matters: the cash available to deans once they have met student needs. The fiscal 2014 and 2015 results are suggestive. Scholarships applied to student income (reductions in term bills, for instance) rose just 3.0 percent, to $984 million—below the 3.7 percent growth in fiscal 2014. And other scholarships and awards paid directly to students increased just 4.6 percent. Even with robust growth in continuing and executive education (which affects the tuition mix), demand for financial aid in degree programs appears to be easing—a proxy for the improving economy.

Data from the Faculty of Arts and Sciences (FAS) confirm the trend: its undergraduate-aid spending rose from $164.2 million in fiscal 2012 to $165.6 million the next year, and $170.2 million in fiscal 2014—before decreasing, minimally, to $170.1 million in the most recent year. That reflects a sharp change from the period beginning in 2007, when financial aid was expanded significantly, and then demand soared as the recession crimped family incomes.

In the meantime, University fundraisers continue to pursue gifts for aid: to secure the programs put in place during the past decade; to cope with families’ rising education costs; and to enable deans to apply more of those unrestricted net tuition receipts to other academic needs. President Drew Faust focused on The Harvard Campaign (see updates, page 26) in her letter in the financial report; she noted that some $686 million had been secured for financial aid across the University—about halfway toward the goal for scholarships.

The endowment remains at the center of Harvard’s finances, again contributing 35 percent of operating revenues: $1.59 billion in fiscal 2015, and $1.54 billion in fiscal 2014. The Corporation is being careful with endowment funds: the operating distribution equaled just 4.6 percent of the endowment’s value at the beginning of the fiscal year, down from 4.9 percent in the prior year. As previously reported, Harvard Management Company (HMC) realized a 5.8 percent return on endowment assets, net of all expenses, in fiscal 2015 (see “Endowment Gain—and Gaps,” November-December 2015, page 22, and “Overhauling the Endowment,” below). For fiscal 2016, the planning guidance to deans envisions a 4 percent increase in the operating distribution, plus a “bonus” distribution of 2 percent for one-time expenses (ensuring that those extra activities will not be built into schools’ permanent expense base, and perhaps reflecting HMC’s most recent results).

Not for nothing have higher-education administrators and science professors been raising alarms about the nation’s research budget. As noted, federal direct sponsorship for research continued to decrease. Other sources of direct research support increased by $18 million; but indirect-cost recoveries associated with such nonfederal grants are a small fraction of those accompanying federal sponsorship, placing a burden on the institution to maintain the research enterprise (see the discussion in “Faculty Figures,” opposite).

Even with the campaign’s success, a conservative course toward growth appears to be in place, given persistent, large operating deficits in FAS and Harvard Medical School. Still, the campaign is having its intended effect. Gifts for current use, generated during the current fund drive, yielded 10 percent of Harvard’s fiscal 2015 revenues. Pledges receivable, a good gauge of what is on tap, surged to $2.25 bil-

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**Overhauling the Endowment**

When Harvard Management Company (HMC) president and CEO Stephen Blyth reported on endowment investment returns last fall, he bluntly described declining performance; laid out a new mission statement and investment goals; detailed a new asset-allocation model; and sketched changes in operations and compensation. In November, he invited Harvard Magazine to HMC’s offices to discuss these changes in depth. Blyth directly addressed an altered investment environment that is reducing returns; University constraints in the wake of the 2008-2009 financial crisis that limited investing options; and other aspects of HMC’s execution that affected endowment performance. He also reviewed the cultural changes under way that aim to put HMC on a post-crisis footing, in pursuit of better investment results. The full transcript of the conversation is available at harvardmag.com/endowment-16. Highlights follow.

*On the investing environment: HMC’s “10-year rolling average real return declined from the double digits to just over between 5 percent and 6 percent annually. That is highly related to the fact that interest rates have declined dramatically…Ten-year, essentially risk-free real rates have declined from 4.5 percent to 0.6 percent….In order to generate 5 percent real return 10 years ago, you could just buy mostly TIPS [inflation-adjusted bonds] and then take a little bit of risk. Today, you need TIPS plus 4 percent of real return” from taking risk.

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*On changing HMC’s culture: “[T]he first thing I did here…was set the new narrative for HMC. I viewed it as…not drawing a line under the financial crisis, but at least starting a new paragraph or new chapter.” Having recognized prior constraints, he continued,
Facility Figures

An interesting perspective on faculty growth, a core element of Harvard's mission, emerges from the intersection of Harvard Campaign plans and constrained research funding. In their annual report letter, CFO Thomas J. Hollister and treasurer Paul J. Finnegan cited academic investments, including "expanded faculty." The capital campaign aims at many objectives (financial aid, House renewal, the new engineering and applied sciences facility—see page 28), but most schools do not identify faculty growth as a major goal. President Drew Faust noted that the campaign had secured endowments for 75 chairs, but most are understood to be existing professorships.

The problem is sufficiently acute that Faculty of Arts and Sciences (FAS) dean Michael D. Smith, sharing his annual report with colleagues in early October, emphasized research funding as among his highest priorities. The report's financial commentary singled out the importance of "enhancing" our internal program of research support to lessen faculty anxiety in an increasingly competitive market and challenging external funding landscape"—so much so that FAS expects to maintain its tenured- and tenure-track-faculty ranks at roughly the current 729 members, rather than seeking to add professorships, with implications for its composition.

From academic year 2000-2001, when these "ladder" faculty numbered just below 600, to the current population, FAS's profile has shifted. Arts and humanities professors rose from 185 to a peak of 210, and now number 196; the ranks of social scientists increased from 214 to a peak of 251, before settling at 245 now. The science cohort, at a multiyear low of 139 in 2000-2001, peaked at 214 and now numbers 203—up by nearly half. And engineering and applied sciences, with 54 faculty members 15 years ago, before becoming a full school, has been on a steep upward trajectory, to 85 now: up nearly 60 percent. With the faculty census essentially level and engineering-related fields targeted for significant expansion (funds are in hand to add a dozen computer-sciences professors alone), FAS's mix of disciplines might continue to evolve.

—J.S.R.

"Let's just...realize that our job is to improve investment performance."

"Interestingly, there was a sense of relief from the organization that that was just said publicly internally. This is the new path. This is about moving from recovering...to competing."

• On relationships with external investment managers: "HMC re-trenched significantly and in a number of ways. It was unable to give capital to subsequent funds from high-conversion managers....We sold certain interests at a discount, as is well documented. As a result, the relationships with private-equity managers as a particular case were affected following the financial crisis....But the relationships that we have with the top-tier private-equity managers and venture-capital managers are just incredibly valuable. Those are assets that need to be managed and looked after in the same way we would look after financial assets. That's an area that I personally, the executive team, the private-equity team are highly focused on—developing those relationships back to a place where they are valuable assets."

• On a more flexible asset-allocation model: "[I]f we're explicitly saying we have this flexibility, all these portfolios are permissible, it allows us now to incorporate the best-ideas concept. I think that's something that is going to be additive....We'll no longer be having, 'This does not fit in my bucket' or 'My bucket is full.' I can't fit any more in.' Things that are just suboptimal from an investment perspective...are no longer in play."

• On reorganizing to foster investment decisions: "We have changed the investment-management structure at HMC in an important way. We've essentially taken out a layer of investment management....I was head of public markets....[with] public equities, public credit, public commodities, and public fixed income reporting to me. The debate across that second layer and what was then a third layer was...suboptimal. When I became CEO, I didn't replace myself....and I'm not replacing the head of alternative assets [who retired]....[A]s CEO, I dropped down to sit on top of the investment committee, which is now the portfolio-management heads. That means the discussion is less vertical and more horizontal just by construct. That changes the decision-making process significantly."

• On HMC's hybrid model of investing assets internally and externally: "I have no target....There's no, 'We want to get this amount internally' or 'We want to get this amount externally.'...We just want to make sure we have the best investors in everything we're doing. If we have an external manager who's not good enough, we're going to redeem. If we have an internal portfolio-management team that is not good enough, we will have to upgrade."


—J.S.R.