult and uncertain. Recent government reforms affecting stock markets, investment banks and securities research practices may make it more difficult for privately held companies to complete successful initial public offerings of their equity securities. The lack of exit strategies also tends to have an adverse effect on the ability of private companies to raise capital.

Even if our portfolio companies complete an initial public offering, the returns on our investments may be uncertain.

When companies in which we have invested as private entities complete initial public offerings of their securities, these newly issued securities are by definition unseasoned issues. Unseasoned issues tend to be highly volatile and have uncertain liquidity, which may negatively affect their price. In addition, we are typically subject to lock-up provisions which prohibit us from selling our investment into the public market for specified periods of time after an initial public offering. The market price of securities that we hold may decline substantially before we are able to sell these securities. Most initial public offerings of technology companies are listed on the Nasdaq National Market. Recent government reforms of the Nasdaq National Market have made market making by broker-dealers less profitable, which has caused broker-dealers to reduce their market making activities, thereby making the market for unseasoned stocks less liquid.

Risks related to our company.

Because there is generally no established market in which to value our investments, our Valuation Committee's value determinations may differ materially from the values that a ready market or third party would attribute to these investments.

There is generally no public market for the equity securities of the companies in which we invest. Pursuant to the requirements of the 1940 Act, we value substantially all of the equity securities in our portfolio at fair value as determined in good faith by the Valuation Committee of the Board of Directors within the guidelines established by the Board of Directors. Because there is typically no readily ascertainable market value for our investments, our Board of Directors determines in good faith the fair value of these investments pursuant to a valuation policy. There is no single standard for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment pursuant to specified valuation principles and processes. We are required by the 1940 Act to value specifically each individual investment on a quarterly basis and record unrealized depreciation for an investment that we believe has become impaired. Conversely, we must record unrealized appreciation if we believe that the underlying portfolio company has appreciated in value. Without a readily ascertainable market value and because of the inherent uncertainty of valuation, the fair value that we assign to our investments may differ from the values that would have been used had a ready market existed for the investments, and the difference could be material. Any changes in estimated fair value are recorded in our consolidated statements of operations as a change in the "Net (decrease) increase in unrealized appreciation on investments."

Because we are a non-diversified company with a relatively concentrated portfolio, the value of our business is subject to greater volatility than the value of companies with more broadly diversified investments.

As a result of investing a greater portion of our assets in the securities of a smaller number of issuers, we are classified as a non-diversified company. We may be more vulnerable to events

affecting a single issuer or industry and therefore subject to greater volatility than a company whose investments are more broadly diversified. Accordingly, an investment in our common stock may present greater risk to you than an investment in a diversified company.

We may be obligated to pay substantial amounts under our profit sharing plan.

Our employee profit-sharing plan requires us to distribute to our officers and employees 20 percent of our net realized income as reflected on our consolidated statements of operations for that year, less the non-qualifying gain, if any. These distributions may have a significant effect on the amount of distributions made to our shareholders, if any.

Approximately 35 percent of the fair value of our investment portfolio, as of June 30, 2003, is concentrated in one company, NeuroMetrix, Inc., which is not a tiny technology company.

We valued our investment in NeuroMetrix, Inc., which is not a tiny technology company, at \$5,075,426, which represents 34.96 percent of the fair value of our equity investment portfolio (19.91 percent of the net asset value) at June 30, 2003. Any downturn in the business outlook of NeuroMetrix, Inc., or any failure of the products of NeuroMetrix, Inc. to receive widespread acceptance in the marketplace, would have a significant effect on our specific investment and the overall value of our portfolio.

Approximately 57 percent of the fair value of our investment portfolio, as of June 30, 2003, is invested in tiny technology.

A significant portion of our current net asset value is composed of investments in short-term government securities and cash. Although all 12 of our portfolio investments added since August 2001 have been in tiny technology companies, and although thirteen of the companies in our current equity investment portfolio are considered tiny technology companies, only 56.99 percent of the fair value of our equity investment portfolio (32.45 percent of the net asset value) at June 30, 2003, is invested in tiny technology companies, which may limit our ability to achieve our investment objective and our mission.

We are dependent upon key management personnel for future success.

We are dependent for the selection, structuring, closing and monitoring of our investments on the diligence and skill of our senior management and other key advisers. We utilize lawyers and outside consultants, including two of our directors, Dr. Kelly S. Kirkpatrick and Lori D. Pressman, to assist us in conducting due diligence when evaluating potential investments. There is generally no publicly available information about the companies in which we invest, and we rely significantly on the diligence of our employees and advisers to obtain information in connection with our investment decisions. Our future success to a significant extent depends on the continued service and coordination of our senior management team, and particularly depends on our Chairman and Chief Executive Officer, Charles E. Harris. The departure of any of our executive officers, key employees or advisers could materially adversely affect our ability to implement our business strategy. We do not maintain for our benefit any key man life insurance on any of our officers or employees.

We will need to hire additional employees as the size of our portfolio increases.

We anticipate that it will be necessary for us to add investment professionals with expertise in tiny technology to accommodate the increasing size of our portfolio. We may need to provide additional scientific, business or investment training for our hires. There is competition for highly qualified personnel and we may not be successful in our efforts to recruit and retain highly qualified personnel.

The market for venture capital investments, including tiny technology investments, is highly competitive.

We face substantial competition in our investing activities from many competitors, including but not limited to private venture capital funds, investment affiliates of large industrial, technology, service and financial companies, small business investment companies, wealthy individuals and foreign investors. Our most significant competitors typically have significantly greater financial resources than we do. Many sources of funding compete for a small number of attractive investment opportunities. Hence, we face substantial competition in sourcing good investment opportunities on terms of investment that are commercially attractive.

In addition to the difficulty of finding attractive investment opportunities, our status as a regulated business development company may hinder our ability to participate in investment opportunities or to protect the value of existing investments.

We are required to disclose on a quarterly basis the name and business description of our portfolio companies and the value of any portfolio securities. Most of our competitors are not subject to these disclosure requirements. Our obligation to disclose this information could hinder our ability to invest in some portfolio companies. Additionally, other current and future regulations may make us less attractive as a potential investor than a competitor not subject to the same regulations.

Our failure to make follow-on investments in our portfolio companies could impair the value of our portfolio.

Following an initial investment in portfolio companies, we may make additional investments in the portfolio companies as "follow-on" investments, in order to: (1) increase or maintain in whole or in part our ownership percentage; (2) exercise warrants, options or convertible securities that were acquired in the original or subsequent financing; or (3) attempt to preserve or enhance the value of our investment. Recently, "pay to play" provisions have become common in venture capital transactions. These provisions require proportionate investment in subsequent rounds of financing in order to preserve preferred rights such as anti-dilution protection or to prevent preferred shares from being converted to common shares.

We may elect not to make follow-on investments or otherwise lack sufficient funds to make those investments. We have the discretion to make any follow-on investments, subject to the availability of capital resources. The failure to make follow-on investments may, in some circumstances, jeopardize the continued viability of a portfolio company and our initial investment, or may result in a missed opportunity for us to increase our participation in a successful operation, or may cause us to lose some or all preferred rights pursuant to "pay to play" provisions. Even if we have sufficient capital to make a desired follow-on investment, we may elect not to make a follow-on investment because we may not want to increase our concentration of risk, because we prefer other opportunities or because we are inhibited by compliance with business development company requirements or the desire to maintain our RIC tax status.

Our issuance of debt securities to fund investments in portfolio companies or to fund our operating expenses could make our total return to common shareholders more volatile. These securities could include fixed-maturity instruments paying interest or dividend-paying preferred stock.

Our use of debt as a source of capital would entail two primary risks. The first risk is that the use of debt leverages our available equity capital, magnifying the impact on net asset value of

changes in the value of our investment portfolio. For example, a business development company that uses 33 percent leverage (that is, \$50 of leverage per \$100 of common equity) will show a 1.5 percent increase or decline in net asset value for each 1 percent increase or decline in the value of its total assets. The second risk is that the cost of debt financing may exceed the return on the assets it is used to acquire, thereby diminishing rather than enhancing the return to common shareholders. If we were to utilize debt financing for any purpose, these two risks would likely make our total return to common shareholders more volatile. In addition, we might be required to sell investments in order to meet dividend or interest payments when it may be disadvantageous for us to do so.

As provided in the 1940 Act and subject to some exceptions, we can issue debt or preferred stock so long as our total assets immediately after the issuance, less some ordinary course liabilities, exceed 200 percent of the sum of the debt and any preferred stock outstanding. The debt or preferred stock may be convertible in accordance with SEC guidelines, which may permit us to obtain leverage at more attractive rates. The requirement under the 1940 Act to pay in full dividends on preferred shares or interest on debt before any dividends may be paid on the common shares means that dividends on the common shares from earnings may be reduced or eliminated. An inability to pay dividends on the common shares could conceivably result in our ceasing to qualify as a RIC under the Code, which would be materially adverse to the holders of the common shares.

The class voting rights of preferred shares we may issue could make it more difficult for us to take some actions that may, in the future, be proposed by the board and/or the holders of common stock, such as a merger, exchange of securities, liquidation or alteration of the rights of a class of our securities if these actions were perceived by the holders of the preferred shares as not in their best interests.

The issuance of preferred shares convertible into shares of common stock might also reduce the net income and net asset value per share of the common shares upon conversion. This income dilution would occur if we could, from the investments made with the proceeds of the preferred shares, earn an amount per common share issuable upon conversion greater than the dividend required to be paid on the amount of preferred stock convertible into one share of common stock. Net asset value dilution would occur if preferred shares were converted at a time when the net asset value per common share was greater than the conversion price.

Loss of status as a RIC would reduce our net asset value and distributable income.

We currently qualify as a regulated investment company, or RIC, under the Code. As a RIC, we do not have to pay Federal income taxes on our income (including realized gains) that is distributed to our shareholders. Accordingly, we are not permitted under accounting rules to establish reserves for taxes on our unrealized capital gains. If we failed to qualify for RIC status, we would have to establish reserves for taxes, which would reduce our net asset value, net of a reduction in the reserve for employee profit sharing, accordingly. To the extent that we, as a RIC, were to decide to make a deemed distribution of net realized capital gains and were to retain the net realized capital gains, we would have to establish appropriate reserves for taxes upon making that decision.

Investing in our shares of common stock may be inappropriate for the investor's risk tolerance.

Our investment objective and strategies result in a high degree of risk in our investments and may result in losses in the value of our investment portfolio. Our investments in portfolio companies are highly speculative and, therefore, an investor in our shares of common stock may lose his or her entire investment.

We operate in a regulated environment.

We are subject to substantive SEC regulations as a business development company. Securities and tax laws and regulations governing our activities may change in ways adverse to our and our shareholders' interests, and interpretations of these laws and regulations may change with unpredictable consequences. Any change in the laws or regulations that govern our business could have an adverse impact on us or on our operations. Also, as business and financial practices continue to evolve, they may render the regulations under which we operate less appropriate and more burdensome than they were when originally imposed.

Quarterly results fluctuate and are not indicative of future quarterly performance.

Our quarterly operating results fluctuate as a result of a number of factors. These factors include, among others, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which we and our portfolio companies encounter competition in our markets and general economic and capital markets 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.

We may be obligated to pay substantial amounts under our profit sharing plan.

Our employee profit-sharing plan requires us to distribute to our officers and employees 20 percent of our net after-tax realized income as reflected on our consolidated statements of operations for that year, less the non-qualifying gain, if any. These distributions may have a significant effect on the amount of distributions made to our shareholders, if any.

To the extent that we distribute income instead of electing to retain after-tax realized capital gains, our need for additional capital to fund our investments and operating expenses will be greater.

We will continue to need capital to fund investments and to pay for operating expenses. 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 realized net capital gains from investments. As a result, such earnings may not be available to fund investments. If we fail to generate net realized capital gains or to obtain funds from outside sources, it would have a material adverse effect on our financial condition and results as well as our ability to make follow-on and new investments. In addition, as a business development company, we are generally required to maintain a ratio of at least 200 percent of total assets to total borrowings, which may restrict our ability to borrow.

Investment in foreign securities could result in additional risks.

We currently have no investments in foreign securities. If we invest in securities of foreign issuers, we may be subject to risks not usually associated with owning securities of U.S. issuers. These risks can include fluctuations in foreign currencies, foreign currency exchange controls, social, political and economic instability, differences in securities regulation and trading, expropriation or nationalization of assets, and foreign taxation issues. In addition, changes in government administrations or economic or monetary policies in the United States or abroad could result in appreciation or depreciation of our securities and could favorably or unfavorably affect our operations. It may also be more difficult to obtain and enforce a judgment against a foreign issuer. Any foreign investments made by us must be made in compliance with U.S. and foreign currency restrictions and tax laws restricting the amounts and types of foreign investments.

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 "value" as defined in the 1940 Act and in the applicable regulations of the SEC. Value, as defined in Section 2(a)(41) of the 1940 Act, is (i) the market price for those securities for which a market quotation is readily available and (ii) for all other assets is 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. Even when the Company's private equity investments complete initial public offerings (IPOs), the Company is normally subject to lock-up agreements for a period of time.

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 determination 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 determined 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."

While the Company invests in short-term money market and U.S. Government and Agency Obligations and draws down on the asset line of credit, the Company does not consider a change in interest rates to result in significant risks.

Item 4. Controls and Procedures

As of the end of the period covered by this report, the Company's Chief Executive Officer and Chief Financial Officer conducted an evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934). Based upon this evaluation, the Company's Chief Executive Officer and Chief Financial Officer during such period concluded that the Company's disclosure controls and procedures are effective in timely alerting them of any material information relating to the Company that is required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934.

There have not been any significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

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 May 5, 2003, the Company held its Annual Meeting of Shareholders for the following purposes: (1) to elect directors of the Company; (2) to ratify, confirm and approve the Audit Committee's selection of PricewaterhouseCoopers LLP as the Company's independent accountant for its fiscal year ending December 31, 2003; and (3) to approve a proposal to authorize the Company to offer long-term rights to purchase shares of the Company's common stock. At the close of business on the record date (March 26, 2003), an aggregate of 11,498,845 shares of common stock were issued and outstanding.

All of the nominees at the May 5, 2003 Annual Meeting were elected directors:

<u>Nominees</u>	<u>For</u>	<u>Withheld</u>
Dr. C. Wayne Bardin	10,979,467	124,411
Dr. Phillip A. Bauman	10,981,641	122,237
G. Morgan Browne	10,980,277	123,601
Dugald A. Fletcher	10,977,806	126,072
Charles E. Harris	10,980,987	122,891
Dr. Kelly S. Kirkpatrick	10,982,471	121,407
Glenn E. Mayer	10,977,375	126,503
Lori D. Pressman	10,981,970	121,908
Charles E. Ramsey	10,981,721	122,157
James E. Roberts	10,979,471	124,407

With respect to proposal number two, described as a proposal "to ratify, confirm and approve the Audit Committee's selection of PricewaterhouseCoopers LLP" as the Company's independent accountant for its fiscal year ending December 31, 2003, the affirmative votes cast were 10,990,137, the negative votes cast were 23,603 and those abstaining were 90,138.

With respect to proposal number three, described as a proposal "to authorize the Company to offer long-term rights to purchase shares of the Company's common stock at an exercise price that, at the time such rights are issued, will not be less than the greater of the market value of the Company's common stock or the net asset value of the Company's common stock. Such rights may be part of or accompanied by other securities of the Company (such as convertible preferred stock or convertible debt)." The affirmative votes cast were 4,652,997, the negative votes cast were 194,926 and those abstaining were 94,462.

Item 5. Other Information

Not Applicable

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

- 10.1* Harris & Harris Group, Inc. Executive Mandatory Retirement Benefit Plan.
- 10.2* Amendment No. 1 to Deferred Compensation Agreement.
- 11.0* Computation of per share earnings. See Consolidated Statements of Operations.
- 31.01* Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.02* Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.01* Certification of CEO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.02* Certification of CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K filed during the quarter ended June 30, 2003

The Company filed a report on Form 8-K on May 8, 2003, concerning NAV at March 31, 2003.

*filed herewith

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 on behalf of the Registrant and as its chief accounting officer.

Harris & Harris Group, Inc.

/s/ Helene B. Shavin

By: Helene B. Shavin, Vice President
and Controller

Date: August 14, 2003