Managing the School's Gifts and Endowment

Harvard Business School closed fiscal 2006 with strong fundraising results. The year marked the conclusion of the five-year Campaign for Harvard Business School (as of December 31, 2005) and saw a new record in unrestricted annual giving. In fiscal 2006, cash received from gifts, including new cash gifts and payments on prior years’ pledges, totaled $55 million. While this is lower than the previous year’s record totals during the Campaign, it is well above gift revenue in the pre-Campaign period. Of the total raised, a record $11.7 million represented unrestricted giving.

Gifts to the Campaign totaled $598 million, nearly 20 percent above the initial goal, and results exceeded the School's targets for each priority area. Campaign giving consisted primarily of gifts to the HBS endowment. The additional capital provided by these endowment gifts will generate increased income to support new educational and research initiatives. It also enhances financial stability, augmenting the School’s capacity to pursue its mission over the long term.

Among the areas strengthened through endowment giving to the Campaign were the Doctoral Programs ($25 million), entrepreneurship ($25 million), the Global Initiative ($15 million), and the Leadership Initiative ($10 million). Campaign gifts for MBA financial aid totaled $109 million. As a result of this generosity, during the five years since the Campaign began, the School has been able to establish more than 150 new fellowship funds. Annual fellowship spending grew by nearly 60 percent from $12 million in fiscal 2002 to $19 million in fiscal 2006. During this period, the average MBA fellowship award grew from $9,001 to $15,647.

While individual gifts of $1 million or more have increased as a percentage of total giving during the span of the Campaign, the generosity of alumni and friends through class reunion and annual giving, over the long term, also contributes significantly to the School’s success. In fiscal 2006, HBS received gifts from more than 11,000 individual donors, including alumni of the MBA, Doctoral, and Executive Education programs, as well as friends of the School. Approximately 30 percent of MBA alumni made gifts to the School in fiscal 2006. MBA participation was consistent with participation rates during the Campaign, compared with 25 percent in the pre-Campaign years.

Due in large part to the HBS community’s class reunion and annual giving, revenue from unrestricted current-use gifts grew by 41 percent to a record $11.7 million in fiscal 2006, from $8.3 million in fiscal 2005. Unrestricted gifts support every area of activity at the School — from technology to case writing to faculty salaries — providing...
stability and fostering innovation and new initiatives. Gifts available for current use often serve as the equivalent of venture funding, allowing HBS to accelerate successful emerging programs and invest in new opportunities. Over the past five years, unrestricted current-use giving to HBS has generated more than $44 million in revenue, an amount equivalent to the income from a $387 million endowment.

Endowment Returns and Performance

The HBS endowment consists of approximately 800 individual funds established over the years by individual donors, corporations, foundations, and reunion classes. Approximately 94 percent of the School’s endowment funds have been designated by the donors for specific uses. In fiscal 2006, roughly 50 percent of the endowment income distributed for the School’s operations supported professorships and faculty research, and 25 percent supported student fellowships. Nineteen percent was used for existing strategic initiatives, building operations, and other ongoing activities of the School. The remaining 6 percent was available for new opportunities at the discretion of the Dean.

The assets within the HBS endowment, 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 goals are to fund current initiatives while preserving principal, to protect the purchasing power of the endowment from erosion by inflation, and to build capital for the future by achieving superior risk-adjusted returns.

Given these goals, the University’s objective is to distribute an average of 4 to 5 percent of the endowment’s market value annually. In years of strong investment performance, the University distributes a smaller percentage of the endowment’s market value. In years when returns are less robust, a larger percentage is distributed. The distribution rate has remained within a range of 3.3 percent to 5.1 percent since fiscal 1995.
The endowment's performance over the past five years has supported a substantial increase in the annual distribution to HBS. Endowment distributions grew from $50 million in fiscal 2002 to $71 million in fiscal 2006, and for the period represented between 17 and 19 percent of the School’s revenue.

Following the endowment's strong investment returns for fiscal years 2003, 2004, and 2005, the University chose to embark on a long-term program of supplemental distribution increases beginning in fiscal 2006. These additional funds draw from the pool of incremental capital generated by the endowment's exceptional long-term performance, and are designed to support additional spending on the highest strategic priorities at each of the Harvard schools. The supplemental distribution available to HBS for fiscal 2006 of approximately $1 million was used for additional MBA fellowship awards. These funds have the potential to become a more significant source of income for the School in the years ahead.

After including all gifts and distributions, at the end of fiscal 2006 the University endowment was valued at $29.2 billion, compared with $25.9 billion at June 30, 2005. Annual endowment performance is measured not only in terms of net value, but also by tracking Harvard’s investments against benchmarks in 11 relevant asset classes.

The University's total investment return for fiscal 2006 amounted to +16.7 percent, net of all expenses and fees, outperforming benchmarks in nine of these asset classes. Emerging markets posted the year's highest total return, while commodities achieved the best performance relative to benchmark. In aggregate, Harvard Management Company outperformed its composite benchmark by 3.7 percentage points, translating into $900 million of added value for the endowment.

Endowment performance benchmarks are also provided by the Trust Universe Comparison Service (TUCS), which evaluates comparative performance of large institutional funds. The Harvard endowment’s fiscal 2006 investment return exceeded the TUCS median of 10.8 percent by 5.9 percentage points. During the past five- and ten-year periods, the University’s endowment has produced annualized total returns of 13.5 and 15.2 percent, respectively, compared with the TUCS median returns of 6.7 and 8.7 percent.

As of June 30, 2006, the HBS endowment represented approximately 8 percent of the total University endowment assets. Reflecting both investment return and new gifts, in fiscal 2006 the combined market value of the School's endowment grew by approximately $275 million, or 13 percent, to $2.3 billion from $2.1 billion in fiscal 2005.