From the Chief Financial Officer

Fiscal 2006 marked the conclusion of both the Campaign for Harvard Business School and five years of significant investment in campus expansion and renewal. It was a good year for the global economy, and a period of increasing worldwide demand for management education and knowledge. The School's fiscal 2006 financial results mirrored these dynamics.

Consolidated revenue grew by $37 million, or 11.2 percent, from fiscal 2005 to $368 million. This was roughly double the average top-line growth experienced by the School over the past five years. More than $18 million of this year's revenue growth came from the School's Executive Education and Harvard Business School Publishing (HBSP) units. About $13 million was attributable to growth in unrestricted gifts and larger distributions of income from the HBS endowment. The planned increase in MBA tuition and fees, coupled with modestly larger MBA class sizes resulting from a higher admissions yield, accounted for $5 million of the remaining $6 million in revenue growth.

Total operating expenses rose by $38 million in fiscal 2006, or 12.4 percent — more than twice the five-year compounded rate — to a total of $345 million. The growth in expenses primarily reflected increased investment in our Executive Education and HBSP businesses and inflationary pressure on some of our fixed costs — employee compensation chief among them.

Operating expenses in Executive Education and HBSP, excluding employee compensation, accounted for about $14 million of this year's increase. Both units experienced higher direct costs as their operations expanded and revenues grew. The expense increase also reflected strategic investments in marketing, corporate relations, and product development aimed at driving future business growth.

About $14 million of the expense increase for fiscal 2006 was related to employee salaries and benefits — the School's largest cost and nearly 50 percent of our budget. The higher amount this year was due mainly to growth in the size of the faculty and salary rate increases for faculty and staff. Benefits expense was up 10 percent in fiscal 2006, compared with a 29.5 percent increase in the prior year, primarily a result of additional FT EEs (full-time equivalents). MBA financial aid spending, which the School reports as an expense, accounted for another $2 million of our fiscal 2006 expense growth, with the remaining $8 million attributable to increased faculty research investment, higher utility and energy costs, and other costs associated with the School's larger scope of activity.
After a half decade of large construction projects on the HBS campus, capital expenses declined from a peak of $79 million last year to $49 million in fiscal 2006. The School’s capital activity centered on completing the renewal of classroom space in Aldrich Hall and the renovation of residential facilities for MBA students at Hamilton Hall. In addition, we made the fourth payment of a multiyear commitment to support the School’s role in the University’s development in Allston. The School also invested in several smaller projects, including the renovation of Sherman Hall (renamed Wyss House), which houses our doctoral programs.

HBS finances capital projects with cash from unrestricted current-use gifts, by accessing reserves, and through borrowings. For major campus construction and renewal projects, the School’s long-standing policy is to use leverage, rather than using gifts or accessing reserves, when market conditions make it preferable to accept the incremental debt service obligation.

Comparing current interest rates with potential future investment returns on the HBS endowment, in fiscal 2006 we decided to increase the School’s borrowings over the next few years. This new debt was used to finance scheduled residence hall and classroom renovations (including Hamilton Hall and Aldrich Hall) as well as other capital projects. New borrowings for fiscal 2006 increased to $38 million from $7 million last year, and building debt rose to $108 million from $74 million in fiscal 2005. As a result, the School’s debt service obligation for fiscal 2007 is expected to rise to $8 million from $4 million in fiscal 2006. The University functions as a banker for HBS, as it does for each of the other Harvard schools.

The School’s reserves balance at year-end 2006 increased by $8 million to $60 million. This is comfortably within our long-term target range and at a level that should enable HBS to continue investing in new strategic opportunities.

A Look Ahead
Executive Education and HBS begin the new fiscal year with solid operational and market momentum. Alumni interest in unrestricted giving has been strong, and we hope to see this continue. In addition, reflecting continued strength in investment returns, the University has announced a further modest increase in the endowment distribution rate for fiscal 2007. Applying this rate to the $2.3 billion fiscal 2006 year-end value of the HBS endowment, we are likely to see the fiscal 2007 endowment distribution exceed the MBA Program as a revenue source for the first time in the School’s history.
As a result, we are looking forward to another year of revenue growth for HBS — growth that will be deployed to enhance teaching and learning across the School. The MBA curriculum will provide more opportunities for student-faculty interaction, with Immersion Programs in China, New Orleans, and Boston (in healthcare) during the January break. Starting with student orientation the first day on campus, and including refinements in the Learning Team concept introduced last year, team-based activities will be strengthened throughout the MBA Program. With the increased endowment distribution, the School is planning a 15 percent increase in MBA fellowship awards to further the student diversity that enhances the richness of classroom discussions and residential life at HBS.

Supporting the faculty’s research and course development will continue to be one of the School’s highest strategic priorities in fiscal 2007. HBS invested nearly $84 million in faculty research in fiscal 2006, enabling the faculty to remain close to practice globally and providing a range of services designed to enhance research productivity across the School.

In addition to the global network of HBS regional research centers, the School provides faculty with an extensive on-campus research infrastructure and a wide range of outstanding support staff services. The Computer Lab for Experimental Research and the Faculty Research Computing Center, for example, provide faculty with the resources they need to pursue ambitious multiyear, and often cross-disciplinary research projects. The School’s investment in faculty research is budgeted to grow more than 9 percent in fiscal 2007 to nearly $92 million.

In fall 2006, Executive Education launched its new portfolio of Comprehensive Leadership Programs, targeted at specific career stages. Our objective for the year ahead is to leverage this momentum to attract high-quality participants to all of the School’s executive programs. At the same time, our executive education footprint will continue to expand globally. Following the introduction of the Global CEO and Senior Executive Programs for China this past year, the School’s future executive program pipeline includes potential new offerings for business managers in India, Latin America, and Europe, in addition to China.

Recent strong results in our executive programs for the corporate market have enabled the faculty to strengthen their commitment to programs for underserved markets overseas, as well as for not-for-profit organizations in the United States. For example, as part of the School’s Healthcare Initiative, a program...
for senior executives from major teaching hospitals was held for the first time this past year. Looking ahead, the faculty has identified interesting intellectual challenges in other markets and sectors that traditionally have not been able to afford premium executive education for their future leaders.

In fiscal 2006, HBSP completed an internal realignment, replacing its long-standing, product-focused structure with a more flexible, customer-focused approach to organizing its operations. As a result, HBSP begins fiscal 2007 with a comprehensive, multiyear strategy for investing in the growth of its existing portfolio, including the Harvard Business Review and HBS cases. HBSP also is pursuing new geographic and product platform opportunities, as well as enhanced integration with Executive Education. Executing this strategy are cross-functional groups newly formed to address the needs of the higher education, corporate learning, and individual manager markets.

Expanding HBSP’s presence in the Greater China and India/South Asia markets will continue to be a strategic focus for growth in fiscal 2007. Under licensing agreements signed this past year, HBSP plans to launch Harvard Business Review South Asia and to relaunch HBR — Complex Characters for the Taiwan market. HBSP also is developing a new strategy for Western Europe. In addition, plans are under way to enhance HBSP’s online customer experience and enable customer-driven packaging of HBSP’s content in multiple languages. HBSP remains strongly positioned in multimedia. As we begin fiscal 2007, its most successful product in this category is Harvard ManageMentor, which is available in an expanded array of 43 modules.

Our fiscal 2007 operating budget projects an increase in total expenses of 7.5 percent to $371 million, from actual fiscal 2006 spending of $345 million. The additional expenses for fiscal 2007 primarily reflect costs associated with the expanded scope of the School’s operations. Our capital budget for fiscal 2007 is $25 million — about half the amount invested in fiscal 2006.

The restoration and expansion of Baker Library, completed this past year, was the last in a series of large capital projects initiated with construction of Spangler Center, which opened in fiscal 2001. Included in the School’s capital plan for fiscal 2007 are the last phases of the Hamilton and Aldrich renewal projects, numerous building maintenance and campus infrastructure priorities, as well as the final payment to the University associated with development in Allston.

Looking forward, faculty and staff are preparing a campus master plan that will serve as the framework for the School’s capital investments over the next 10 years. Although the University’s Allston development strategy provides the long-term context for this planning — and an unprecedented opportunity to advance the mission of the School — the campus plan will reflect the long-term aspirations of HBSP and our community’s desire to maintain the integrity and residential character of the School’s unique campus. Over the next few years, we anticipate a significant increase in campus construction and renewal activity with commensurate growth in capital investment.

Thanks to generations of support from our generous alumni and friends, Harvard Business School continues to have the financial capacity to accomplish its educational mission. We are committed to sustaining the School’s legacy of innovative and thoughtful resource stewardship in the year ahead.

Richard P. Melnick, MBA ’92
Chief Financial Officer
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