THE MBA PROGRAM continues to attract high-quality applicants from around the world, even as the number and type of management programs proliferate. Yield reflects the percentage of admitted students who ultimately choose to attend HBS; 89 percent is unparalleled not just among top business schools, but also among colleges and universities generally.

DOCTORAL PROGRAMS graduates go on to fill faculty positions at leading global universities and business schools—including HBS. In the last five years alone, approximately 80 doctoral students have accepted positions in academia, extending the reach and influence of the School.

THE EXECUTIVE EDUCATION PORTFOLIO includes programs ranging from a few days to multiple weeks, covering topics from strategy to governance to nonprofit management. The participants in these programs return to their organizations—in every sector and in every region of the globe—with new leadership skills and fresh ideas, connecting the School and its faculty to practice at a deep level.

FACULTY produce a wide array of teaching materials, including field cases, industry notes, field method team exercises, and simulations. Most measures of research impact, including citations and other rankings, place HBS faculty members at the very top of their fields.

HARVARD BUSINESS PUBLISHING is the leading supplier of cases to business schools and educational programs—about 4,000 such institutions worldwide. In this way, HBS faculty have helped shape the curricula of management education for generations of faculty and students.

5-YEAR SUMMARY

FOR THE FISCAL YEAR ENDED JUNE 30,

Financial Data (in millions)	**2014**	**2013**	**2012**	**2011**	**2010**
Revenues	**$ 633**	$ 587	$ 546	$ 509	$ 467
Expenses	**597**	542	504	456	415
Cash from Operations	**36**	45	42	53	52
Capital Investments	**98**	78	51	34	14
Building Debt Outstanding	**85**	91	99	103	112
Unrestricted Reserves	**99**	83	119	79	99
Endowment	**3,224**	2,880	2,665	2,779	2,311
Total Assets	**$ 4,409**	$ 3,831	$ 3,490	$ 3,528	$ 3,087
MBA Program					
Applications	**9,543**	9,315	8,963	9,134	9,524
Percent Admitted	**12%**	12%	13%	12%	11%
Yield	**89%**	89%	90%	90%	89%
Enrollment	**1,859**	1,838	1,805	1,860	1,864
Tuition	**$ 56,175**	$ 53,500	$ 51,200	$ 48,600	$ 46,150
Average Fellowship Aid per Student	**$ 31,710**	$ 30,725	$ 29,843	$ 26,745	$ 23,989
Doctoral Programs					
Applications	**792**	816	868	830	931
Percent Admitted	**4%**	5%	4%	5%	4%
Yield	**76%**	71%	68%	68%	69%
Enrollment	**150**	143	137	132	125
Executive Education					
Enrollment	**9,993**	9,992	9,891	9,939	8,670
Faculty					
Faculty Positions (full-time equivalents)	**234**	227	232	217	218
Teaching Materials	**617**	684	640	635	538
Research Articles	**193**	181	184	150	155
Books	**18**	17	23	18	29
Staff					
Staff Positions (full-time equivalents)	**1,447**	1,335	1,198	1,138	1,087
Publishing					
Cases Sold	**11,991,870**	11,448,076	10,603,000	9,764,000	9,668,000
Harvard Business Press Books Sold	**1,980,542**	1,950,931	1,580,000	1,665,000	1,769,000
HBR Circulation	**292,954**	285,520	256,000	241,000	236,000
HBR Reprints Sold	**3,312,578**	3,231,384	3,355,000	3,098,000	2,946,000

FROM THE CHIEF FINANCIAL OFFICER

Harvard Business School's economic model performed well in fiscal 2014. Driven primarily by revenues in Harvard Business Publishing (HBP) and Executive Education, as well as philanthropic income from gifts, HBS was solidly cash flow positive, extending a record that began more than a decade ago.

This cash flow enabled HBS to fund its core educational programs, spur innovation in teaching and research, and invest in strategic opportunities. HBS also used internally generated cash from operations to increase its capital investment in the campus, without taking on new debt, while still ending fiscal 2014 with a strong balance of unrestricted reserves. These reserves are crucial in providing the School with sufficient liquidity to execute on its mission and sustain the campus through economic cycles over the long term.

One of our key financial planning goals for HBS is to serve as a living model of a well-run organization—consistent with the skills, tools, and frameworks taught across the School's educational programs each year. Achieving this goal starts with transparency. To that end, the School's fiscal 2014 financial results are explained in detail in the Supplemental Financial Information section that begins on page 22. The balance of this letter will speak to the School's financial condition in the context of strategic changes taking place at HBS, looking at both the past year's results and our plan for fiscal 2015.

FISCAL 2014 IN REVIEW

The HBS economic model starts with a faculty whose research brings them into contact with leaders and managers of organizations around the world. That contact generates new ideas meant to transform the practice of management. Executive Education and HBP transform the resulting ideas into new programs and materials that reach, increasingly, many thousands of students, academics, and managers worldwide.

Executive Education and HBP revenues result in margin contributions that fund the faculty's research and enable them to stay close to practice, thus completing the cycle and allowing it to begin anew. Revenues from Executive Education and HBP also help cover costs associated with strategic initiatives across the School.

Fiscal 2014 marked the first year of significant investment in the School's online learning platform, HBX. Launched publicly in spring 2014, HBX embodies the HBS principle of participant-centered learning reimagined on a digital platform. HBX aspires to create a learning experience both transformational for students and as distinctive and outstanding as any other HBS activity or program. Totaling nearly $12 million, expenses related to this work at HBX were a significant new factor in the School's overall financial performance for fiscal 2014. Although HBX is in start-up mode at present, over the long term it has the potential to join Executive Education and HBP as a significant contributor of earned revenue and income from operations.

The School's fiscal 2014 strategic investments also included the new global research center in Istanbul, Turkey, which opened during the year, as well as The Harvard Business School Campaign launch. In addition to staff support and event expenses, the year's major Campaign investments included development costs for a new I.T. infrastructure to support the goal of increased alumni engagement with the School.

The School's total operating expenses for fiscal 2014 rose by $55 million, or 10.1 percent, from the prior year, to $597 million. Approximately $35 million of the $55 million stemmed from these and other strategic initiatives, plus underlying inflation. The other $20 million consisted of investments in Executive Education and HBP made to strengthen their capacity for generating revenue and cash flow to support the School's economic model. Both groups continued to translate this funding into solid revenue growth and increased margin contributions in fiscal 2014.

HBP operates in the context of a rapidly evolving publishing industry that necessitates ongoing investment in technology and marketing. Nonetheless, the School's publishing business results exceeded our expectations for the fifth consecutive year, as other capacity was lost with the residence building Baker Hall being taken off line for renovations and the closing of Kresge Hall for dining in order to begin construction on the new Ruth Mulan Chu Chao Center, limiting growth in Executive Education enrollments. In addition, fiscal 2014 marked the first year of higher depreciation expense associated with Tata Hall and related Executive Education facilities recently constructed by the School.

Executive Education rose to these challenges, and executive program revenue growth for fiscal 2014 was significantly stronger than we expected. This growth was junction with The Harvard Business School Campaign launch. By the fiscal year's end, the Campaign had raised more than $721 million in new gifts and pledges.

The majority of the Campaign giving was intended to sustain the School's core operations over the long term by creating new endowment or restricted current use accounts, or by adding to existing accounts. Approximately $160 million was earmarked for capital projects. The School's distribution of income from the endowment in fiscal 2014, as well as the endowment's investment performance, is discussed in detail beginning on page 23.

Executive Education and HBP transform ideas into new programs and materials that reach, increasingly, many thousands of students, academics, and managers worldwide.

Fellowship Spending (in millions)	**MBA**	**Total***
FY 14	**$ 31**	**$ 43**
FY 13	29	40
FY 12	27	37
FY 11	26	36
FY 10	25	35

** includes Doctoral Programs and Executive Education*

Investment in Research (in millions)	
FY 14	**$ 117**
FY 13	110
FY 12	109
FY 11	97
FY 10	92

four of HBP's five market groups continued to deliver top-line growth. This growth was led by the Corporate Learning group, driven by strong demand for its flagship eLearning product, Harvard ManageMentor.

Higher Education group sales also grew substantially, reflecting increased demand for HBS cases, particularly in international markets. Further, fiscal 2014 was the second consecutive record year for circulation revenue from *Harvard Business Review*. At the same time, HBP continued to effectively manage its expenses and growth-focused investments, and its fiscal 2014 margin contribution also came in higher than initially planned.

Executive Education also delivered strong financial results in fiscal 2014, while successfully building for the future. Although opening Tata Hall added much-needed living and classroom space during the year, driven by additional offerings of multiweek comprehensive leadership programs during the year, higher enrollments in custom and other programs across the portfolio, and tuition increases.

Although Executive Education made major investments in sales and marketing systems, staff, and infrastructure to drive future enrollment growth as new capacity comes on line, total operating costs remained well controlled. As a result, the group's fiscal 2014 margin contribution was up substantially year-over-year, also exceeding the School's forecast.

In addition to earned income from Executive Education and HBP, the School's economic model is heavily reliant on two philanthropic revenue streams: distribution from the HBS endowment and unrestricted current use gifts. Fiscal 2014 was a milestone year for giving to the School, in con- Fiscal 2014 was also a strong year for unrestricted current use giving to HBS. Together with endowment gifts and gifts for capital projects, this type of giving is deeply important to the School. The flexible funding provided by unrestricted current use gifts functions as seed money to launch the kinds of visionary efforts—such as FIELD, the Harvard i-lab, and HBX—that have long been a hallmark of teaching and learning at the School.

Reflecting the HBS community's generous response to the Campaign, as well as reunion and annual giving during the year, revenue from unrestricted current use gifts in fiscal 2014 rose by $6 million, or 27 percent, from the prior year to a record $28 million. Driven in large part by Campaign gifts, total current use giving in fiscal 2014, including restricted and unrestricted gifts, increased 50 percent from the prior year to a record $65 million.

Income from gifts provides crucial support for the School's capital investments. Encompassing building renewal and maintenance, infrastructure and I.T. upgrades, and construction of new facilities, these investments are based on a comprehensive, long-term campus planning strategy. For the past three years, this strategy has focused on enhancing the Executive Education buildings at the northeast corner of the campus.

The School's fiscal 2014 capital agenda also included the majority of the construction of the HBX Live studio (an interactive virtual classroom facility for HBX), numerous building upgrades and renewals, and environmental sustainability measures implemented across the campus. In addition, to meet Executive Education food preparation and service needs during construction of the Chao Center, HBS constructed and began operating a temporary dining facility, Crimson Commons, and expanded the Spangler Center kitchen.

FISCAL 2015 OUTLOOK

Over the past five years the School has made good progress on its strategic objectives while continuing to generate a healthy operating surplus. Nonetheless, in this same period revenues have grown at a compound annual rate of 6 percent while expenses have risen 6.5 percent. As a result, the School's operating margin has declined from 7.2 percent to 5.7 percent.

Although our objective is to reverse this trend, the School is likely to continue facing strong pressures on margin over the next two years. In addition to the underlying increase in costs associated with the growing scope of the School's operations, these pressures stem from several unrelated, temporary circumstances.

In Executive Education, margins will be reduced because of added depreciation for recently built facilities. At the same time, Executive Education will continue to invest in sales and marketing to ensure that new capacity is utilized as it comes on line over the next two years.

In addition, there will be one-time expenses as The Campaign for Harvard Business School engages alumni in regional events around the world, while Campaign pledges will convert into cash over a longer period of years. Moreover, a revenue recognition accounting change at HBP will significantly affect the group's top-line results. Finally, as a start-up business, HBX will continue to face revenue uncertainties while its costs become increasingly fixed.

Our financial plan for fiscal 2015 balances these challenges against a modestly favorable outlook for the School's core operations, and top-line performance is closely tied to the health of the global economy. Global economic growth appears to be on a modestly upward path at this writing. Against this backdrop, we are forecasting total year-over-year revenue growth of 5 percent in fiscal 2015.

Revenue from MBA tuition and fees is projected to rise 5 percent, partially offset by an increase in financial aid. The University has advised the School that its fiscal 2015 endowment payout will grow 3 percent from fiscal 2014. Reflecting this anticipated payout, as well as income from new gifts to the endowment, we expect the School's total endowment distribution revenue for fiscal 2015 to increase 4 percent from fiscal 2014.

The flexible funding provided by unrestricted current use gifts functions as seed money to launch the kinds of visionary efforts—such as FIELD, the Harvard i-lab, and HBX—that have long been a hallmark of teaching and learning at the School.

Publishing Revenue (in millions)

FY 14	**$ 194**
FY 13	180
FY 12	165
FY 11	152
FY 10	135

Executive Education Revenue (in millions)

FY 14	**$ 163**
FY 13	146
FY 12	142
FY 11	132
FY 10	113

At HBP, revenue for fiscal 2015 is forecasted to grow 3 percent—significantly slower than growth over the past four years, and reflecting a new approach to revenue recognition for Harvard ManageMentor as it shifts from packaged software to a subscription service model. The impacts of this accounting transition are expected to begin gradually diminishing in fiscal 2016.

Executive Education revenue is forecasted to be approximately flat in fiscal 2015. The opening of Tata Hall has eased some capacity constraints this past year, but operating with Baker Hall off line and Kresge Hall closed will limit revenue growth in the year ahead.

The top-line challenges faced by Executive Education and HBP underscore the strategic importance of the School's two philanthropic revenue streams: distribution from the HBS endowment and unrestricted current use gifts. The latter will remain crucial to the School's success in the year ahead—not only in supporting innovation, but also in remaining cash flow positive during this upcoming period of higher pressure on margins. At the same time, the expanding scope of activity at the School is creating new needs for long-term funding as students and faculty engage in endeavors such as FIELD and cross-disciplinary global research. Endowment giving helps fuel these long-term initiatives.

Endowment giving also provides crucial support for MBA financial aid. Fellowships are more essential than ever to attract not only the most talented students, but also students who bring a mix of backgrounds and experiences that enriches the HBS learning experience for all involved. Consequently, revenue from both current use and endowment giving through the Campaign will be crucial in the School's financial planning for fiscal 2015 and beyond.

Against this backdrop of uncertainty on the revenue front, HBS will be facing challenges from a cost perspective in fiscal 2015. After retirements and departures, the total size of the faculty declined from 234 a year ago to 228 in fiscal 2015.

Consequently, faculty recruiting, development, and retention continue to be high among the School's priorities for the year ahead, as does the addition of administrative staff. This staff growth partly reflects expansion in the School's core operations, but the majority of the new positions will be focused on realizing income growth potential in HBP, Executive Education, and HBX, as well as supporting Campaign-driven growth in External Relations.

Capital Investment (in millions)

FY 14	**$ 98**
FY 13	78
FY 12	51
FY 11	34
FY 10	14

Reflecting salary increases and upward pressures on benefits costs, the School's fiscal 2015 financial plan assumes a 9 percent increase year-over-year in total compensation expense. Professional services costs, however, are forecasted to come in 2 percent lower than in the prior year.

The School is planning major strategic investments for fiscal 2015. In addition to scaling HBX, the faculty will be launching elements of the field method in the MBA Elective Curriculum. At the same time, the School's External Relations group will be managing a growing number of Campaign events. Incremental dollars have been budgeted in each of these areas for technology and staff support.

In light of the School's commitment to making education at HBS affordable to a broader cross section of applicants, we have planned a 9 percent increase in fellowship spending across the School for fiscal 2015. In addition, the plan includes significant investment in I.T. infrastructure, spread across salaries and benefits; services purchased; and equipment, among other expenses. Although academic and administrative I.T. plays a critical role in the School's strategic priorities, we are working to slow the pace of growth in this key area in order for HBS to maintain a sustainable economic model.

HBS is planning to work on several ambitious capital projects in fiscal 2015. Adding Executive Education capacity remains the focus, highlighted by continued construction of the Chao Center and the renovation of Baker Hall. The capital plan also includes further design work this year on Klarman Hall, a convening facility to be located next to Spangler Center.

The School's capital investment in smaller renewal and upgrade projects across the campus is expected to double in fiscal 2015. In addition to implementing energy efficiency measures to meet the University's greenhouse gas reduction goals, these projects are designed to prevent deferred maintenance and preserve the value of the campus for future generations. The School's total capital budget for fiscal 2015 is $107 million—up 9 percent from the $98 million invested in fiscal 2014.

We are carefully watching the economic trends as fiscal 2015 begins, with an eye toward adjusting spending as necessary. Looking ahead longer term, HBS enters the new fiscal year with a reserves balance sufficient to fund its planned investments in innovation and in the campus, without taking on debt leverage that could lead to increased financial risk. We remain committed to thoughtful stewardship of the School's resources in the year ahead.

RICHARD P. MELNICK, MBA 1992
CHIEF FINANCIAL OFFICER
OCTOBER 1, 2014

Over the past five years the School has made good progress on its strategic objectives while continuing to generate a healthy operating surplus.

STATEMENT OF ACTIVITY & CASH FLOWS*

FOR THE FISCAL YEAR ENDED JUNE 30,

Revenues (in millions)	**2014**	**2013**	**2012**
MBA Tuition & Fees	**$ 113**	$ 107	$ 99
Executive Education Tuition	**163**	146	142
Publishing	**194**	180	165
Endowment Distribution	**120**	117	109
Unrestricted Current Use Gifts	**28**	22	19
Housing, Rents, & Other	**15**	14	11
Interest Income	—	1	1
Total Revenues	**$ 633**	$ 587	$ 546

Expenses			
Salaries & Benefits	**$ 276**	$ 255	$ 241
Publishing & Printing	**71**	67	59
Space & Occupancy	**51**	48	47
Supplies & Equipment	**11**	9	10
Professional Services	**57**	40	35
Fellowships	**43**	40	37
University Assessments	**19**	18	17
Debt Service	**5**	6	6
Other Expenses	**64**	59	52
Total Expenses	**$ 597**	$ 542	$ 504

Cash from Operations	**$ 36**	$ 45	$ 42
Restricted Current Use Gifts & Endowment Appreciation	**56**	22	24
Cash Before Capital Activities	**$ 92**	$ 67	$ 66

Capital Expenses	**$ (98)**	$ (78)	$ (51)
Change in Capital Project Funding	**17**	(26)	1
Use of Gifts for Capital Projects	**17**	11	17
Net Capital Expenses	**$ (64)**	$ (93)	$ (33)

New Borrowings	**$ 0**	$ 0	$ 0
Debt Principal Payments	**(6)**	(8)	(4)
Other Non-Reserve Activity	**(6)**	(2)	11
Net Debt & Other	**$ (12)**	$ (10)	$ 7

Change in Unrestricted Reserves	**$ 16**	$ (36)	$ 40
Beginning Balance, Unrestricted Reserves	**$ 83**	$ 119	$ 79
Ending Balance, Unrestricted Reserves	**$ 99**	$ 83	$ 119

CONSOLIDATED BALANCE SHEET

FOR THE FISCAL YEAR ENDED JUNE 30,

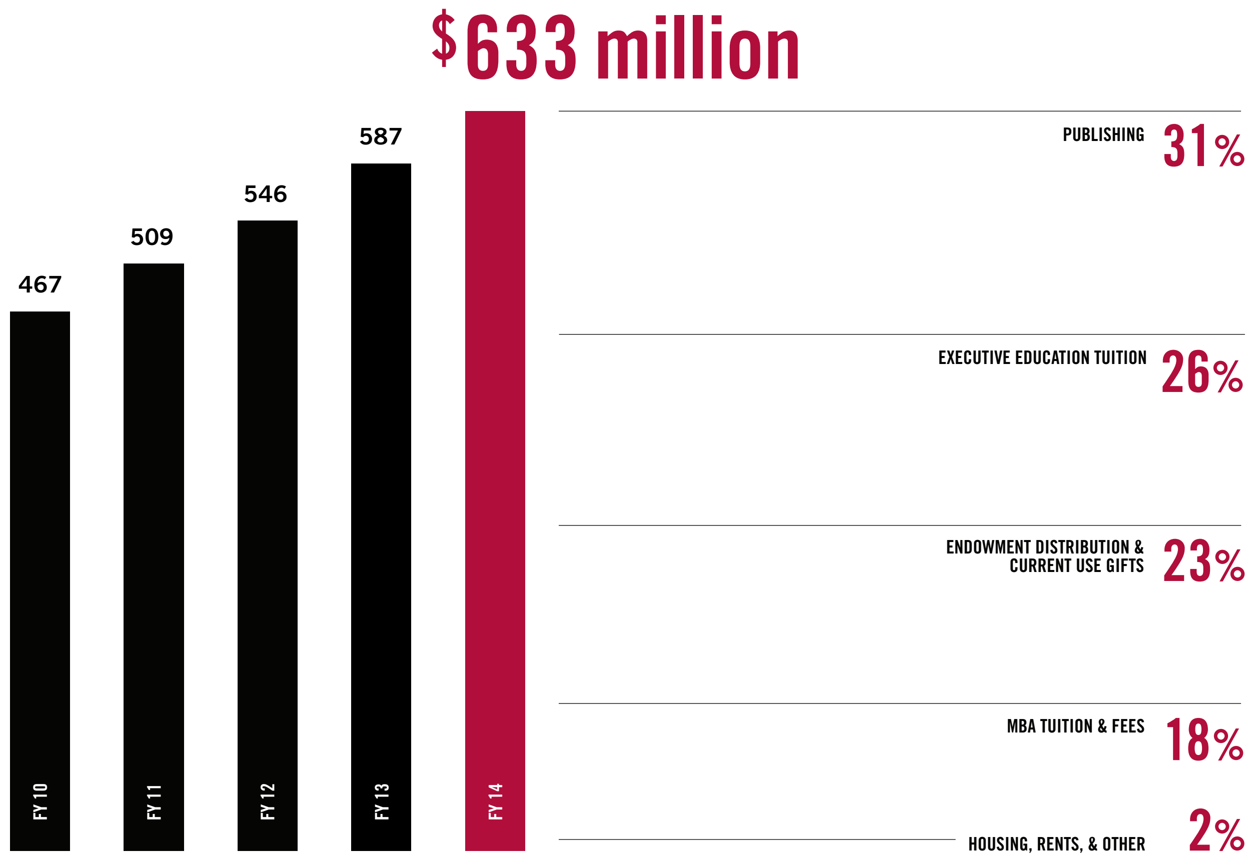
Assets (in millions)	**2014**	**2013**	**2012**
Cash	**$ 44**	$ 38	$ 26
Unrestricted Reserves	**99**	83	119
Receivables, Loans, & Other Assets	**475**	319	222
Invested Funds:			
Endowment Investments	**2,970**	2,658	2,485
Current Fund Investments	**96**	78	42
Interest in Trusts Held by Others	**158**	144	138
Facilities, Net of Accumulated Depreciation	**567**	511	458
Total Assets	**$ 4,409**	$ 3,831	$ 3,490

Liabilities			
Deposits, Advances, & Other	**$ 60**	$ 56	$ 53
Deferred Revenue	**88**	85	65
Other Debt Owed to University	**27**	23	23
Building Debt	**85**	91	99
Total Liabilities	**$ 260**	$ 255	$ 240

Composition of Net Assets			
Unrestricted Reserves	**$ 99**	$ 83	$ 119
Undistributed Income & Other	**16**	5	5
Pledge Balances	**317**	179	92
Student Loan Funds	**11**	9	10
Investment in Facilities	**482**	420	359
Endowment & Other Invested Funds	**3,224**	2,880	2,665
Total Assets Net of Liabilities	**$ 4,149**	$ 3,576	$ 3,250

* The Statement of Activity & Cash Flows 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 $41 million in fiscal 2014. Cash flows, however, would be equivalent under GAAP.

SUPPLEMENTAL FINANCIAL INFORMATION



REVENUES

As outlined on page 16, at the core of Harvard Business School's economic model is internally funded faculty research. The resulting intellectual capital is disseminated by Executive Education and Harvard Business Publishing (HBP) to managers around the world.

Completing a self-sustaining cycle, revenues from these two groups serve as the primary source of research funding. Margins from Executive Education and HBP also provide crucial support for strategic innovation at the School, including initiatives such as the Harvard i-lab, the multiyear U.S. Competitiveness Project, and experiments in teaching and learning such as FIELD and HBX.

Philanthropic revenues, including distribution from the HBS endowment and current use gifts, are equally important to the School's economic model. Funds from alumni giving provide additional financial stability and flexibility that are crucial to the School's ability to execute on its mission.

The revenues from these sources in any given year are sensitive to trends in the economy and the capital markets. These trends remained favorable for a fourth consecutive year in fiscal 2014. As a result, the School's total revenues grew by $46 million, or 8 percent, from fiscal 2013.

MBA Tuition & Fees

Tuition and fee revenue from the School's core educational program grew to $113 million, from $107 million in fiscal 2013. First-year MBA tuition in fiscal 2014 was $56,175—which is near the midpoint among the seven comparable schools tracked by HBS—compared with $53,500 last year. MBA tuition and fees revenues do not fully recover annual MBA Program operating expenses, much less the School's long-term investments in academic innovation. This shortfall is offset primarily with income from gifts given by MBA alumni, whose generosity enriches the HBS educational experience for future generations of students.

Executive Education

The Executive Education group delivered strong revenue growth in fiscal 2014. Although total participant enrollment was essentially flat with the prior year at nearly 10,000, tuition revenues grew 12 percent to $163 million, from $146 million in fiscal 2013. This growth was driven by additional offerings of multiweek comprehensive leadership programs during the year, higher enrollments in comprehensive and custom programs, and tuition increases.

Harvard Business Publishing

The School's publishing business performed strongly in fiscal 2014. HBP's total revenues grew by $14 million, or 8 percent, from fiscal 2013 to $194 million. Driven in large part by strong international demand, sales were up from fiscal 2013 across the product portfolio. *Harvard Business Review (HBR)* circulation revenue reached a second consecutive all-time high. Reflecting HBP's ongoing digital transformation, eLearning product sales were up 11 percent year-over-year. Combined sales of HBS cases and reprints plus *HBR* revenue increased 7 percent. International revenues grew 13 percent, comprising 34 percent of total publishing revenues for the year.

Gifts & Endowment

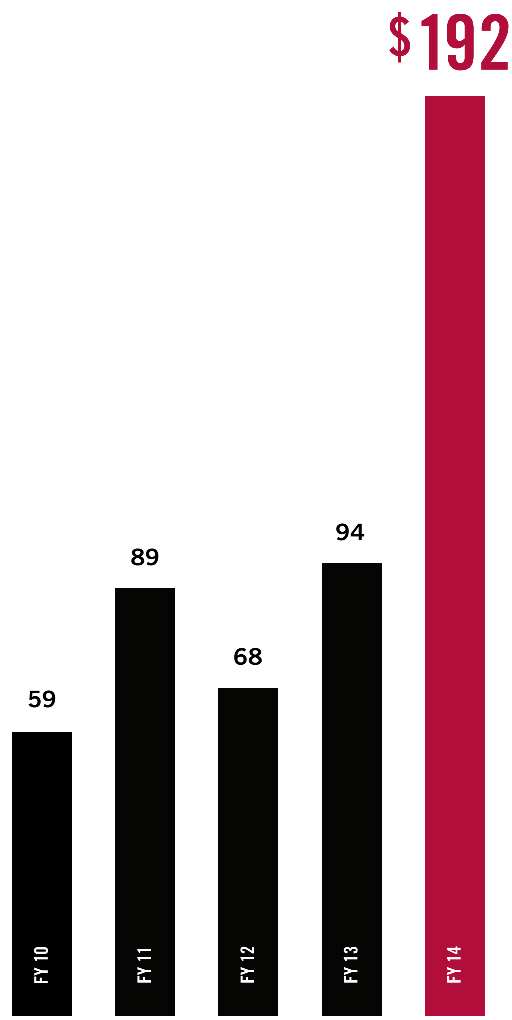
Although income from Executive Education and HBP makes HBS less reliant on the performance of the endowment relative to other schools at Harvard, philanthropic revenues have been increasingly important to the School's economic model in recent years. This trend continued in fiscal 2014 as revenue from gifts—in the form of the endowment distribution and current use gifts—increased to $148 million, or 23 percent of the School's total revenues, from $139 million in fiscal 2013.

Fiscal 2014 marked the launch of The Campaign for Harvard and, as part of that effort, The Harvard Business School Campaign. The HBS community continued to demonstrate extraordinary involvement and generosity, giving a record $369 million in new gifts and pledges to the School, up 82 percent, from $203 million in fiscal 2013.

HBS received gifts from nearly 13,000 donors in fiscal 2014, including MBA, Doctoral, and Executive Education alumni, as well as friends of the School. Similar to fiscal 2013, approximately 28 percent of the School's MBA alumni gave to HBS during the year. Total cash received from gifts, including new endowment gifts and gifts for capital construction projects, payments on prior years' pledges, and restricted and unrestricted current use giving, more than doubled to $192 million, from $94 million in fiscal 2013.

Fiscal 2014 marked a second consecutive year of exceptionally strong growth in unrestricted current use giving to HBS. Revenue from these flexible gifts increased 27 percent to $28 million, from $22 million in fiscal 2013, providing critical funding for innovation across the School. Cash giving for construction projects rose to $46 million, from $17 million in fiscal 2013, and endowment giving more than doubled to $77 million, from $31 million in the prior fiscal year.

Distributions of income from the HBS endowment have comprised 20 percent of total revenues at HBS for the past several years. In fiscal 2014, the School's endowment distribution increased 3 percent from the prior year to $120 million, growing for the third consecutive year and



CASH RECEIVED FROM GIFTS (in millions) amounting to 19 percent of total revenues.

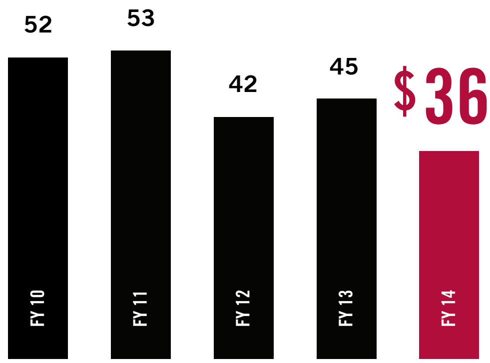
The HBS endowment currently consists of more than 1,000 discrete funds established over the years by individual donors, corporations, and reunion classes. The School budgets the use of endowment distributions to support operations according to the terms of each gift. Funds within the HBS endowment, along with those of the other Harvard schools, are managed by Harvard Management Company (HMC), a subsidiary governed and wholly owned by the University.

The University determines the payout rate—that is, the percentage of the endowment withdrawn in any given year and distributed for operations and for strategic purposes. Consistent with the long-term goal of balancing the maintenance of the endowment's purchasing power for future generations and the desire to pursue nearer-term opportunities, the University's targeted annual payout range is between 5.0 and 5.5 percent. The payout rate for fiscal 2014 was 5.6 percent, compared with 5.2 percent for fiscal 2013.

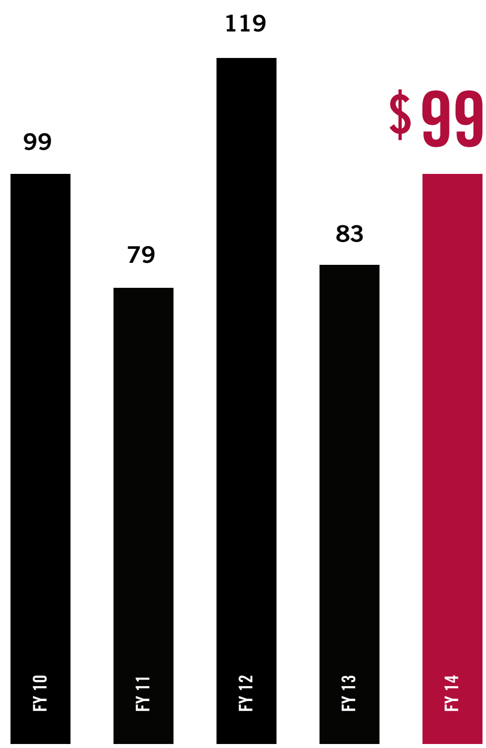
HMC manages the University endowment with three primary objectives: growth of the portfolio, sufficient liquidity, and appropriate risk management. The investment return on the Harvard endowment for fiscal 2014 was +15.4 percent, net of all expenses and fees, compared with +11.3 percent for the prior year.

The past five years have been a period of significant recovery and repositioning for the University endowment. During this period, HMC has consistently delivered returns in excess of its Policy Portfolio benchmark, resulting in cumulative value-added above the markets of $1.9 billion, net of all costs. The University endowment's annualized return for this five-year period was 11.6 percent, which is consistent with the long-term returns HMC has delivered over the past 10, 20, and 40 years.

The fiscal 2014 year-end market value of the HBS endowment, plus the School's current use funds, was $3.2 billion at June 30, 2014, compared with $2.9 billion a year earlier. This increase reflected the 15.4 percent net appreciation in market value and the subtraction of the School's annual distribution and decapitalizations,



CASH FROM OPERATIONS (in millions)



UNRESTRICTED RESERVES (in millions)

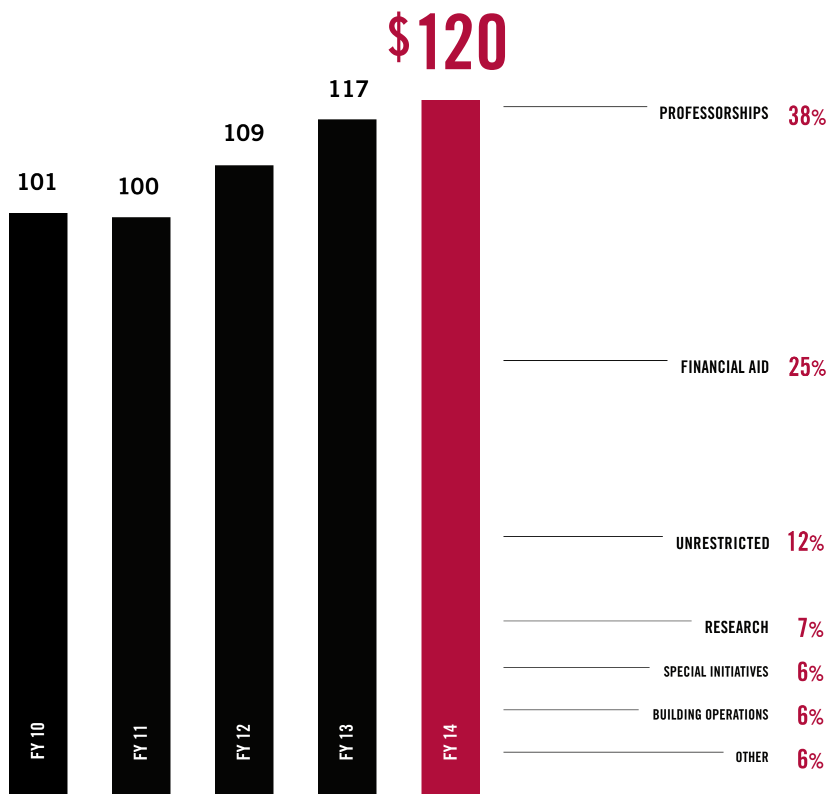
offset by the $77 million in endowment gifts received by HBS during the year.

Other Revenues

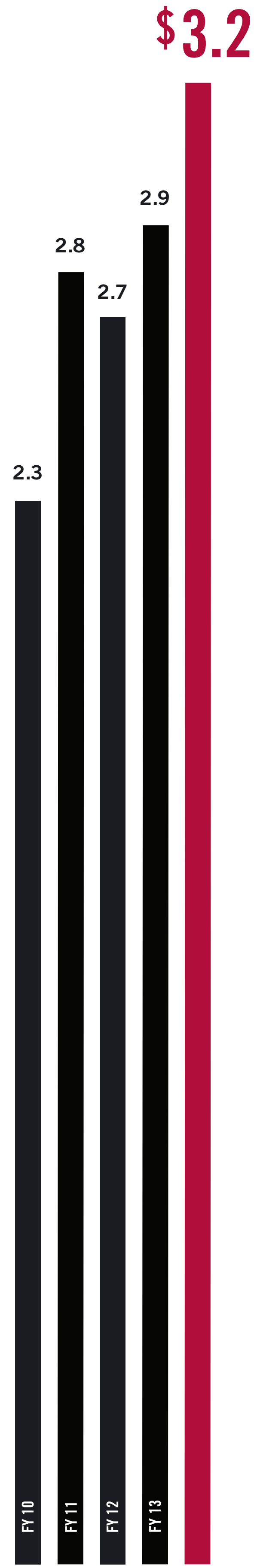
Revenue in the Housing, Rents, and Other category for fiscal 2014 increased 7 percent from the prior year to $15 million. This was due to a combination of increases in MBA application revenue, rental and event income, and initial revenues from HBX. Reflecting historically low interest rates, the School's interest income declined to zero in fiscal 2014, from $1 million in the prior year.

Harvard Endowment Returns

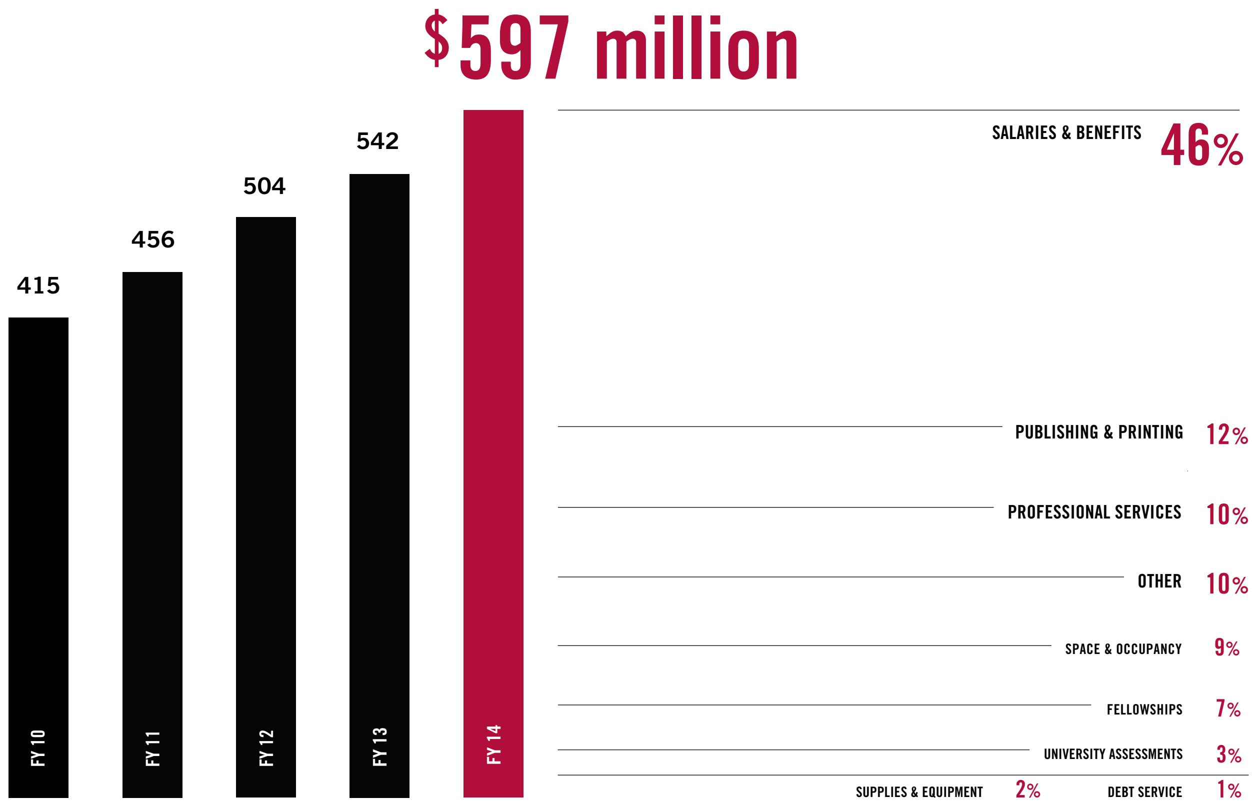
FY 14	**15.4%**
FY 13	11.3
FY 12	–0.1
FY 11	21.4
FY 10	11.0
FY 09	–27.3
FY 08	8.6
FY 07	23.0
FY 06	16.7
FY 05	19.2
3-Year Growth	**8.9%**
10-Year Growth	**9.9%**



ENDOWMENT DISTRIBUTION (in millions)



ENDOWMENT GROWTH (in billions)



EXPENSES

The School's total operating expenses for fiscal 2014 came in precisely on budget at $597 million, up by $55 million, or 10.1 percent, from the prior year. Approximately $35 million of this increased spending reflected the growing scope of the School's core operations. This expansion is being driven, in part, by strategic initiatives such as HBX, The Campaign for Harvard Business School, and multifaculty, cross-disciplinary research.

The School also incurred new costs in fiscal 2014 for I.T. infrastructure to support increased alumni engagement, as well as FIELD enhancements in the MBA Program. MBA tuition and fees recover only a minor portion of these costs.

The balance of this year's increase in expenses consisted of investments in Executive Education and HBP, primarily aimed at positioning these groups for future growth. Although HBS characterizes publishing and executive program costs as "expenses," they would in large part be considered "cost of goods sold" in a profit-seeking enterprise.

Expenses charged to HBP and Executive Education include direct costs for staff compensation, specialized outside professional services in functional areas such as I.T. and marketing, and residence expenses for executive program participants. Both groups delivered strong operating leverage on revenue growth in fiscal 2014. As a result, despite incurring higher expenses and making significant growth-focused investments, each group provided important income contributions to the School's operations for the year.

The School's total spending for faculty research support in fiscal 2014 rose by $7 million, or 7 percent, from the prior year to $117 million. This increase reflected, in part, the opening of an eighth HBS global research center in Istanbul, Turkey. It also was driven by an increasing diversity in the methodologies and approaches faculty members bring to bear in conducting research with power in practice, including multiyear, cross-unit initiatives like the U.S. Competitiveness Project.

Faculty research expenses at HBS cut across several line items in the Statement of Activity and Cash Flows. The cost of faculty research includes a portion of faculty salary and benefits expense. It also includes direct costs for research support staff and travel, and for the School's network of global research centers. In addition, HBS allocates a portion of the costs associated with library resources, campus facilities, technology, and administration to faculty research.

Salaries & Benefits

Employee compensation is the School's largest expense, comprising nearly 50 percent of total operating costs. Salaries and benefits expense increased 8 percent in fiscal 2014 to $276 million, from $255 million in the prior year. This marked slightly higher year-over-year growth than in fiscal 2013, primarily driven by an increase in the size of the faculty and staff.

The total number of faculty at HBS, as measured in full-time equivalents (FTEs), can rise or fall in any given year as a result of retirements, departures, and fluctuations in recruiting activity. Net of retirements and departures, the School's faculty increased by 7 FTEs to 234 in fiscal 2014, from 227 FTEs a year earlier. HBS also continued to expand its administrative staff, which grew to a budgeted 1,447 FTEs, from 1,335 in the prior year.

In addition to supporting core academic programs and assisting in I.T. infrastructure development, the majority of the staff positions added in fiscal 2014 were focused on generating future income growth. Nearly one-third of the School's newly recruited staff are involved in launching and scaling HBX, while others are working in HBP, Executive Education, and Campaign-related External Relations positions.

Fellowships

HBS categorizes fellowships, or financial aid, as an expense line item on the Statement of Activity and Cash Flows. Attracting the most talented MBA Program applicants, regardless of their country of origin or their financial resources, is a long-standing goal of the School. The prospect of entering or returning to the workforce with high levels of education debt can deter strong MBA candidates from applying to HBS and restrict their career choices upon graduation. This is particularly true for younger students, women, those from outside the United States, and students whose early career paths have not enabled them to reduce their undergraduate loans.

Consequently, the School assists students in minimizing their debt at graduation by ensuring that fellowship support at least keeps pace with tuition and fees. Extending the School's long-term commitment to annual increases in financial aid, average fellowship support per student increased 3 percent in fiscal 2014 to $31,710, from $30,725 in the prior year. Over the past five fiscal years, the School's average two-year MBA fellowship award has grown from $49,246 for the Class of 2010 to $64,000 for the Class of 2015.

Approximately half of the School's MBA students currently receive fellowships, which cover an average of more than 50 percent of a student's total tuition. Total fellowship expense for fiscal 2014, including assistance for Doctoral candidates and a limited number of Executive Education participants, as well as for MBA students, increased by $3 million from fiscal 2013 to $43 million. Funding for fellowships comes primarily from restricted endowment and current use giving by HBS alumni and friends.

Publishing & Printing

Publishing and printing expense includes HBP's production costs plus a small amount of spending related to the School's printed materials and publications. HBP's continuing growth in a fast-changing and highly competitive publishing environment reflects, in part, the success of the group's long-term program of strategic investment in digital infrastructure and content. Reflecting this investment, along with HBP's larger operational scale, the School's total publishing and printing expenses for fiscal 2014 increased by $4 million from fiscal 2013 to $71 million.

Space & Occupancy

The HBS campus includes 35 buildings encompassing nearly 1.8 million square feet of occupied space. Space and occupancy expense includes costs related to maintaining and operating the School's buildings and campus infrastructure. In addition, facilities improvement and renovation costs that do not qualify as capital expenses are generally categorized as space and occupancy. Also included in space and occupancy are expenses related to dining facilities and other campus services, as well as costs associated with leased space that houses HBP's operations and HBX, as well as the School's global research offices. In addition, residence expenses for executive program participants are reported under this category. Largely reflecting the addition of Tata Hall, the build-out of Crimson Commons, and the development of the HBX Live studio, the School's space and occupancy expenses for fiscal 2014 increased by $3 million from the prior year to $51 million.

Professional Services

Professional services expense for fiscal 2014 increased by $17 million from the prior year to $57 million. This increase was primarily driven by spending for external resources related to the Campaign launch and related alumni website, the HBX rollout, and Executive Education's implementation of a new CRM platform.

Supplies & Equipment and Other Expenses

Spending in the Other Expenses category, which includes items such as travel and catering, increased by $5 million in fiscal 2014 to $64 million. This increase primarily reflected higher technical services and catering costs. Supplies and equipment expense rose by $2 million from the prior year to $11 million.

University Assessments

University assessments cover essential services provided to HBS by the University, including payroll and benefits administration, processing of accounts receivable and payable, and legal services. The amount charged to HBS in any given year is primarily calculated as a percentage of the School's total expenses. As expected, the School's expense in fiscal 2014 for these assessments increased by $1 million from the prior year to $19 million.

Debt Service

HBS finances major capital projects with a mix of three sources of funding. The most important sources are gifts and unrestricted reserves of internally generated cash. The School also makes strategic use

I.T. Investment (in millions)

FY 14	**$ 79**
FY 13	68
FY 12	54
FY 11	50
FY 10	40

Building Debt Outstanding (in millions)

FY 14	**$ 85**
FY 13	91
FY 12	99
FY 11	103
FY 10	112

of debt financed through the University as a means of optimizing its capital structure.

Relying on the University as its banker provides HBS, as well as the other Harvard schools, with access to debt on a triple-A-rated tax-exempt basis. The School borrows only to finance qualified capital projects, carefully considering the interest rate environment, expectations for the performance of the Harvard endowment, and the availability of University debt.

Reflecting this cautious approach, the School's balance sheet historically has been only modestly leveraged, and debt leverage remained low in fiscal 2014. HBS increased its capital investments during the year to $98 million, from $78 million in the prior year. As in fiscal 2013, this growth was primarily funded by internally generated cash, and there were no new borrowings. HBS paid down $6 million in building debt in fiscal 2014, compared with $8 million a year earlier.

As a result, the School's year-end fiscal 2014 building debt-to-asset ratio decreased to 2.0 percent, from 2.5 percent in the prior year. Other University debt—mainly consisting of repayment obligations to the University for mortgage loans made by HBS as a faculty recruiting incentive—increased by $4 million from fiscal 2013 to $27 million.

The School's debt service expense consists of interest payments to the University and is covered by using cash from operations. Fiscal 2014 debt service expense declined by $1 million from the prior year to $5 million. As in fiscal 2013, this expense was mainly associated with borrowings to finance prior years' campus expansion. The interest portion of the School's debt service amounted to slightly less than 1 percent of total operating expenses in fiscal 2014.

CASH BEFORE CAPITAL ACTIVITIES

The School's cash from operations decreased in fiscal 2014 by $9 million from the prior year to $36 million. As in fiscal 2013, this cash was largely generated by margin contributions from Executive Education and HBP, as well as the HBS community's generous giving to the School. In addition, use of restricted current use gifts plus cash drawn from endowment appreciation contributed $56 million to the School's cash flow in fiscal 2014, compared with $22 million in fiscal 2013.

This unusually large year-over-year increase in Restricted Current Use Gifts and Endowment Appreciation included a one-time $17 million use of funds in the School's endowment reserve, which was established more than 10 years ago to finance upcoming capital projects. The net result was a $25 million increase in cash available for capital activities to $92 million, from $67 million in fiscal 2013.

NET CAPITAL EXPENSES

As noted above, the School's fiscal 2014 capital expenses increased by $20 million from the prior year to $98 million. This growth was primarily associated with Executive Education facilities investment, including the completion of Tata Hall and the tunnel connecting it to the rest of the campus, initial construction of the Chao Center and the related demolition of Kresge Hall, and the initial renovation work at Baker Hall. In addition, HBS continued to invest in numerous projects focused on the renewal and maintenance of buildings, infrastructure, and I.T. systems across the campus.

On a net basis, capital expenses for fiscal 2014 were $64 million, down from $93 million in the prior year. This reflected an increase in use of gifts for capital projects, as well as a $17 million change in capital project funding planned for fiscal 2015. This item is listed in the Statement of Activity and Cash Flows as Change in Capital Project Funding.

NET DEBT & OTHER EXPENSES

Because gifts and unrestricted reserves have been available and sufficient to finance capital activities, fiscal 2014 marked the School's sixth consecutive year with no new borrowings. Debt principal payments decreased to $6 million, from $8 million in fiscal 2013.

Other Non-Reserve Activity in fiscal 2014 was negative $6 million, compared with negative $2 million in the prior year. Together with the School's fiscal 2014 debt principal payments, the negative $6 million in fiscal 2014 Other Non-Reserve Activity resulted in a decrease of $12 million in Net Debt and Other, compared with a decrease of $10 million in the prior year.

ENDING BALANCE, UNRESTRICTED RESERVES

Together with a mix of internally generated cash, gifts, and debt, HBS relies on unrestricted reserves to finance major campus expansion projects and capitalize on unforeseen strategic opportunities. More than 56 percent of the School's revenues come from Executive Education and HBP—groups that are highly sensitive to the economy.

Consequently, maintaining an ample balance of unrestricted reserves outside the endowment is crucial in providing HBS with sufficient liquidity to fulfill its educational and research mission on a long-term basis. Reflecting the School's continued healthy cash from operations, as well as the one-time $17 million withdrawal from endowment reserves, fiscal 2014 was a successful year in this regard. HBS sustained its operations while investing in the campus and in strategic innovation, while still concluding the year with a strong unrestricted reserves balance of $99 million.