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NORTH FACADE

BAKER LIBRARY REOPENS, SEPTEMBER 2005



NEW SOUTH FACADE

EDUCATING LEADERS

BUILDING KNOWLEDGE

COMMUNICATING WORLDWIDE

From the Dean

Harvard Business School is fully engaged in advancing its mission as we begin the new fiscal year. Building on former Dean Kim Clark's legacy of leadership over the past decade, HBS is setting new standards in using information technology to enhance case-method learning, in global research and outreach, and in our commitment to ethics and principled leadership. We continue to innovate in our educational programs, ensuring that the classroom is a transformative experience for our students.

This work will continue in fiscal 2006. We will nurture the faculty's creation of knowledge that has power in practice. We will educate the kinds of leaders the world needs—people who bring both character and competence to their endeavors, and who will make a positive contribution to their enterprises and their communities. And we will strive to embody high standards of stewardship for the benefit of this and future generations as we manage the School's resources.

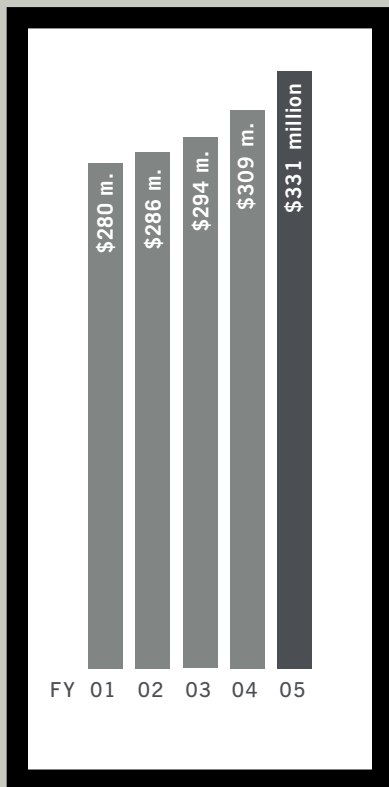
We have published this Annual Report to provide the HBS community with greater insight into the origins and uses of these resources. The following pages summarize the School's financial performance in fiscal 2005, highlight key programs and activities and the impact of the Campaign, and present a look forward into our operating plan for fiscal 2006 and beyond. This plan closely reflects the strategy we have executed for the past several years, which focuses on extending the School's reach and impact, while enhancing student diversity as well as academic achievement.

Every year, millions more people enter the global economy. The market for management knowledge and talent has grown exponentially, and we are seeking new ways to engage the current and next generation of leaders, and educators, around the world. As the corners of the globe draw closer, the School's mission has never been more important. Harvard Business School can deliver tremendous value if we continue to experiment and innovate, but the costs of pioneering are very high. Our challenge is to find new ways to mobilize the School's resources so the teaching and research that take place at HBS make an even greater difference in the world.

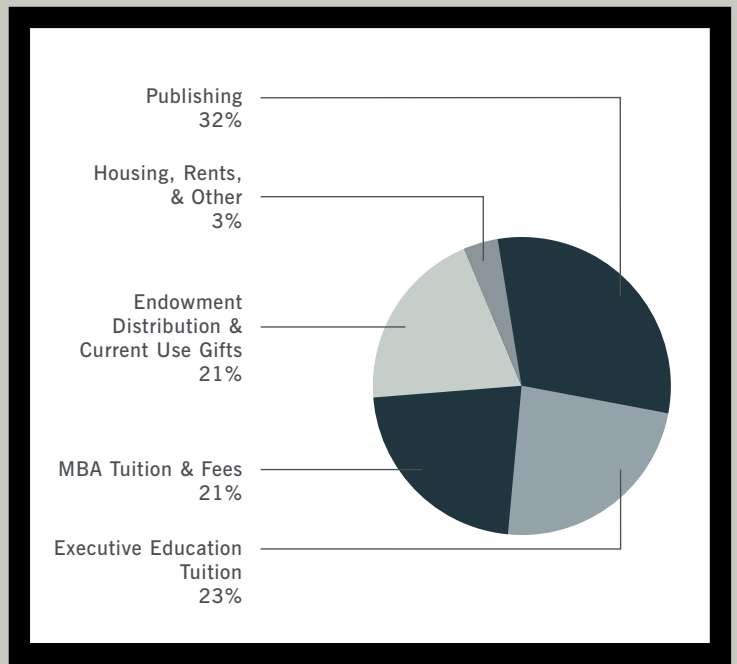


JAY O. LIGHT, DEAN

DWIGHT P. ROBINSON, JR. PROFESSOR OF BUSINESS ADMINISTRATION



REVENUES



REVENUE COMPONENTS, FY 2005

Financial Highlights

TOTAL REVENUES

Total revenues increased by \$22 million, or 7.1 percent, from last year to \$331 million, and were 3.4 percent above the School's forecast.

MBA PROGRAM REVENUES

MBA Program revenues grew by \$3 million, or 4.6 percent, to \$68 million due to normal increases in tuition and fees.

EXECUTIVE EDUCATION & HBS PUBLISHING REVENUES

Revenues from Executive Education and HBS Publishing increased by a combined \$13 million, or 7.7 percent, to \$182 million.

ENDOWMENT INCOME

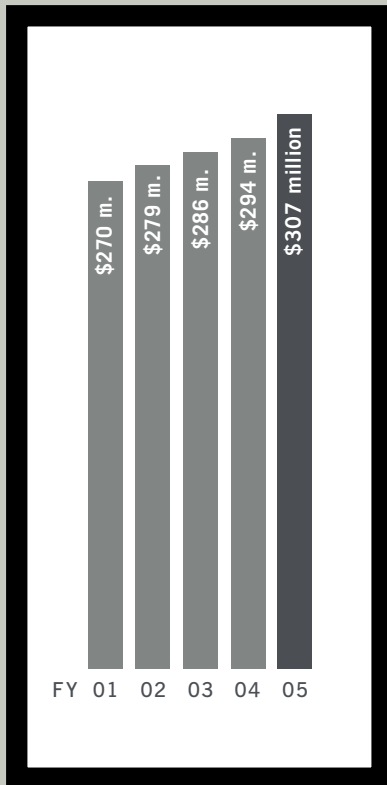
Endowment income distributed for operations rose by \$6 million to \$62 million, the result of an increase in the endowment payout and growth in the size of the endowment from new gifts to the capital campaign. The increased distribution was used primarily to fund financial aid awards and faculty research.

OPERATING EXPENSES

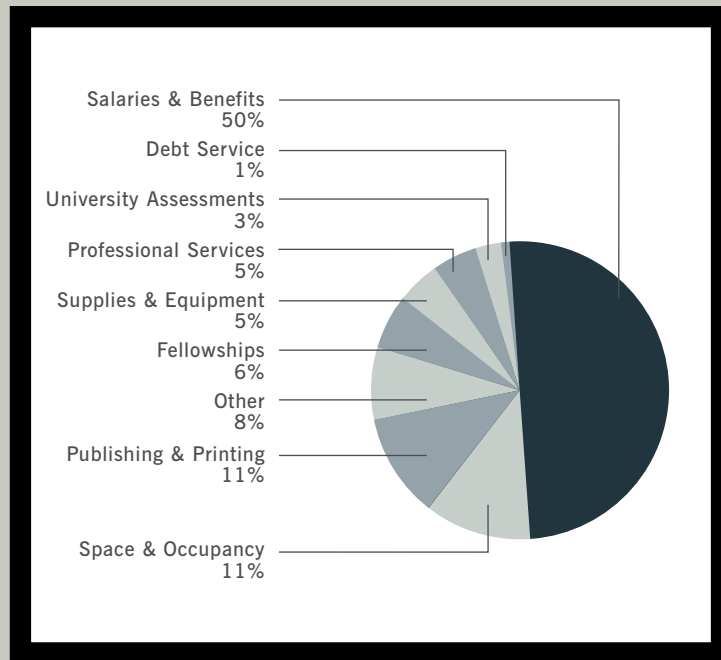
Operating expenses increased by \$13 million, or 4.4 percent, to \$307 million.

CASH FROM OPERATIONS

Cash from operations grew by \$9 million to \$24 million. In addition, gifts from prior years, available to be spent pursuant to the donors' specifications, added \$13 million to the School's cash flow, equal to the prior year. Cash before capital activities thus grew by \$9 million to \$37 million.



EXPENSES



EXPENSE COMPONENTS, FY 2005

CAPITAL EXPENSES

Capital expenses for construction and renewal of campus facilities rose by \$25 million to \$79 million, primarily due to the Aldrich Hall and Baker Library projects. Additional funding came from gift accounts for specific capital projects amounting to \$49 million, as well as \$7 million in new borrowings. The comparable fiscal 2004 amounts were \$28 million and \$7 million, respectively.

DEBT

Total debt outstanding at June 30, 2005, increased to \$74 million, from \$70 million a year earlier.

RESERVES

Unrestricted reserves decreased \$4 million to \$52 million at the end of fiscal 2005. In addition, HBS added \$15 million to endowment reserves, bringing the total in such endowment funds to a June 30, 2005, end-of-year value of approximately \$50 million.

ENDOWMENT & CURRENT USE FUNDS

The market value of the HBS endowment and current use funds increased by approximately 17 percent to \$2.1 billion as of June 30, 2005, from \$1.8 billion a year earlier, reflecting both strong returns and new endowment gifts. Total return on the endowment for fiscal 2005 was +19.2 percent.

GIFTS

Alumni and friends continued to be exceptionally generous in fiscal 2005. As the School's capital campaign continued, cash from gifts increased by \$25 million, or more than 25 percent from fiscal 2004, to \$123 million. Much of this new cash was the result of donors paying off existing pledges, thus pledge balances decreased from \$122 million to \$83 million. This generosity remained vital in fiscal 2005, as current use gifts and endowment distribution together generated 21 percent of the School's revenues, the same proportion as last year. Approximately 29 percent of MBA alumni made a gift to the School in fiscal 2005.

Five-Year Financial Data Summary

IN MILLIONS	FOR THE YEAR ENDED JUNE 30,				
	2001	2002	2003	2004	2005
Revenues	\$ 280	\$ 286	\$ 294	\$ 309	\$ 331
Expenses	270	279	286	294	307
Cash from Operations	10	7	8	15	24
Capital Investments	54	34	39	54	79
Debt Outstanding	83	91	71	70	74
Unrestricted Reserves	68	70	56	56	52
Endowment & Current Use Funds	1,374	1,339	1,485	1,766	2,065
TOTAL ASSETS	\$ 1,874	\$ 1,895	\$ 2,038	\$ 2,367	\$ 2,693

Key Facts

	2001	2002	2003	2004	2005
MBA PROGRAM					
Applications	8,893	10,382	8,540	7,139	6,559
Percent Admitted	12%	10%	12%	15%	16%
Yield	87%	89%	90%	87%	89%
Enrollment	1,773	1,822	1,800	1,800	1,794
DOCTORAL PROGRAMS					
Applications	729	782	821	744	587
Percent Admitted	3%	3%	3%	4%	4%
Yield	82%	83%	74%	70%	80%
Enrollment	95	94	91	98	98
EXECUTIVE EDUCATION					
Enrollment	7,296	6,798	6,982	7,360	8,133
<i>(programs range from 2 days to 9 weeks)</i>					
FACULTY					
Faculty Positions <i>(full-time equivalent)</i>	188	196	207	204	201
Teaching Materials Produced	714	640	653	588	561
Research Articles Published	141	133	119	127	103
Books Published	40	34	24	23	36
STAFF					
Staff Positions <i>(full-time equivalent)</i>	1,043	1,117	1,066	1,017	1,044
PUBLISHING					
Cases Sold	6,488,000	6,434,000	6,663,000	6,999,000	6,958,000
HBS Press Books Sold	1,078,000	1,010,000	771,000	1,180,000	1,272,000
HBR Circulation	240,000	238,000	247,000	240,000	240,000
HBR Reprints Sold	3,342,000	2,924,000	2,908,000	2,910,000	2,929,000
CAMPUS					
Number of Buildings	32	33	33	33	33
Square Feet	1,421,241	1,470,241	1,476,041	1,476,041	1,512,753

Case Studies

FULFILLING THE MISSION:

TO EDUCATE LEADERS WHO MAKE
A DIFFERENCE IN THE WORLD

914

STUDENTS ENROLLED,
CLASS OF '07

38%

WOMEN

33%

INTERNATIONAL

22%

U.S. MINORITY

Students

Successful case-method teaching and learning are achieved by having students with widely varied backgrounds, experiences, and viewpoints in the classroom. The MBA Class of 2007 represents more than 65 countries, with the largest percentage of women students in the School's history (and higher than that of most other leading business schools). As part of the School's Early Career Initiative, more than 20 students were admitted directly from college, and over 20% of the class has less than three years of full-time work experience. Graduates, on average, had 2.3 job offers from which to choose. Of those seeking employment, 94% received offers before Commencement, and 88% accepted offers.

M

B

Ensuring Success in the Classroom

100

MILES OF CABLE
CONNECTING
CLASSROOMS

Curriculum

While the fundamentals of the MBA curriculum—the required first year and the elective second year—have remained unchanged for many decades, innovation is constant. In FY '05, an online prematriculation module in Accounting was added to a suite of three others so that all students, regardless of background, entered the program with a shared understanding of the subject. New courses are launched annually in the elective curriculum, including (in FY '05) Entrepreneurship and Global Capitalism, and Commercializing Science and High Technology. Many students take their studies off campus and into the workplace through field-based learning. The Social Enterprise Initiative, for example, matched 152 students with pro bono consulting projects through the Volunteer Consulting Organization, a student club of HBS.

Facilities

The residential campus is a distinguishing and key component of the School's learning model. In FY '05, the renovation of seven Aldrich classrooms, corridors, and study alcoves was completed, and work began on the remaining nine classrooms and nearby spaces. Each classroom, like those in Hawes Hall, now incorporates in-room polling, video capture, and two-way webcasting. Wireless networking was implemented throughout the campus. The Exchange, a new space in Baker Library, was launched to provide real-time business and financial information for the HBS community. It features international newspapers, terminals with access to online resources such as Bloomberg and Thomson StreetEvents, and special presentations.

RECENT PROGRAM INNOVATIONS

- Required first-year courses: The Entrepreneurial Manager and Leadership and Corporate Accountability
- Development of diverse six-member Learning Teams, assigned at orientation to work together during the first year on graded projects and as study groups

A

Innovations

In FY '05, HBS launched a joint MD/MBA program with Harvard Medical School, allowing students to complete an integrated curriculum in just five years. Joint or concurrent degrees are also offered with the Law School and the Kennedy School of Government. These programs enable students to build a strong foundation of general management and leadership skills while pursuing specific or emerging fields; MD/MBA graduates, for example, may choose to manage complex health care delivery organizations. Other activities, such as the HBS Business Plan Contest, enable students to hone their entrepreneurial skills, whether in the for-profit or nonprofit sector.

500 Cases prepared during two-year program

30% International cases taught in required curriculum

32% New cases taught

243 Students presenting HBS Business Plan Contest entries

100 Case protagonists and lecturers on campus each semester



201

TOTAL FACULTY

28 New Faculty

23% Women Faculty

19% U.S. Minority Faculty

Faculty

The School's faculty bring diverse experience as scholars, executives, and entrepreneurs into the classroom to create a dynamic learning environment. In FY '05, HBS invested nearly \$77 million in faculty research. The C. Roland Christensen Center for Teaching and Learning (CCTL) was launched, and Willis Emmons (MBA '85, PhD '89) was named its first director. The CCTL works one-on-one with new and experienced faculty to help them develop and sharpen their classroom skills, and with all faculty in identifying and sharing best practices. Faculty wrote 209 new field cases, and an additional 352 other notes and public source cases. The Course Development Research Seminar was also launched to support faculty developing new courses and course materials.

Our theory is that organizations naturally downplay ambiguous threats.

As future leaders,
our students need to learn how to develop processes for investigating and exploring the nature and seriousness of the ambiguous threats that their organizations will face.

Enriching the Case Method

Eighty-one seconds after the space shuttle *Columbia's* liftoff from Cape Canaveral on the morning of January 16, 2003, a piece of insulating foam broke off the external fuel tank and struck the orbiter's left wing. In a meeting held midway into the flight, NASA's Mission Management Team examined the available evidence and dismissed the foam strike as a minor anomaly. *Columbia* reentered the Earth's atmosphere on February 1, 2003, and disintegrated in the sky above Texas. The seven astronauts onboard lost their lives.

Why was NASA wrong? What are the implications for management practice? A new addition to the School's portfolio of multimedia cases, "*Columbia's* Final Mission" brings these questions to life in the classroom. In a web-based software application that presents video, audio, and print content drawn directly from NASA's archives, the case places students in the role of one of six NASA managers and engineers during the fateful days leading to the *Columbia* disaster.

"Our theory is that organizations naturally downplay ambiguous threats," says faculty member Michael Roberto, who, with colleagues Richard Bohmer and Amy Edmondson, authored the case. "As future leaders, students should not leave HBS without a deep understanding of this phenomenon. Moreover, our students need to learn how to develop processes for investigating and exploring the nature and seriousness of the ambiguous threats that their organizations will face."

"*Columbia's* Final Mission" facilitates this understanding by deploying the case method in a unique way. As they prepare for the class discussion, students are exposed to different mixes of information depending on which of the six protagonist roles they are playing. This asymmetry stimulates highly energized interaction in the classroom.

"The case leads students right to the precipice—the Mission Management Team meeting on Flight Day 8 when NASA decided the foam strike was not a safety concern," says Roberto. Instead of exploring the case through classroom

discussion, students reenact this crucial meeting as they think it actually happened, playing their assigned roles as members of the NASA team. After reviewing the reenactment, they rerun the meeting based on how they believe their protagonists should have behaved. “The process in the classroom can be chaotic, but the results are incredibly powerful,” says Roberto.

“I played the role of the NASA junior engineer who knew the most about the foam strike,” says Matt Beecher (MBA ’05). “During the Mission Management Team meeting, I couldn’t believe how much of the information that I saw on my desktop hadn’t been allowed to flow freely up and down the organization. My first reaction was surprise, which turned to frustration, because the discussion around the table was less urgent than I had expected. When companies are facing ambiguous threats, there may be a few splinters of clarity in certain roles. They need processes that encourage dissenting voices to speak up without fear of retribution.”

Logging onto “*Columbia’s Final Mission*” from their laptops prior to class, students watch a mini-documentary produced at HBS. Providing rich background for further work on the case, the film vividly illustrates the history of America’s space program from the 1950s to *Columbia’s* final launch.

Faculty Courseware Development, FY ’05

HBS completed more than 40 instructional technology projects, including multimedia cases, as well as online case simulations and tutorials for use in MBA and Executive Education courses and programs:

Among them was the Venture Capital Game, an in-class simulation in a second-year MBA course on venture capital and private equity. Teams of students function as venture capital firms, deciding whether to invest in companies seeking first-round financing.

The School’s new online tutorials included a unit on micro-economics for the first-year MBA course on strategy. Online tutorials allow students to quickly review key concepts relevant to cases before discussing them in class.

HBS also introduced a web-based prematriculation module on accounting to a set of online courses that students are required to pass before entering the MBA Program.

To support wider use of online learning, the School completed a multiyear rebuild of the classroom networking infrastructure at Hawes and Aldrich Halls. The wireless network now has enough bandwidth, for example, to involve all 900 first-year MBA students in simultaneous online simulations.

Students then begin experiencing the mission as it unfolds day by day. They view video clips from interviews with outside experts, as well as with former astronauts and NASA officials. These videos help clarify the sequence of concerns and options considered during the flight by the Mission Management Team. Students listen to audio reenactments of key NASA meetings, read e-mails the individuals received, review memos and documents presented at meetings, and even pick up virtual “while you were out” slips that recount critical phone calls.

“During the Mission Management Team meeting, I couldn’t believe how much of the information that I saw on my desktop hadn’t been allowed to flow freely up and down the organization.”

As a new feature of the MBA and Executive Education curricula, “*Columbia’s Final Mission*” demonstrates that technology can inject visceral doses of realism into the classroom. “Actively confronting problems that people actually have had to solve in the past not only enriches the teaching, but helps ensure that the concepts being taught have real power in practice,” says Bohmer. For nearly a decade, HBS has invested heavily in software and IT infrastructure designed to bring this kind of experience to an expanding range of courses.

During fiscal 2005, 180 second-year MBA students experienced “*Columbia’s Final Mission*” in the elective course General Management: Processes and Action. The case was also taught in the School’s Executive Education programs to management teams from Novartis and the World Bank. In addition to including “*Columbia’s Final Mission*” in future course curricula, the School’s publishing unit will be adding the software to its product offerings for distribution as a new multimedia case. In this way, the faculty’s work will be disseminated to corporate and academic audiences around the world.

“Everyone knows what happened to *Columbia*, but being involved in the dysfunction that led to the tragedy is a truly striking experience for students,” says Roberto. “The case is a vivid lesson, not only in how organizational failures like NASA’s can arise, but in how to prevent them from happening, and how to manage them when they do occur.”



HBS India Research Center

THE HBS INDIA RESEARCH CENTER IS THE LATEST ADDITION TO THE SCHOOL'S NETWORK OF RESEARCH CENTERS AND OFFICES IN ASIA, LATIN AMERICA, EUROPE, AND CALIFORNIA. BASED IN MUMBAI, THE CENTER DEVELOPS CONTACTS FOR THE FACULTY WITH REGIONAL LEADERS AND COMPANIES.

Building Ventures in Latin America

THIS NEW EXECUTIVE EDUCATION PROGRAM, OFFERED IN CONJUNCTION WITH SIX OF THE LEADING BUSINESS SCHOOLS AND UNIVERSITIES IN BRAZIL, WAS LAUNCHED IN PARTNERSHIP WITH THE SCHOOL'S LATIN AMERICA RESEARCH CENTER.

FULFILLING THE MISSION:
CREATING KNOWLEDGE GLOBALLY

Creating Knowledge Globally

The law of gravity exerts an identical force at any point on the globe, but is the same thing true for theories of management? “A tremendous amount of management knowledge has been based on the experiences of U.S. companies, because the United States is where the body of management research largely originated,” says Professor Krishna Palepu, Senior Associate Dean for International Development, who leads the School’s Global Initiative.

“It was only recently that we began asking whether the conclusions coming from this research are valid universally,” Palepu says. “Before HBS created its global research centers, it was difficult to test which theories are globally relevant, and which are not.”

“Now that we are doing more and more research around the world, we are realizing that concepts at either end of the spectrum—those related to management strategy and those at the tactical level—tend to travel seamlessly across borders,” adds Professor Debora Spar, Senior Associate Dean and Director of Research. “But at an intermediate level, where management practices are contextual due to the influence of institutions, culture, or government, best practices may be radically different depending on the location. In practical terms, this means that organizations outside the United States face an array of problems that U.S. business schools have not studied in a systematic manner.”

Understanding these problems is a key focus of the School’s Global Initiative. “The future leaders of enterprises in countries around the world are populating our classrooms at HBS,” says Palepu. “We want to ensure that what students learn here at the School is relevant to the specific business environments they will encounter when they leave.”

Says Yegor Popov (HBS ’06), “In our class, Globalization of Emerging Markets, we explored the corporate and entrepreneurial realities of countries such as India, China, and Brazil, where there are many points of difference from business reality in the United States. Upon graduation I plan to return to Russia, and I know the key areas where I should focus my attention based on what various

companies have done in similar emerging market situations. I have a much better understanding of how Western partners view emerging markets, the differences in their expectations, and how to address them.”

“I have a much better understanding of how Western partners view emerging markets, the differences in their expectations, and how to address them.”

Since launching the Global Initiative in 1996, the School has established research centers on four continents, and the HBS faculty has generated significant intellectual capital in field locations outside the United States. The research centers assist the faculty in disseminating this new knowledge within the academic and business communities in their regions. In this way, the faculty’s global research not only enriches teaching and learning at HBS; its deployment in practice stimulates economic growth around the world.

“The first step in creating a global research center is to engage HBS alumni in the region,” says Professor Richard Vietor, Senior Associate Dean and Faculty Chair for Asia. “Alumni are invaluable in helping us identify the phenomena that are locally interesting, and in opening doors to the companies and individuals our faculty should be meeting as they conduct their research. Alumni are energized—as we are—by the opportunity to study local companies and management issues, develop locally based cases, and then take the new knowledge back not only to HBS, but to organizations in their home countries.”

Another key step in establishing a global research center is recruiting the leadership. After nearly two decades in business consulting and the financial services industry, Ajay Mookerjee (DBA ’88) became the new India Research Center’s Executive Director in February 2005. “HBS faculty interested in India research have identified opportunities in several broad categories, including innovation in the technology and biotech sectors, business models, and strategies for reaching India’s middle-class market of 600 million consumers,” says Mookerjee. More than a dozen faculty members have already committed to starting research projects in India.

The School’s other research centers in Hong Kong, Tokyo, Buenos Aires, Paris, and Palo Alto sponsor programs designed to share with local business and academic leaders the intellectual capital developed by HBS faculty within the region. In May 2005, the Latin America Research Center successfully tested

a new local outreach model by hosting the School's first Global Research Symposium. In an intensive one-day session held in Rio de Janeiro, a small group of Latin America's key business leaders and academics engaged in challenging discussions with HBS faculty who have done research in the area.

"Over the past five years, the Latin America Research Center has assisted the faculty in producing a tremendous amount of knowledge," says Gustavo Herrero (MBA '76), the Center's Executive Director. "Our hypothesis was that focused dialogue involving faculty and local thought leaders would be a powerful way to feed this knowledge back to the region. The symposium exceeded everyone's expectations." Building on lessons learned in Rio de Janeiro, the HBS Europe Research Center in Paris hopes to host the School's second Global Research Symposium.

Millions of people in developing countries enter the market economy each year, driving worldwide demand for management knowledge and skilled leaders. Through the School's Global Initiative, HBS is responding to this demand in a unique way. "The typical model is for U.S.-based business schools to do research in the United States and then distribute the resulting knowledge around the world through educational programs," says Spar. "The HBS approach is to go out into the field with humility and an open mind, and develop intellectual capital in the places where it will be used. We then bring this learning back to globally diverse MBA classes studying here at HBS. When international students return home, they apply this knowledge in practice."

"The HBS approach is to go out into the field with humility and an open mind, and develop intellectual capital in the places where it will be used."

"People often ask why the HBS global research centers don't supplement their research and outreach activities by offering local MBA programs," says Palepu. "We are focused on doing something more challenging, complicated, and cost-intensive; that is, doing field-based research around the world to create enduring knowledge that will be more valuable to the societies in these regions in the long term."

Revitalizing Baker Library

Baker Library has been the iconic image and literal center of Harvard Business School since it was dedicated in 1927 with the opening of the campus. Reopened in September 2005 after two intensive years of restoration and new construction, the renovated Baker Library will continue to serve as the physical and intellectual hub of the School.

The Library is home to some of the world's largest and most renowned collections of business information. Refurbished and expanded from 130,000 to 168,000 square feet, at a cost of \$53.4 million, Baker Library now provides secure, climate-controlled facilities for both the historical and the general collections, and accommodates a broader range of services to support the HBS community in creating, preserving, and exchanging intellectual capital.

The main lobby on the north side of the building, painstakingly restored to look much as it did in 1927, includes exhibit space that will showcase the lessons and legacies of business history, the history of the School, and current faculty research. A newly constructed south entrance—like the main entrance of Spangler Center—further opens the campus to Boston's Allston neighborhood, where Harvard University is working with community leaders on its plans for future expansion. In addition to offices and meeting areas for library and academic support staff, Baker Library now houses 67 faculty offices and a new Faculty Commons that includes three research seminar rooms.

Among the new spaces within Baker Library is The Exchange, a gathering place on the first floor where students, faculty, and staff can observe and discuss market activity and business news from around the globe. An array of wall-mounted monitors displays content from online sources and 19 domestic and international newspapers. Computer terminals provide access to all of Baker Library's online resources, in addition to proprietary financial databases.



THE NORTH FOYER



THE STAMPS READING ROOM

HBS DOCTORAL PROGRAMS, 2005:

700

APPLICATIONS RECEIVED

24

STUDENTS ADMITTED

83%

YIELD

91

TOTAL ENROLLMENT

28

AVERAGE AGE AT
ADMISSION

20%

INTERNATIONAL

9

DEGREE PROGRAMS
OFFERED

90%

ACCEPTED TEACHING JOBS
AFTER GRADUATION

\$250,000

INVESTMENT PER CANDIDATE
(5 YEARS OF STUDY)

FULFILLING THE MISSION:
EDUCATING ACADEMIC LEADERS

Educating Academic Leaders

In their role as teachers, graduates of HBS Doctoral Programs extend the School's reach by educating and influencing thousands of future leaders at top-tier business schools around the globe. In their role as scholars, HBS doctoral graduates make valuable contributions to knowledge that has power in practice. Many of these graduates are recruited to teach at HBS, where they help build a rich and vibrant intellectual community.

In fiscal 2005, the School's average investment for doctoral candidates during their five years of study and research exceeded \$250,000 per candidate. This investment will increase over several years, beginning in 2006. Recognizing the growing impact of doctoral education at HBS, a gift of \$25 million from Hansjoerg Wyss (MBA '65) will enhance the experience of current HBS doctoral students and finance ambitious improvements in the School's Doctoral Programs. The endowment established by Mr. Wyss is the largest gift ever given to a doctoral program at a business school.

"HBS has significantly expanded its commitment to doctoral education during the past five years," says Professor Amy Edmondson, Chair of the Doctoral Programs. "New courses, additional MBA course participation, more rigorous training in academic disciplines, and added emphasis on teaching skills have enhanced our doctoral curriculum. At the same time, more faculty are involved in teaching the programs and in mentoring doctoral candidates. Mr. Wyss's generous gift will allow us to build on this momentum and further strengthen the School's Doctoral Programs."

"Our distinctive competence in doctoral education is in training scholars who will contribute to the growth of knowledge that has relevance for both theory and practice," says Janice McCormick, Executive Director of the Doctoral Programs. "We encourage our doctoral students to be flexible and eclectic in selecting their research methodologies, and to immerse themselves in the organizations they are studying in the field. Ambitious field research is expensive, but it results in deeper understanding."

In fiscal 2005, student doctoral theses included field research in areas ranging from retail, banking, and health insurance to human services, finance, and footwear design.

“We expect graduates of our doctoral programs not only to be outstanding scholars but excellent teachers, and to know how to communicate their ideas by connecting with an audience,” says McCormick. “That’s why we require

“HBS encourages its doctoral students to be flexible and eclectic in selecting their research methodologies, and to immerse themselves in the organizations they are studying in the field.”

candidates in our Doctor of Business Administration program to become a teaching assistant for an MBA course, or to take a course on case-method teaching. They also receive personal coaching aimed at enhancing their presentation skills. Producing outstanding educators is a crucial doctoral program objective at HBS—one that requires continued innovation and investment to sustain.”

In addition to enhancing the doctoral curriculum, the Wyss gift will enable the School to cover a larger proportion of student living expenses through increased stipends. It also will allow HBS to create new fellowships, and to modestly increase Doctoral Program enrollment. Sherman Hall, which houses the programs’ offices, will be renovated and rededicated as Wyss House, and doctoral candidates receiving support will be known as Wyss Fellows.

HBS has a long history of attracting outstanding doctoral candidates. Students apply to one of five doctoral programs at the School: the Doctor of Business Administration (DBA), managed exclusively by HBS, and four programs offered jointly with the University’s Graduate School of Arts and Sciences. The DBA program comprises five special fields: Accounting and Control; Marketing; Policy and Management; Strategy; and Technology and Operations Management. The PhD programs offered jointly with the University include Business Economics; Health Policy; Information, Technology and Management; and Organizational Behavior.

In selecting candidates for admission to its doctoral programs, the School seeks students whose interests are equally at home in academia and in business. The programs receive 700 to 800 applications annually for an entering class of

approximately 20 students. Yield among admitted students has ranged from 70–85%—approximately double that of comparable schools. Total enrollment is nearly 100 students.

Approximately 90 percent of the School’s doctoral students accept teaching positions after graduation. More than half of these graduates have gone on to teach at HBS and other top-tier business schools, including the University of Chicago, London Business School, the University of Michigan, MIT, Stanford, and Wharton. In fiscal 2005, 11 of the School’s 13 graduates accepted university teaching or academic research positions, and the remaining two individuals plan to begin academic careers during the summer of 2006.

Graduates of the School’s doctoral programs currently serve on the faculty or as president, dean, or associate dean at many leading schools and universities, and its doctoral alumni have made important contributions to the fields of management and management education. As members of the HBS faculty, they have been instrumental in sustaining its tradition of case-based learning and field-based research, as well as in leading and shaping the School.

“Our goal is to continue attracting a diverse group of brilliant young people destined for notable accomplishments as members of the next generation of university and business school faculty,” says Edmondson. “Training future academic leaders who will do research and teach the HBS way is crucial to advancing the School’s mission.”

DBA: Power in Practice

Combining academic rigor and managerial relevance, the DBA program provides students with the flexibility to apply a broad range of disciplines and research methods to their chosen area of study. In addition, students benefit from the wide range of faculty expertise in management fields, such as accounting and marketing, and multiple opportunities to actively pursue field-based research.

ACCOUNTING & CONTROL

MARKETING

POLICY & MANAGEMENT

STRATEGY

TECHNOLOGY & OPERATIONS MANAGEMENT

PhD: Disciplinary and Management Expertise

The PhD programs are offered jointly by Harvard’s Graduate School of Arts and Sciences (GSAS) and Harvard Business School. They combine the disciplinary expertise of a GSAS department with the management expertise of HBS. As a result, students build a strong foundation in a particular discipline and then apply those methods and approaches to their research on relevant managerial problems.

BUSINESS ECONOMICS

HEALTH POLICY

INFORMATION, TECHNOLOGY & MANAGEMENT

ORGANIZATIONAL BEHAVIOR

We have yet to encounter an urban school district in this country that has achieved excellence at scale. Our objective is to take isolated excellence within a district and spread it across the entire school system.

FULFILLING THE MISSION:
EFFECTING MEANINGFUL CHANGE

Effecting Meaningful Change

In a joint venture with the Harvard Graduate School of Education (HGSE), HBS is involved in an innovative partnership with the leaders of nine of the nation's largest public school districts, representing more than 1 million students. The goal of Harvard University's Public Education Leadership Project (PELP) is to adapt and integrate existing management concepts, as well as to create new knowledge, within the demanding context of public education, and dramatically improve student achievement in these districts.

"You can find pockets of excellence—great schools in underperforming districts and wonderful classrooms in terrible schools—but we have yet to encounter an urban school district in this country that has achieved excellence at scale," says faculty member Stacey Childress (MBA '00), the senior researcher managing PELP for HBS and HGSE. "Our objective is to figure out how to crack the code—how to take isolated excellence and spread it across an entire school system."

Professor Allen Grossman, HBS faculty chair, says, "Many of the challenges faced by leaders in K-12 public education are analogous to those in the corporate world. But we also know that management theory requires substantial adaptation and modification when applied in the complex environment of an urban school district. Because the various stakeholder constituencies have competing interests, it can be difficult even getting to square one—that is, reaching agreement that the primary job of a public school is to educate all of the students to their highest potential."

Drawing on insights and proven approaches from the corporate, nonprofit, and education sectors, improving the management of human capital has become a key focus for PELP. "Every team told us their human resources systems are broken," says HGSE Professor Robert Schwartz. "Education is a labor-intensive sector, yet for reasons specific to the public education environment, staff training, development, deployment, and compensation are not high priorities for most school districts."

"One of the most critical challenges is recruiting great people for hard-to-staff

schools—how do you motivate the best teachers and administrators to take on the most challenging assignments?” says Schwartz. “Solving this problem has become a major concern for the school leaders participating in PELP.”

With principal funding from the HBS Class of 1963, PELP operates as a learning laboratory. The nine participating school districts employ in excess of 10,000 people and manage annual budgets that average more than \$1 billion. They include some of the country’s largest cities, including Boston, Chicago, Memphis, and San Francisco. Based on a rigorous selection process, a joint HBS-HGSE faculty design team invited the districts because each had a performance improvement strategy and a long-term commitment to enhancing student achievement. They also demonstrated a base of school board and community support for systemwide change.

“The fundamental purpose of K–12 education is to drive student achievement. Accomplishing this in large and complex urban districts demands excellent management practice across the system.”

The districts had free rein in assembling their PELP leadership teams, and the teams are full partners in the knowledge development process with a core group of 10 faculty from HBS and HGSE. The two groups of faculty bring complementary strengths to the partnership, which draws on knowledge about management in the corporate world originating at HBS, coupled with HGSE’s understanding of school culture and effective pedagogy. “HBS and HGSE didn’t initiate PELP as institutions, but rather as faculty at each school who had previously worked with one another,” says Schwartz. “Coming from diverse backgrounds, we found that we shared a desire to make a difference in the world of urban public schools.”

Now in its third year, PELP consists of two principal components. The first is a weeklong executive education program offered on the HBS campus each summer, consisting of newly developed content. Senior scholars from HBS and HGSE also work with district leadership teams of eight individuals to develop strategic improvement goals for the coming school year.

The summer program is followed during the school year by periodic on-site facilitation involving the district leadership teams, faculty, and research associates. At the same time, HBS and HGSE faculty generate new knowledge about the

connection between effective leadership and management and educational outcomes. These deep field-based engagements have resulted in more than 15 cases, which will be disseminated to the wider audience of public education leaders nationwide.

When they return to the School's campus in July 2006, the nine PELP district teams will collaborate with their HBS and HGSE faculty partners to evaluate their progress and the program's impact on their districts. The schools are considering future options for disseminating the knowledge generated by PELP on a broad basis, while continuing the core learning laboratory process with a group of urban school districts.

Childress says, "The fundamental purpose of K-12 education is to drive student achievement. To accomplish this in large and complex urban districts, you need excellent management practice across the system at scale. Our long-term goal for PELP is to generate and communicate ideas that have real power in practice, so that education leaders, managers, policymakers, and other stakeholders can effect meaningful change in public school systems across the country."

Participating School Districts	Students	FTE Staff & Teachers	Expenditures (FY '04; in millions)
Anne Arundel County, Maryland	74,500	8,100	\$ 698
Boston, Massachusetts	60,200	7,900	1,001
Charleston, South Carolina	44,100	3,700	470
Chicago, Illinois	434,400	27,600	4,159
Harrisburg, Pennsylvania	7,900	1,100	117
Memphis, Tennessee	116,200	12,900	944
Montgomery County, Maryland	139,200	17,900	1,676
San Diego, California	138,000	13,900	1,701
San Francisco, California	57,800	5,000	572
Total	1,072,300	98,100	\$ 11,338

Financial Review

From the Chief Financial Officer

Harvard Business School's financial results were exceptionally strong in fiscal 2005. Global economic conditions remained favorable, and demand for management knowledge in the corporate and academic markets accelerated for the second consecutive year. The School's operations expanded to accommodate this growth in demand. Total revenue in fiscal 2005 exceeded our forecast by 3 percent, growing \$22 million, or 7.1 percent, from last year to \$331 million.

Nearly \$13 million of this top-line growth was attributable to the School's market-sensitive units, Executive Education and Harvard Business School Publishing (HBSP), which together generate more than 50 percent of our revenue. Endowment distributions accounted for another \$6 million of the fiscal 2005 revenue increase, reflecting gifts to The Campaign for Harvard Business School and robust investment returns. The remaining \$3 million of revenue growth was associated with the planned increase in MBA tuition and fees. Consistent with past years, the MBA Program produced about one-fifth of the School's total revenue.

This revenue growth enabled HBS to make further investments in teaching and research initiatives that expand the reach of the

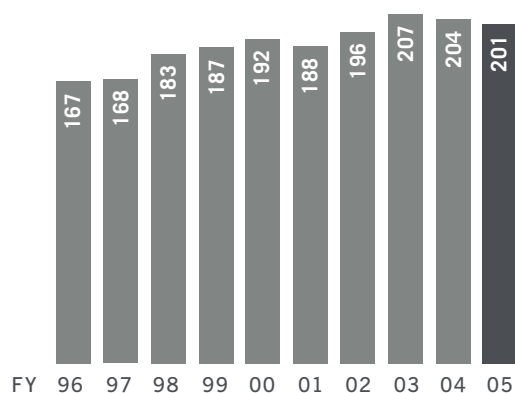
School. At the same time, the School's faculty and administrative departments continued to do a remarkable job in holding the line on costs. We had budgeted an \$18 million increase in spending for fiscal 2005, but the School's total operating expenses grew only \$13 million, or 4.4 percent, to \$307 million.

Expenses for employee compensation—the largest cost in our budget—increased 10 percent from fiscal 2004 to \$153 million. This growth was largely related to the anticipated increase in University-wide employee health-care and pension rates, which increased the School's benefits expense by 29.5 percent from last year. Excluding employee compensation, the School's expenses actually decreased nearly 1 percent for the year, despite a 19.3 percent increase in MBA fellowship spending.

Education and research are the core activities of the School, and salaries and benefits for faculty and their research associates comprise nearly half of our employee compensation costs. To support academic innovation and broader impact for the School, our long-term plan calls for a modest amount of continued faculty growth.

In the short term, however, the size of the faculty can fluctuate, depending on personal decisions that lead to retirements and departures in any given year, as well as the recruiting market. Although the size of the faculty, as measured on a full-time equivalent (FTE) basis, has declined by six FTEs during the past two years, we expect to see the faculty grow in fiscal 2006.

The size of the School's administrative staff is another important planning consideration. Despite the expansion in our core teaching and research activities and the growth in Executive Education and HBSP, administrative



FACULTY (FULL-TIME EQUIVALENT)

staff FTE levels decreased slightly from fiscal 2001 through fiscal 2004. Recognizing that continuing to operate under such tight constraints would begin to compromise the School's ability to support its faculty, students, and alumni, we expanded our administrative staff by 27 FTEs, or 2.7 percent, in fiscal 2005.

Fiscal 2005 marked the conclusion of a decade of campus renewal and expansion at HBS, and was a peak year for investment in physical facilities. Capital expenses grew 46 percent from \$54 million in fiscal 2004 to \$79 million. The restoration and expansion of Baker Library, essentially completed during the year, consumed \$38 million in capital. HBS also invested \$21 million in renovating Aldrich Hall. The remaining \$20 million in capital spending included the third annual payment to support the School's role in the University's development in Allston, as well as student residence and faculty office renovation projects on the HBS campus.

Funding for the School's fiscal 2005 capital activity was derived from gifts donated specifically for these projects, new borrowings, internally generated cash, and reserves. Our capital financing activities reflected the planned shift toward use of cash and debt in funding the final phase of Aldrich renovations. Although HBS added \$4 million to its debt balance in fiscal 2005, the School's reserves balance remained well within its target range, and at a level that will allow HBS to continue investing in strategic opportunities.



CAPITAL INVESTMENT

A LOOK AHEAD

In planning and budgeting for fiscal 2006, we forecast continued growth in the corporate and academic learning markets served by the School, but at a more modest pace than in fiscal 2005. Carrying strong top-line momentum and a reasonably sized fixed-cost structure into the new fiscal year, HBS is well-prepared for more subdued growth.

In Executive Education, we expect to see continued growth in program enrollment, driven by new offerings in the core general management portfolio, including the new Program for Emerging Leaders (PEL), piloted in early fiscal 2006. Making innovative use of distance learning technology and targeting a new segment of the market, PEL meets growing demand from enterprises that want to provide general management education to their high-potential managers. New products that complement the program experience, such as a series of CD-based learning materials, should drive additional revenue growth.

At HBS Publishing, we will be working to extend the strong fiscal 2005 performance of our major periodical, the *Harvard Business Review* (HBR). Expanding the HBR franchise by enlarging the subscriber base in Asia and further improving global subscriber retention are key objectives. We also plan to grow the HBS Press business by leveraging HBSP's recently established relationships with partners in China and Japan. In addition, HBSP will be adding several modules to the popular *HarvardManageMentor* multimedia suite. Although it will not be easy to repeat the unusually strong top-line growth HBSP achieved in fiscal 2005, we look forward to solid results from our publishing unit in the year ahead.

We expect the HBS endowment to provide additional support for the School's academic programs in fiscal 2006. As a result of the Harvard endowment's strong investment

performance during the past three years, the University has announced a modest increase in the endowment payout rate. Reflecting potential market-driven revenue from HBS and Executive Education, together with incremental distributions of endowment income, we are forecasting another year of revenue growth.

Our operational plans for fiscal 2006 include strategic investments in teaching, research, and faculty development across the School. One key objective is to continue increasing MBA financial aid. The School's long-standing commitment to the case method makes student diversity an imperative. Having students from varied backgrounds on campus and in the classroom enhances the richness of residential life and case discussions, and our MBA financial aid strategy is focused in this direction.

Additional MBA fellowship resources will be deployed to attract students with the strongest leadership potential worldwide and across all demographics. Selective use of supplemental fellowships also will help make it possible for the School's MBA graduates to choose where to make their mark based not on their education debt but on their skills, interests, and long-term goals.

The School's MBA Program will be strengthened academically in fiscal 2006 through the introduction of Learning Teams for all required courses. The faculty's objective is to encourage student interaction in team settings by dividing each class into approximately 150 units of six students representing a diverse mix of backgrounds and interests. Students' work on specific course assignments will be evaluated at the team level.

Enhancing the faculty's effectiveness in the classroom and mastery of case-method teaching is another key objective for fiscal 2006. Dedicated in May 2005, the C. Roland Christensen Center for Teaching and

Learning will be fully operational with staff, office space, and a portfolio of services and programs. Among the center's activities will be the School's first annual Colloquium on Teaching and Learning in fiscal 2006, which will focus on preparing faculty for transitions between MBA, doctoral, and executive program teaching.

The HBS Global Initiative continues to be a strategic priority for the School. The new India Research Center will assist an initial group of more than a dozen faculty with their field research in the region. The School's other regional research centers have been operating for a number of years, and have generated a substantial volume of new, regionally based knowledge. The faculty is committed to realizing mutual benefit from these valuable research opportunities by sharing the knowledge with leaders and practicing managers in the countries where it originated. HBS plans to build on the School's first and highly successful initiative of this kind—the May 2005 Global Research Symposium in Rio de Janeiro—by holding a second symposium in Europe.

Our operating plan for the coming year also reflects the School's strong commitment to information technology as a means of enhancing learning. A key objective is to leverage the recent investment in Baker Library by developing its Research Services group into a knowledge management unit that serves the entire HBS community. With the School's IT group, the Baker Library team will be developing a new information governance structure for HBS.

Planned IT expenditures for fiscal 2006 of \$29 million are consistent with IT spending for the past five years. In addition to the work at Baker Library, a significant portion of this activity will center on Aldrich Hall. The nine Aldrich classrooms slated for refurbishing in fiscal 2006, like those upgraded in fiscal 2005, will feature a variety of technology

innovations, including in-room polling and video capture, and enhanced two-way simulcasting. Fiscal 2006 IT spending also will focus on courseware projects similar to “Columbia’s Final Mission,” highlighted earlier in this report. This investment will support the faculty’s increasing use of electronic simulations and exercises to add a real-life dimension to the study of cases in the classroom.

The School’s total expenses for fiscal 2006 are projected to rise 9 percent to \$335 million from actual spending of \$307 million last year. Although operational scope has expanded, the majority of this increase relates to planned growth in the size of the faculty, amplified by the fact that actual faculty FTEs were slightly fewer than initially budgeted for fiscal 2005. In addition, the School’s fiscal 2006 budget includes modest increases in compensation rates for faculty and staff across the board. It also reflects facilities costs for Baker Library, which reopened in September 2005.

Now that the restoration and expansion of Baker Library has been largely accomplished, capital spending will diminish significantly. The School’s capital budget for fiscal 2006 is \$54 million, down from \$79 million in actual capital expenses in fiscal 2005 and more consistent with recent years. Completing the renovation of Hamilton Hall will be the

School’s largest capital project in fiscal 2006.

The capital budget also includes final costs for the Baker Library project and the concluding phase of renovations at Aldrich Hall. In addition, HBS will be making a further payment to support the School’s role in the University’s de-

velopment in Allston, and office space will be refurbished at Sherman Hall, home to the School’s Doctoral Programs, which will be renamed Wyss House. Beyond fiscal 2006, the School’s capital investments are expected to focus in the near term on renewing MBA residential space.

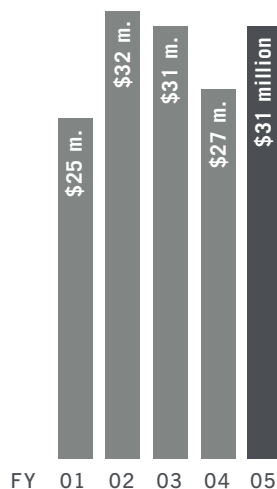
The School’s long-term financial plan includes strategic use of debt to support qualified capital activities. Major campus projects are typically financed first through gifts. As the projects near completion and available funds from gifts are spent, the School pays for the remaining construction through borrowings. As a result of the dramatic increase in capital activity in fiscal 2005, the School concluded the year with additional debt on its balance sheet.

We anticipate further modest increases in the School’s debt level in fiscal 2006 and subsequent years, reflecting the planned transition from gifts to debt financing in order to complete Aldrich renovations, and focus on other residence halls. The University functions as a banker for HBS, as it does for each of the other Harvard schools. The precise level of debt incurred by the School will depend on the interest rate environment and our expectations for the Harvard endowment’s investment return.

Planning and managing the financial affairs of a large enterprise is an increasingly complex and challenging task. As the stewards of the HBS legacy, we welcome and greatly appreciate this responsibility. We are determined to ensure that the School has the financial resources it needs to continue accomplishing its mission for the benefit of this and future generations.



RICHARD P. MELNICK, MBA '92
CHIEF FINANCIAL OFFICER
NOVEMBER 15, 2005



IT INVESTMENT

Managing the School's Gifts and Endowment

As the five-year Campaign for Harvard Business School drew to a close, cash received from gifts, including new cash gifts and payments on prior year's pledges, reached a record \$123 million in fiscal 2005, eclipsing the previous records of \$98 million and \$92 million set in fiscal years 2004 and 2003, respectively. By fiscal year-end, the Campaign

had raised more than \$571 million, surpassing the initial goal of \$500 million by 14 percent. Final results for the Campaign, which concludes on December 31, 2005, will be reported in a subsequent fiscal year.

The enormously successful Campaign has exceeded targets in all areas designated for support—including student fellowships, global research, technology, faculty development, and renewal of the residential Soldiers Field campus—enabling HBS to make critical investments in teaching, research, and MBA fellowships that would not otherwise have been possible.

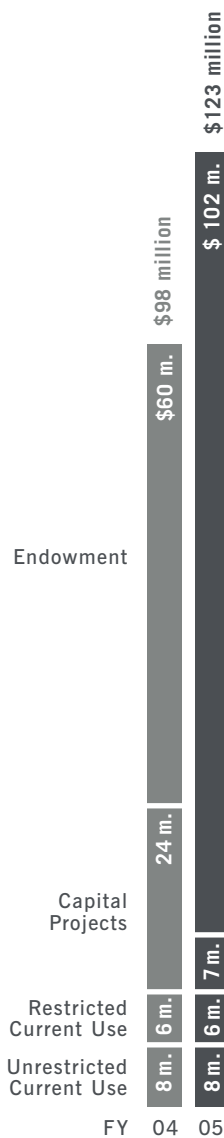
Many of the Campaign gifts will be used to provide endowment funds that ensure long-term financing for these initiatives. The other Campaign gifts, for the most part, were designated to support specific campus construction and renewal projects. In addition, growth in endowment distributions

related to Campaign giving provides significant support to the School's operating budget.

UNRESTRICTED ANNUAL GIVING

Unrestricted alumni gifts provide a steady stream of revenue that helps support the School's operations and, importantly, gives HBS the flexibility to launch new activities, much like the role venture capital plays in funding promising businesses. From fiscal 2002 through fiscal 2004, unrestricted annual giving to HBS produced a total of \$24.2 million in revenue, an amount equivalent to the income from a \$213 million endowment. In fiscal 2005, unrestricted annual giving totaled \$8.3 million.

While individual gifts of \$1 million or more have increased as a percentage of total giving during the span of the Campaign, class reunion and annual giving continues to be the engine that drives innovation at HBS. In fiscal 2005, HBS received gifts from nearly 12,000 individual donors, encompassing alumni of the School's MBA, Executive Education, and Doctoral Programs, as well as friends of the School. Over 10 percent were first-time donors, and more than 2,300 donors increased their gift as compared with the previous year. Nearly 29 percent of MBA alumni made gifts to the School in fiscal year 2005. HBS plans to continue building on this foundation to sustain and increase levels of alumni participation going forward.



GIFTS RECEIVED

ENDOWMENT RETURNS & PERFORMANCE

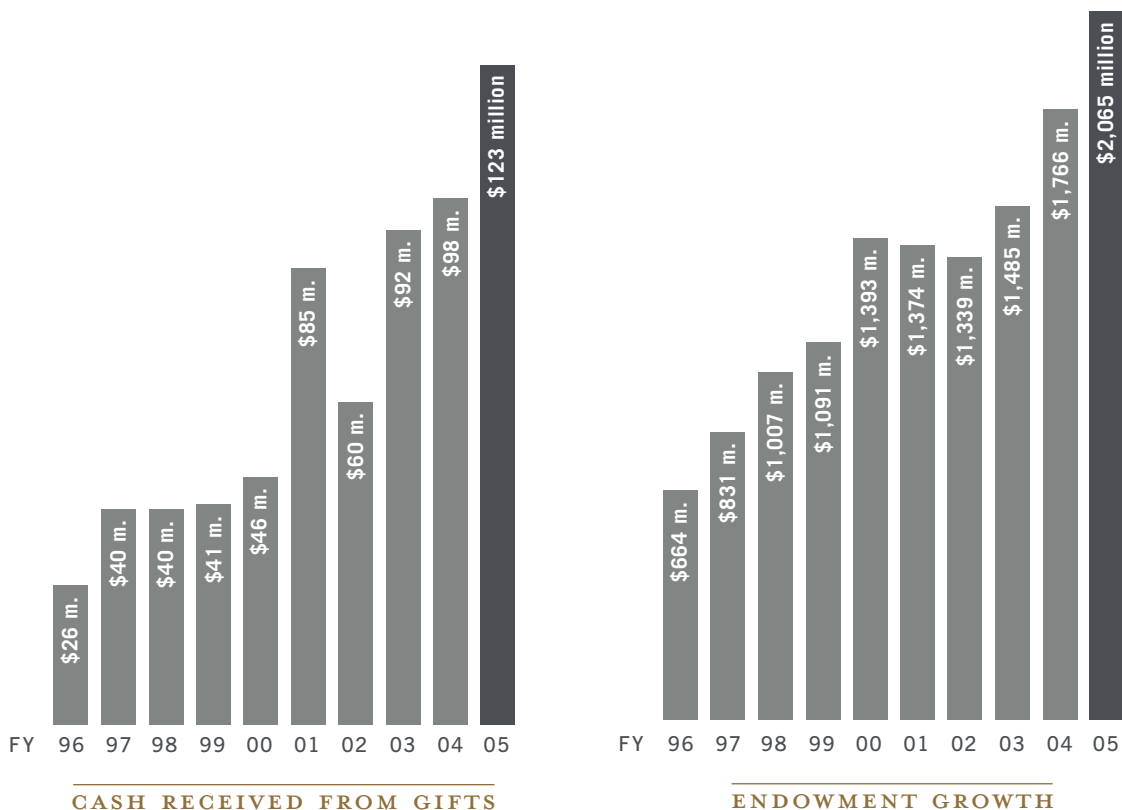
The HBS endowment consists of approximately 800 individual funds established over the years by individual donors, corporations, foundations, and reunion classes. The vast majority of endowment funds are designated for specific uses, and access to individual funds is often specified or restricted. The assets within these funds, along with the University's other endowments, are managed by Harvard Management Company (HMC), a wholly owned subsidiary of the University. HMC was founded in 1974 to manage the University's endowment, pension assets, working capital, and deferred giving accounts. The President and Fellows of Harvard College appoint a Board of Directors that governs HMC.

Most endowment gifts are made in perpetuity, allowing little or no access to principal, while some allow access to principal to provide the School flexibility in achieving the purposes for which they are designated. HBS also uses

the principal and capital appreciation associated with prior-year gifts in line with donor intentions to support key initiatives.

The aggregate amount distributed from the endowment each year is determined according to a disciplined annual payout policy that reflects Harvard Management Company's projections of future endowment returns. The University's investment goal is to fund current initiatives while preserving principal, protecting against inflation, and building capital for the future by achieving superior risk-adjusted returns.

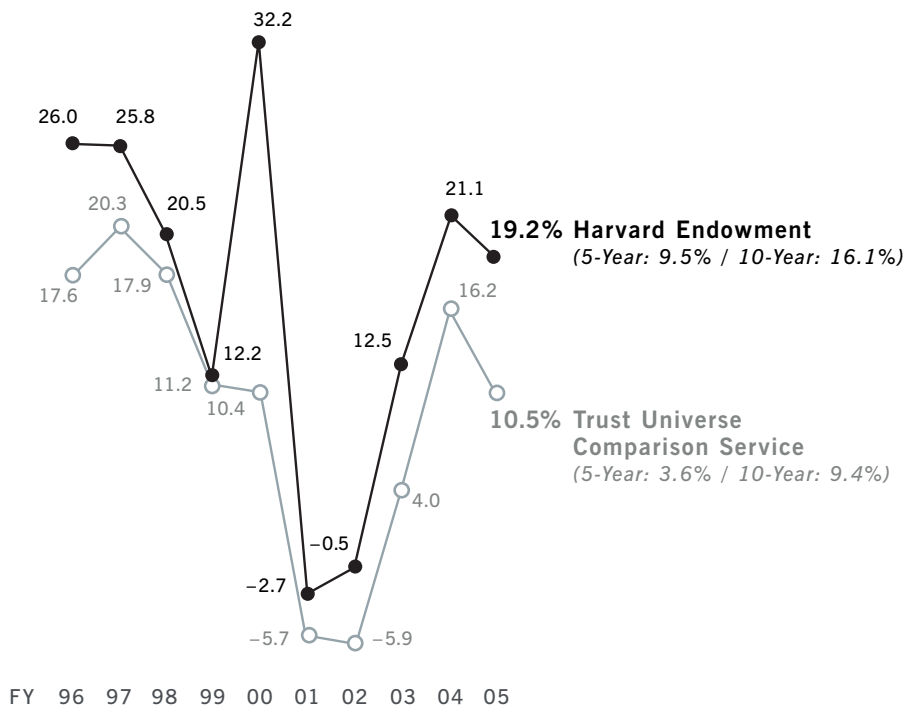
Given this goal, the University's objective is to distribute an average of 4 to 5 percent of the endowment's market value annually. The endowment's performance over the past five years has supported a substantial increase in the annual distribution to HBS. Endowment distributions grew from \$40 million in fiscal 2001 to \$62 million in fiscal 2005, and for the period represented an average of 17 percent of the School's revenue.



Benchmarks for the endowment's performance are provided by the Trust Universe Comparison Service (TUCS), which evaluates comparative performance of large institutional funds. During the past one-, five-, and ten-year periods, the University's endowment has produced annualized total returns of 19.2 percent, 9.5 percent, and 16.1 percent, respectively, compared with the TUCS median returns of 10.5 percent, 3.6 percent, and 9.4 percent, respectively. At fiscal year-end, the University endowment was valued at \$25.9 billion, an increase of \$3.3 billion from \$22.6 billion at June 30, 2004. If the Harvard endowment had earned median returns over the past 10 years—which might be expected from a large, diversified institutional fund—the University would have had \$14.4 billion less in endowment assets than it actually did at the end of fiscal 2005.

As of June 30, 2005, the HBS endowment represented approximately 8 percent of the University endowment. Reflecting both investment return and new gifts, in fiscal 2005 the combined market value of the School's endowments and current use funds grew by approximately \$300 million, or 17 percent, to \$2.1 billion from \$1.8 billion in fiscal 2004.

The endowment's investment results over the past 10 years have been sufficiently strong to provide some cushion against future volatility in market returns. The large size and excellent performance of the endowment do not, however, insulate HBS from financial pressures. While the endowment's recent strong annual returns mark a reversal from the negative returns of fiscal 2001 and 2002, this level of performance is not likely to be sustainable over time.



ENDOWMENT RETURNS

Financial Review

BUSINESS MODEL

The HBS business model is unusual in higher education. More than 50 percent of the School's funding comes from Executive Education and Harvard Business School Publishing (HBSP), units that are particularly sensitive to business conditions. In addition, HBS typically does not accept government or other third-party-sponsored grants for faculty research. This frees the faculty from the constraints and administrative requirements associated with outside funding, and enables them to pursue research opportunities that they believe have the greatest potential to result in new knowledge with power in practice.

Faculty research funding accounts for approximately 25 percent of the School's total operating budget. Research spending includes a significant portion of faculty compensation, as well as direct costs for research support staff, fieldwork, and IT services. Also included are allocated costs for Baker Library resources, campus facilities, technology, and administration. Given the strategic importance of knowledge creation at HBS, as well

as the size of the research budget, planning and efficiently managing the School's research activities is a key operational priority that is shared by both faculty and staff.

Through its Executive Education and HBS Publishing units, the School translates the intellectual capital

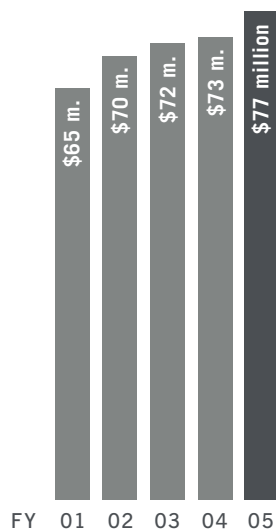
produced by faculty into executive courses, periodicals, books, cases, and eLearning materials. These products are sold in corporate and academic markets around the world, and the School deploys the contribution from these sales to fund the faculty's further initiatives in knowledge creation.

REVENUES

Funding for the School's operations is derived from four primary sources:

- MBA Program tuition and fees. Revenue from the School's core academic program increased to \$68 million in fiscal 2005, from \$65 million in fiscal 2004.
- Executive Education tuition and fees. Revenue from the School's open-enrollment and custom Executive Education programs grew to \$76 million in fiscal 2005, from \$71 million in fiscal 2004.
- HBS Publishing revenue, generated through sales of periodicals, books, cases, and eLearning products. In fiscal 2005, HBSP revenue increased to \$106 million from \$98 million in fiscal 2004.
- Endowment distribution and unrestricted current use gifts. The annual distribution from the School's endowment and revenue from unrestricted current use gifts accounted for \$70 million in funding in fiscal 2005, compared with \$64 million last year.

The School's total revenues have increased at a compound average rate of 5.3 percent annually since fiscal 2000. In fiscal 2005, total revenues increased by \$22 million, or 7.1 percent, to \$331 million, from \$309 million last year. As in fiscal 2004, market-driven growth in HBSP sales and Executive Education enrollment was responsible for the



INVESTMENT IN RESEARCH

majority of the revenue increase this year. Strong growth in distribution of income from the School's endowment added to the revenue gains. The increase in distributions was made possible by the University endowment's solid investment returns, as well as the growth in the size of the HBS endowment resulting from alumni giving to The Campaign for Harvard Business School. MBA tuition and fees continued to rise at approximately the underlying rate of inflation for the higher education sector.

MBA TUITION & FEES

MBA Program tuition and fees increased to \$68 million in fiscal 2005, from \$65 million last year.

MBA tuition and fees amounted to 20.5 percent of the School's total revenue in fiscal 2005. MBA class size at HBS has remained level for the past three years at approximately 900 students. The fiscal 2005 increase in MBA tuition and fees reflected not only inflation in program delivery costs, but also the School's continuing investments in faculty development, campus facilities, and technology. Annual MBA tuition for fiscal 2005 was \$35,600—near the midpoint among the 10 comparable schools tracked by the School—compared with \$33,650 last year.

EXECUTIVE EDUCATION

Executive Education programs generated a record \$76 million in tuition revenue in fiscal 2005, up 7 percent from \$71 million last year, and represented 23 percent of the School's total revenue.

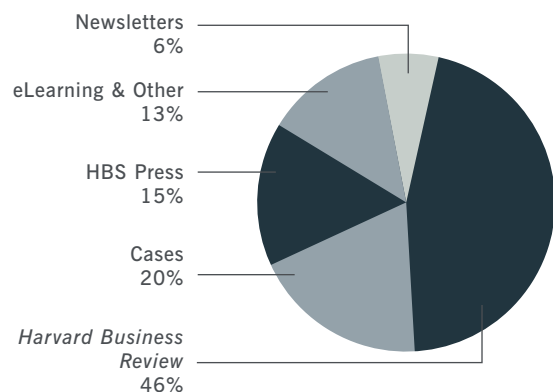
Executive Education programs educate leaders from around the world, while engaging faculty in the key business challenges facing practicing managers today. In this way, Executive Education extends the School's academic reach and helps the faculty ensure that knowledge created at HBS has practical relevance and value.

Executive Education set new records for applications and enrollment in fiscal 2005. Applications rose 11.1 percent from fiscal 2004 to more than 10,000. The number of participants enrolled grew 10.5 percent to 8,133. Fiscal 2005 was exceptionally strong for the core open-enrollment programs. Open-enrollment revenue grew to \$56 million, from \$52 million in fiscal 2004. Spring enrollment in the core Advanced Management Program was particularly strong. At the same time, revenue from custom programs reached an all-time high, increasing to \$20 million in fiscal 2005, from \$19 million last year.

HBS PUBLISHING

Revenue from the School's publishing unit increased by 8.2 percent in fiscal 2005 to a record \$106 million, from \$98 million last year. HBSP generated 32.0 percent of the School's total revenue in fiscal 2005, compared with 31.7 percent in fiscal 2004.

The mission of HBS Publishing is to improve the practice of management and its impact on a changing world. HBSP disseminates the knowledge created by HBS faculty and other thought leaders to corpo-



PUBLISHING REVENUES, FY 2005

rate and academic audiences on a global scale. HBS Publishing has traditionally focused on print media offerings, including our flagship, the *Harvard Business Review*; HBS Press books; and an extensive catalog of HBS cases.

Over the past decade, HBSP has diversified its product portfolio and its revenues by offering CD/DVD-based and eLearning products. In fiscal 2003 and 2004, HBSP posted solid growth in revenue from these new products, as well as from some highly successful titles published by HBS Press. This more than offset a decline in revenue from the *Harvard Business Review*, which felt the effects of an industry-wide slowdown in the periodicals business.

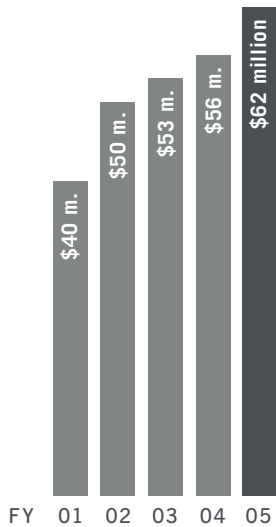
Fiscal 2005 was a year of improved results for the *Harvard Business Review*. Driven by stronger demand for advertising space, as well as increased subscription and reprint revenue, *Harvard Business Review* generated \$38 million of HBSP's revenue in fiscal 2005, compared with \$35 million last year. In addition, HBS Press had another strong year, reflecting exceptional sales for two titles that debuted during the year, as well as stronger demand for books released previously.

The School's case business, including sales of new cases and reprints, continued to grow, and another solid performance by HBSP's eLearning division reflected the continued success of its *HarvardManageMentor* multimedia product suite.

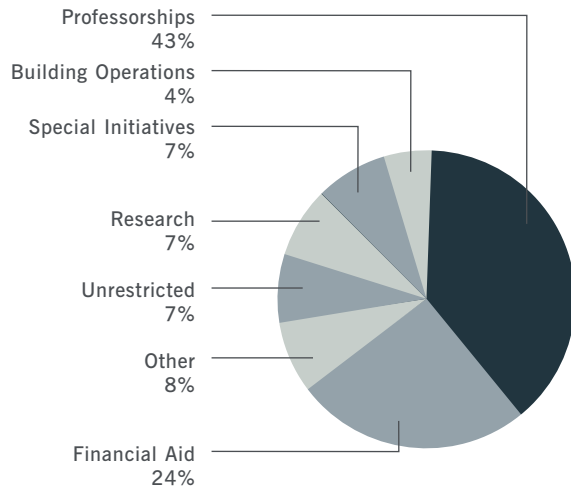
GIFTS & ENDOWMENT

The annual distribution of income from the School's endowment, together with revenue from unrestricted current use gifts, accounted for \$70 million in funding in fiscal 2005, or 21.1 percent of the School's total revenue. This compares with \$64 million in fiscal 2004, or 20.7 percent of total revenue. Unrestricted current use gifts, which provide crucial support for the School's operations, grew to \$8.3 million in fiscal 2005, from \$7.7 million last year.

The distribution from the HBS endowment rose 10.7 percent to \$62 million in fiscal 2005, from \$56 million last year. This increase reflected the University's targeted 4 percent growth in annual endowment payout, coupled with new gifts. Consistent with the prior two years, the fiscal 2005 endowment distribution represented more than 18 percent of the School's total revenue.



ENDOWMENT DISTRIBUTION



ENDOWMENT COMPONENTS, FY 2005

After this fiscal 2005 distribution, the School's endowment and current use funds totaled \$2.1 billion at year-end, up nearly \$300 million, or 17 percent, from fiscal 2004. The increase in the market value of the endowment for fiscal 2005 reflects \$102 million in endowment gifts received by HBS during the year, as well as endowment principal appreciation of \$197 million. Total investment return was +19.2 percent in fiscal 2005, net of all expenses. The School's strategy for managing its gifts and endowment is discussed on pages 31–33 of this report.

EXPENSES

A decade ago, HBS embarked on a long-term strategy designed to strengthen the School's global impact. This strategy focused on educating leaders and creating knowledge for an economy that is increasingly entrepreneurial, technology-driven, and worldwide in scope. Executing this strategy has changed the School's operational profile in significant ways:

- Endowed financial aid funds have grown markedly, and the School is attracting a more diverse pool of outstanding MBA candidates. Through increased fellowships, the School is enabling growing numbers of students with financial need to pursue a Harvard MBA.
 - Innovative use of technology has enhanced the learning experience. The School's new technology infrastructure provides ubiquitous access to information in classrooms and across the campus. Courses have been enriched through use of interactive software to an extent that was unimaginable just a few years ago.
 - HBS has successfully accommodated a period of generational turnover in the faculty, and the size of the faculty, measured in full-time equivalents (FTEs), has been modestly expanded. New faculty have strengthened the School's research activities and course offerings.
 - Important new research and teaching initiatives have spurred planned growth in administrative staff and faculty support services. In connection with these initiatives, the School created the Arthur Rock Center for Entrepreneurship, strengthened its Doctoral Programs, and expanded its activity in the fields of Social Enterprise, Leadership, and Corporate Governance.
 - The School's research and academic activities have become more global in scope. Working in conjunction with regional research centers from Silicon Valley to Buenos Aires to Mumbai, the faculty has significantly increased its fieldwork around the world. In addition to creating a large amount of intellectual capital, this work has infused the School's classrooms and courses with rich content that reflects key problems that leaders encounter in today's rapidly globalizing world economy.
 - HBS Publishing and Executive Education have capitalized on recent economic growth by expanding their product offerings and pursuing new markets. Reflecting careful attention to their fixed costs, both units are delivering substantially improved margins to support faculty research and MBA education at the School.
 - HBS has nearly completed the most ambitious campus renewal and expansion since the School's founding nearly a century ago. Since fiscal 1996, HBS has constructed nearly 339,000 square feet of occupied space, expanding the size of the campus by 29 percent on a square-footage basis. At the same time, the School has renovated approximately 400,000 square feet of space.
- In making the strategic decision to strengthen its global impact, HBS committed to facing the challenge of operating a larger enterprise while continuing to operate within its means. Recognizing that the strong underlying rate of inflation in the higher education sector

would complicate this task, the School has been vigorous in its efforts to enhance operational efficiency, control administrative staff levels, and trim campus facilities expenses.

As a result, despite the large increase in operational scale required to support its strategic initiatives during the past five years, the School's expenses have grown at a compound annual rate of only 5.7 percent. In fiscal 2005, total operating expenses grew by \$13 million, or 4.4 percent, from last year, to a total of \$307 million.

Employee compensation is the School's largest expenditure, and salaries and benefits expenses have grown at a compound annual rate of 8 percent for the past five years. In fiscal 2005, these costs grew by \$14 million, or 10 percent, from the prior year, to \$153 million, and represented nearly 50 percent of total operating expenses.

Although growth in the size of the faculty and cost-of-living increases for faculty and staff have contributed to the increase in employee compensation expense, the rising cost of healthcare and pension benefits has been the most important factor. In fiscal 2005, the School's budget accommodated a further increase in the University's benefits rate, which, on a blended basis for HBS, grew to 27.3 percent of total salaries and wages, from 22.3 percent in fiscal 2004. As a result, the School's benefits expense increased 29.5 percent to \$32.9 million. The School's blended benefits rate has risen 7.7 percent, compounded annually, since fiscal 2000. For this five-year period, higher benefits expense equated to a structural increase of approximately \$10 million in the School's annual fixed costs.

Salaries and benefits for faculty and their research associates represent nearly 50 percent of the School's employee compensation costs, or approximately 25 percent of total expenses. To support its educational programs and research priorities, for the past several years HBS has been working to gradually expand the faculty. The total number of faculty FTEs can increase or decrease in any given year due to retirements, departures, and normal fluctuations in recruiting activity. Although the School's faculty FTEs declined in fiscal 2004 and 2005, the size of the faculty has grown from 192 to 201 over the past five years. Thanks to successful recruiting efforts this past year, the size of the faculty is expected to increase to 216 FTEs in fiscal 2006.

Operating on a larger scale in publishing, executive programs, information technology, and global research requires additional staff. Recognizing the economic sensitivity of the School's revenue stream, administrative staff levels have been tightly controlled—particularly in non-revenue-generating functions of the School. Vacant staff positions in these areas have remained unfilled where possible, and new hiring has been modest. Despite continued growth in the scope of the School's operations, administrative staff FTEs decreased slightly from fiscal 2001 through fiscal 2004. In fiscal 2005, the School's administrative staff grew by 27 FTEs, including 12 positions at HBSP.

Excluding employee compensation, the School's operating costs for the past five years have grown at a compound annual rate of 3.7 percent. This includes the strategic increase in fellowships, or financial aid, which HBS categorizes as an expense. The School's objective is to increase financial aid support for MBA and doctoral students at a rate that exceeds the rise in tuition and fees. The prospect of entering the workforce with high levels of debt can deter strong candidates from applying to HBS and restrict their career

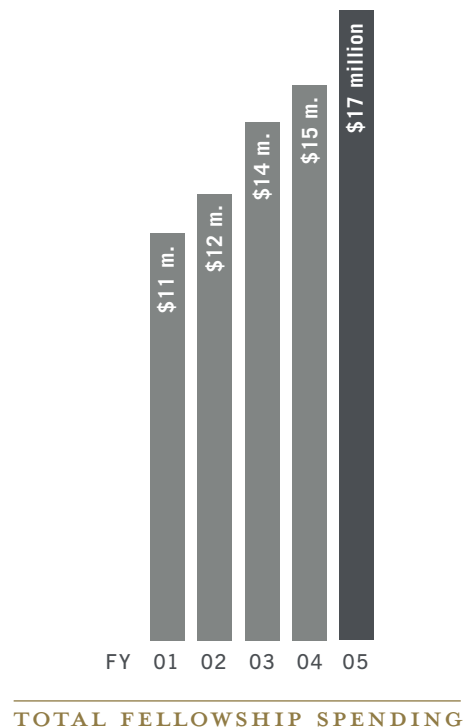
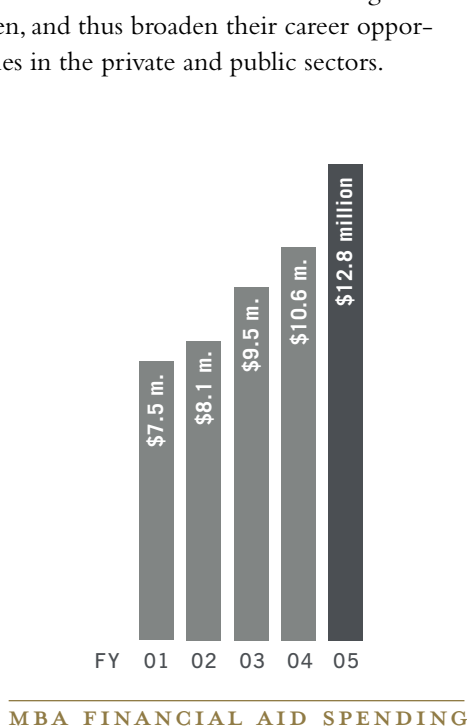
choices upon graduation. This is particularly true for students with fewer years in the workplace, those from outside the United States, and students whose early career paths have not enabled them to reduce their undergraduate loans.

Generous giving by HBS alumni and friends has enabled the School to increase MBA fellowship spending during the past five years at a compound annual rate of 13.8 percent. Total financial aid expense, which includes fellowships for doctoral candidates and support for MBA students, has risen at a compound annual rate of 11.2 percent.

The average two-year MBA fellowship award grew from \$12,600 for the Class of 2000 to \$23,400 for the Class of 2005. In addition to MBA financial aid, other fellowship expenses include MBA social enterprise fellowship programs and doctoral fellowships. Total fellowship spending for fiscal 2005 increased by \$2 million, or 13 percent, from last year to a record \$17 million. Despite this growth, the average MBA loan balance at graduation in fiscal 2005 was \$81,100, compared with \$78,000 in fiscal 2004. HBS continues to seek ways to assist MBA students in alleviating this burden, and thus broaden their career opportunities in the private and public sectors.

Excluding employee compensation and fellowships, the School's operating expenses for the past five years have increased at a compound annual rate of 2.9 percent. This includes costs incurred by HBSP in disseminating the intellectual capital created by the faculty and thus generating growing revenue to support the School's research and academic programs. The School's publishing and printing expenses include HBSP's cost of goods sold, as well as operations and marketing expenses, along with all costs for the School's other publications.

While HBSP's market-driven revenue performance has improved in each of the past three years, the unit has maintained tight control over its operating costs. Largely as a result of greater efficiency, the School's publishing and printing expenses have remained flat at \$35 million for the past three years. Despite generating higher revenue in fiscal 2005, HBSP incurred lower expenses for printing and paper, marketing, and author royalties. These decreases were offset by a reclassification of certain facilities-related costs. This accounting reclassification is discussed



in more detail below in connection with space and occupancy expenses.

HBS is responsible for managing its own campus; facilities maintenance and construction are not centralized University responsibilities as they are at many other schools. The School's campus currently includes 33 buildings encompassing more than 1.5 million square feet. Space and occupancy costs include expenses related to maintaining and operating these buildings and associated campus infrastructure. In addition, facilities improvement and renovation costs that do not qualify as capital expenses are categorized as space and occupancy costs. Also included are expenses related to dining facilities and other campus services, as well as costs associated with leased space that houses HBSP's operations.

The School's space and occupancy expenses historically have included costs associated with operating and maintaining campus facilities. Some of these costs—chief among them heat, utilities, and security—have increased faster than the general rate of inflation in recent years. The HBS staff has offset these increases through innovative approaches to campus management, while at the same time accommodating the School's new research and educational initiatives, as well as operating expenses for Spangler Center. Opening Spangler in fiscal 2001 added 121,000 square feet to the occupied space on campus.

After rising dramatically in fiscal 2001 to \$29 million, largely reflecting new operating costs for Spangler, space and occupancy expenses were essentially level for the next three years at \$30 million to \$31 million. The renovation and expansion of Baker Library has taken much of that major facility out of service in recent years, which moderated growth in operating expenses. Baker Library reopened in September 2005, and operating costs for the expanded building will be included in the School's operations budget for the coming year.

The fiscal 2005 increase in space and occupancy expense was primarily related to an accounting reclassification. As part of an effort to improve consistency and comparability in financial reporting across the University, some of HBSP's facilities-related costs, formerly characterized by the School as supplies and equipment expense, have been included in space and occupancy. Largely due to this recharacterization, space and occupancy expense grew to \$35 million in fiscal 2005.

Expenses for supplies and equipment decreased by \$9 million, or nearly 38 percent, in fiscal 2005 to \$15 million. Approximately \$2 million of the decrease was due to one-time charges incurred by HBSP last year that were not repeated in fiscal 2005. Approximately \$6 million of the decrease resulted from the aforementioned reclassification of HBSP expenses from supplies and equipment to space and occupancy, publishing and printing, and other. Excluding the HBSP reclassifications and one-time expenses, supplies and equipment expenses decreased approximately \$1 million across the School in fiscal 2005, primarily as a result of the nature of projects undertaken and tight cost controls.

Other expenses, which primarily includes telecommunications, travel and entertainment, and postage costs, remained level at \$22 million in fiscal 2005.

Professional services expenses increased \$2 million to \$16 million in fiscal 2005. These costs primarily include payments to faculty who teach in custom Executive Education programs, as well as expenses for outside technology contractors and publication services. The growth in professional services expenses in fiscal 2005 largely reflected an increase in custom program activity.

Expenses for University assessments are calculated as a percent of the School's total expenses on a two-year lagged basis. These assessments cover essential services provided to HBS by the University, including payroll

and benefits administration, processing of accounts receivable and payable, and legal services. For fiscal 2005, University assessments expense remained level with the prior year at \$10 million.

Debt service, which consists of interest payments to the University on building debt, has remained essentially level for the past five years. New borrowings for campus renewal and construction have been offset by debt principal repayments made possible by alumni gifts, as well as a general decline in the interest rate paid by the School to the University. This rate is determined annually by the University, and is based on the University's weighted average debt rate.

CASH FROM OPERATIONS

Executive Education and HBS Publishing grew rapidly in the late 1990s, along with the global economy. Although this growth boosted cash from operations, which peaked at \$23 million in fiscal 2000, it stretched the School's human and physical resources. Economic conditions weakened during the subsequent two years, yet HBS continued to invest in its long-term strategic initiatives, adding faculty, expanding the faculty's research activity, and investing in technology and campus expansion and renewal. As a result, cash from operations returned to more traditional levels in fiscal 2002 and 2003, totaling \$7 million and \$8 million, respectively.

Along with the economy's strengthening during the past three years, revenues from executive programs, publishing, and endowment distributions have accelerated. While the School's strategic initiatives have broadened the scope and scale of its operations, the costs associated with this expansion have been carefully managed. As a result, cash from operations nearly doubled in fiscal 2004 to \$15 million, and increased 60 percent to \$24 million in fiscal 2005.

USE OF ENDOWMENT PRINCIPAL & APPRECIATION

HBS regularly funds key initiatives with principal and related capital appreciation of gifts made in prior years intended for these purposes. These funds vary from year to year depending on the type of gifts available, the purposes for which these gifts were given, the status of the School's initiatives related to these purposes, and the available appreciation. Use of endowment principal and appreciation remained level in fiscal 2005, at \$13 million.

CASH AVAILABLE FOR CAPITAL ACTIVITIES

It is essential that HBS generate sufficient cash flow to cover capital expenses and any related debt service over the long term. Cash generated before capital activities has closely tracked cash flow for the past five years, peaking in fiscal 2000 at \$39 million, declining to \$20 million in fiscal 2002, and rebounding to \$37 million in fiscal 2005. Nearly \$23 million of this cash was invested in capital projects. The School used the remaining \$14 million, in conjunction with \$4 million drawn from reserves, to make principal payments on existing debt and invest in a new \$15 million reserve endowment. Although cash flow has fallen short of net capital expenses in each of the past five years, HBS expects that future operations, which include planned reductions in capital spending, together with the School's reserves, will provide sufficient resources to service its debt and execute on its long-term capital plan.

CAPITAL EXPENSES

Fiscal 2005 was a record year for capital investment in the campus. The ongoing restoration and expansion of Baker Library was substantially completed by year-end, and the School advanced on its multiyear project to renew classroom space in Aldrich

Hall. Capital expenses increased to \$79 million in fiscal 2005, from \$54 million in fiscal 2004. The School spent \$59 million of its fiscal 2005 capital budget on Baker Library and Aldrich Hall construction.

Fiscal 2005 capital spending also included investments in a number of smaller projects. HBS made the third payment in a multiyear commitment to support the School's role in the University's development in Allston. Space temporarily occupied by Executive Education at Chase Hall was refurbished and returned to the MBA Program for residential use. Humphrey House was renovated and renamed Greenhill House, and the School launched a project to renovate residential space at Hamilton Hall.

These fiscal 2005 capital expenses were funded with \$49 million in gifts for capital projects, new borrowings of \$7 million, internally generated cash, and reserves. The new borrowings were used primarily to finance the renovation of Aldrich Hall as this project neared completion. In fiscal 2004, sources of funding for capital expenditures included gift payments for specific capital projects of \$28 million and new borrowings of \$7 million, as well as internally generated cash.

BALANCE SHEET

The HBS balance sheet reflects a conservative but flexible approach to managing the School's financial resources. Liquid assets, consisting of cash and reserves, increased to \$73 million at June 30, 2005, from \$70 million a year earlier. The School's liquid assets have remained within a narrow range of \$70 million to \$78 million for the past five years, covering current liabilities an average of 1.3 times for the period. However, the majority of the School's operating expenses are paid, as incurred, out of current cash flow. The School's balance sheet is moderately leveraged, with a debt-to-asset ratio of only 2.7 percent at June 30, 2005.

DEBT

HBS borrows only on qualified capital projects, giving careful consideration to the interest rate environment and expectations for the performance of the Harvard endowment. The School's policy is to borrow when market conditions make accepting the incremental debt service obligation preferable to using endowment principal and appreciation. Total debt has averaged only 3.6 percent of total assets for the past five years. The interest portion of the School's debt service amounted to 1.3 percent of total operating expenses in fiscal 2005, compared with 1.4 percent in fiscal 2004.

Since fiscal 2001, HBS has been executing on a multiyear plan to finance the aggressive program of building construction and refurbishing across the campus. As a result, the School's debt level rose to a record \$91 million at the end of fiscal 2002. Since then, continued strength in cash from operations, coupled with successful fundraising, have enabled HBS to reduce its reliance on debt for funding campus renovations. After reaching a peak of \$15 million in fiscal 2002, new borrowings declined to \$7 million in fiscal 2003 and remained at this level in fiscal 2004. Despite the School's record capital expenditures in fiscal 2005, new borrowings remained at about \$7 million.

HBS will continue to use debt strategically as a means of optimizing its capital structure. The School is considering further increases in borrowings over the next few years to finance planned residence hall renovations and other major capital projects. The University functions as a banker for HBS, as well as for the other Harvard schools, allowing HBS to borrow on a triple-A-rated tax-exempt basis. For operational borrowing, the rate in fiscal 2005 was 5.6 percent.

For large capital projects that are in the construction phase, the University offers an at-

tractive short-term borrowing option at rates that mirror the current yield on Treasury bills of comparable maturity. The interest rate on such “construction-in-progress” loans averaged 1.88 percent in fiscal 2005, and substantially all of the School’s new borrowings consisted of this type of debt. Once the School’s current construction projects have been completed, this debt will be serviced at the University’s prevailing long-term interest rate. In the accompanying balance sheet, building debt includes construction-in-progress debt.

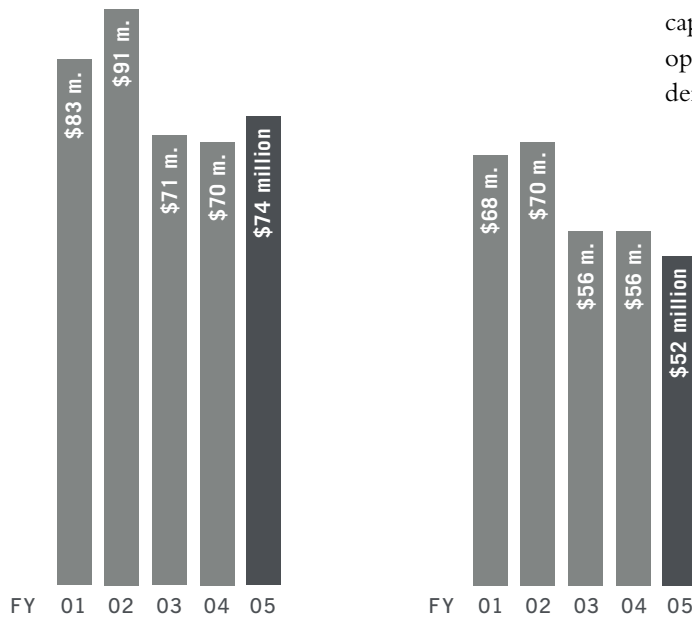
ENDOWMENT & CURRENT USE FUNDS VALUE

The market value of the HBS endowment and current use funds grew to \$2.1 billion, or approximately 8 percent of total University endowment assets, as of June 30, 2005, from \$1.8 billion a year earlier. The total return on the endowment was +19.2 percent, net of all expenses, following a +21.1 percent return in fiscal 2004. Harvard Management Company continues to out-

perform the market. As measured by the Trust Universe Comparison Service (TUCS), a universe of institutional funds with assets greater than \$1 billion, the performance of the University’s endowment has exceeded its benchmark and the median return of other large institutional funds in each of the past five years, placing Harvard in the top 5 percent of all institutional funds.

UNRESTRICTED RESERVES

HBS relies on unrestricted reserves as a resource for responding to unforeseen opportunities and, as part of the mix with gifts, internally generated cash, and debt, to finance capital projects. Reflecting the School’s ambitious campus construction and renewal activities, reserves have declined at a measured rate during the past five years. The School’s year-end reserves balance was \$52 million in fiscal 2005, compared with \$56 million last year. In addition, HBS invested \$15 million to augment the unrestricted endowment reserve established several years ago. The market value of this reserve was \$49.6 million at June 30, 2005, compared with \$29.8 million a year earlier. As fiscal 2006 begins, HBS is confident that its reserves are sufficient to provide funding for capital projects and to pursue newly emerging opportunities to further the School’s academic mission.



TOTAL DEBT OUTSTANDING

UNRESTRICTED RESERVES

Statement of Activity & Cash Flows*

IN MILLIONS

FOR THE FISCAL YEAR ENDED JUNE 30,

	2005	2004	2003
REVENUES			
MBA Tuition & Fees	\$ 68	\$ 65	\$ 61
Executive Education Tuition	76	71	67
Publishing	106	98	93
Endowment Distribution	62	56	53
Unrestricted Current Use Gifts	8	8	8
Housing, Rents, & Other	9	8	8
Interest Income	2	3	4
TOTAL REVENUES	\$ 331	\$ 309	\$ 294
EXPENSES			
Salaries & Benefits	\$ 153	\$ 139	\$ 135
Publishing & Printing	35	35	35
Space & Occupancy	35	31	31
Supplies & Equipment	15	24	23
Professional Services	16	14	14
Fellowships	17	15	14
University Assessments	10	10	9
Debt Service	4	4	5
Other Expenses	22	22	20
TOTAL EXPENSES	\$ 307	\$ 294	\$ 286
Cash from Operations	\$ 24	\$ 15	\$ 8
Use of Endowment Gifts or Appreciation	13	13	14
CASH BEFORE CAPITAL ACTIVITIES	\$ 37	\$ 28	\$ 22
Capital Expenses	\$ (79)	\$ (54)	\$ (39)
Use of Gifts for Capital Projects	49	28	27
NET CAPITAL EXPENSES	\$ (30)	\$ (26)	\$ (12)
New Borrowings	\$ 7	\$ 7	\$ 7
Debt Principal Payments	(3)	(8)	(33)
Other Activity	(15)	(1)	2
NET DEBT & OTHER	\$ (11)	\$ (2)	\$ (24)
CHANGE IN UNRESTRICTED RESERVES	\$ (4)	\$ 0	\$ (14)
BEGINNING BALANCE, UNRESTRICTED RESERVES	\$ 56	\$ 56	\$ 70
ENDING BALANCE, UNRESTRICTED RESERVES	\$ 52	\$ 56	\$ 56

* This statement presents a managerial view of Harvard Business School operations focused primarily on cash available for use. It is not intended to present the financial results in accordance with generally accepted accounting principles (GAAP). A presentation in accordance with GAAP would report higher operating revenues for gifts and endowment distribution and would include depreciation expense, yielding income from operations of \$18 million in fiscal 2005. Cash flows, however, would be equivalent under GAAP.

Consolidated Balance Sheet

IN MILLIONS

FOR THE FISCAL YEAR ENDED JUNE 30,

	2005	2004	2003
ASSETS			
Cash	\$ 21	\$ 14	\$ 15
Unrestricted Reserves	52	56	56
Receivables, Loans, & Other Assets	165	195	173
Invested Funds			
<i>Endowment Investments</i>	1,924	1,603	1,331
<i>Current Fund Investments</i>	17	43	45
<i>Interest in Trusts Held by Others</i>	124	120	109
Facilities, Net of Accumulated Depreciation	390	336	309
TOTAL ASSETS	\$ 2,693	\$ 2,367	\$ 2,038
LIABILITIES			
Deposits, Advances, & Other	\$ 30	\$ 30	\$ 21
Deferred Revenue	34	32	34
Building Debt	74	70	71
TOTAL LIABILITIES	\$ 138	\$ 132	\$ 126
ASSETS NET OF LIABILITIES	\$ 2,555	\$ 2,235	\$ 1,912
COMPOSITION OF NET ASSETS			
Unrestricted Reserves	\$ 52	\$ 56	\$ 56
Undistributed Income & Other	28	14	19
Pledge Balances	83	122	97
Student Loan Funds	11	11	17
Investment in Facilities	316	266	238
Endowment & Current Use Funds	2,065	1,766	1,485
TOTAL ASSETS NET OF LIABILITIES	\$ 2,555	\$ 2,235	\$ 1,912

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**HARVARD BUSINESS SCHOOL
SOLDIERS FIELD
BOSTON, MA 02163**

This document is intended to provide insight into the way Harvard Business School manages its resources, and plans strategically for its future. Further information about the School can be found at www.hbs.edu.

Data in this report can be viewed and downloaded online at www.hbs.edu/about/financial.html.

Harvard Business School is led by the Dean of the Faculty in conjunction with various advisory and oversight groups comprising faculty, staff, alumni, academics, and business practitioners.

Harvard University appoints a Visiting Committee to review Harvard Business School's strategic goals and objectives and to provide advice and input to the Dean. The group meets annually and reports to Harvard University's Board of Overseers.

We welcome questions and comments from our readers. They should be directed to:
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