

HARVARD | BUSINESS | SCHOOL



Harvard Business School
Centennial Celebration

2008

Annual Report



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HBS was founded in 1908 in the midst of a financial crisis that has striking parallels to the economic turbulence the world is witnessing today. The School now has an even greater opportunity and responsibility to deliver on its mission to educate leaders who make a difference in the world.

Dean Jay Light reflects on the issues Harvard Business School is addressing as it embarks on its second century.

Q. We hear a lot these days about the complexities of doing business in the global economy. What is HBS doing to educate students to be successful in this new environment?

A. In all the ways that characterize this school—the thinking, the cases, the curriculum, the courses, the research, and the faculty—we’re becoming a more global place in order to prepare our students for tomorrow’s world. We’ve set up a chain of six research centers in key regions of the world. We’ve produced 170 new global cases in the last year. We’re constantly renewing the curriculum to focus on the truly global aspects of the decisions that our students will face in the future.

We’ve brought a number of important new second-year courses into the curriculum that focus directly on issues of doing business around the world—particularly in emerging and increasingly competitive markets. We’re thinking about setting up classrooms in other areas around the world. And our faculty continue to become more global and diverse.

Our broader global strategy demands that we have a presence around the world by developing the same kinds of networks and intellectual material we have always had in the domestic context. There are many challenges involved, the same ones that organizations of all kinds are facing as they become more global.

Q. The School has recently launched initiatives directed at healthcare and science-based business more broadly. What can HBS do for these increasingly important sectors?

A. Healthcare is on its way to becoming 20 percent of the GDP of this country. It’s also obviously a sector where management is extremely important, and where Boston really is the global leader. HBS, in collaboration with other parts of Harvard, is creating what we believe is the world’s broadest and best institution focused on the business of healthcare.

We also realize that in the coming decades science-based businesses are where the future of our economy lies. These types of enterprises are significantly different from traditional businesses, and teaching our students how to manage them is essential. For example, the key people within those companies are the scientists, who are deeply involved in creating the intellectual capital. These companies straddle the business and not-for-profit sectors. The pace of change is accelerated, and we must understand how to translate that pace into strategic ideas.

Q. HBS has done an impressive job of recruiting a diverse MBA student population. How can the School further enhance diversity, especially by reaching those who may not think it is financially accessible?

A. Students from very different backgrounds come to our MBA Program. They also come from all over the world and are headed for very different kinds of careers. We view it as a challenge to provide enough financial aid to make sure that we have a diverse set of students here in every sense of that word.

 Hear more from Dean Light in his video Q&A:
www.hbs.edu/annualreport

One of the things we did in the recent capital campaign was to raise additional funds from our alumni to support fellowships, and those funds invested in the endowment have done very well. Together, those two things have allowed us to provide more and more generous fellowship aid. While the cost of tuition for the MBA Program continues to rise at about the pace of inflation, we have been increasing the financial aid available in the form of fellowships to students of lesser financial means, and so we have driven down the actual cost of getting an MBA here. It's come down considerably in the last three years, and with the generosity of our alumni going forward, we hope to be able to continue to do that.



Jay O. Light
Dean of the Faculty

Q. The current global economic crisis appears more serious than anything we've witnessed in modern history. How is the School thinking about it?

A. The complex modern global financial system has proven to be far more fragile than anyone anticipated. We all failed to understand how that fragility might evidence itself, and thus we are witnessing today a sobering failure of financial safeguards, of global markets, and of financial institutions.

There are a number of actions to be taken. In the short run, we must restore confidence in our institutions and markets. In the long run, it will likely mean building an entirely new financial system with a new set of regulators, a new set of regulations, and even a new set of firms different from any we've seen before. These tasks will require capital, good decisions, and, most of all, new kinds of leadership.

Harvard Business School's faculty, students, and alumni must be engaged in this effort, from analyzing the problems to adapting our curriculum to reflect changes in the culture of how business is done. We have begun important work already, adding new cases and activities in the MBA curriculum. And our faculty are deeply engaged, writing cases, articles, and op-eds on aspects of the crisis, including the housing market, securitization, bank dividends, and consumer finance.

Operationally at HBS, we have been monitoring, and will continue to watch, key performance metrics. We will continue to ensure that our educational programs and the faculty's research remain strong. We will make important incremental investments to offset the effects of the downturn (for example, increasing our support to students in their job searches). Finally, we will seek out opportunities to strengthen our long-term position.

The view at the Summit

The year 2008 marked the 100th anniversary of the founding of Harvard Business School. To commemorate the milestone, the School convened more than a dozen academic and industry colloquia on topics ranging from entrepreneurship and creativity to healthcare to the future of market capitalism. For alumni, in addition to more than 50 regional celebrations around the world, the culminating event was the Centennial Global Business Summit in October. The summit brought together nearly 2,000 graduates to engage in a dialogue with leading figures in business and society on the issues that will shape global management for decades to come.

2008 Alumni Achievement Awards

For four decades, HBS has honored outstanding graduates with the Alumni Achievement Awards. Like their predecessors, the 2008 honorees are exemplary role models who have contributed significantly to their companies and communities while upholding the highest standards and values in everything they do.

JOHN DOERR, MBA '76

JEFFREY R. IMMELT, MBA '82

ANAND G. MAHINDRA, MBA '81

MEG WHITMAN, MBA '79

JAMES D. WOLFENSOHN, MBA '59

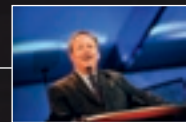


"You need an open environment. I was at a meeting one time and someone said when you're a CEO you need around you one truth teller, someone who will always tell you the truth no matter what. To which I said, 'If you're a CEO and you have ten people around you and only one is a truth teller, you should fire the other nine.'"

JAMES DIMON, MBA '82
CHAIRMAN/CEO, JPMORGAN CHASE

"I believe that the choices that the United States, as a nation, makes going forward in cooperation with other nations will in the broad economic area have profound impact on the lives of literally hundreds of millions of people who will never know what a credit default swap is, who will never know who the financial minister of any country is, but whose lives will be affected in hugely consequential ways by the choices that our society makes."

LAWRENCE SUMMERS
CHARLES W. ELIOT UNIVERSITY PROFESSOR



"You have areas where people can't afford to buy drugs, and therefore the incentive to invent those drugs is very small. That's a certain type of market failure. A dramatic example is that if you look at the amount of money that's been spent on male baldness, it's ten times the amount that's been spent on malaria.... That's clearly the kind of thing a foundation should come and do."

BILL GATES
CHAIRMAN, MICROSOFT CORPORATION

“Although we have a large and highly talented applicant pool, we also see people who are not applying and whose voices would enrich our classrooms and alumni network. That’s the catalyst behind admissions initiatives ranging from increased financial aid to targeted merit aid to the 2+2 Program.”

DEIRDRE LEOPOLD, MBA ’80
Managing Director
MBA Admissions & Financial Aid

Leaders for a changing world

The leaders of tomorrow must understand and represent the world. HBS has delivered on its commitment to bring diverse perspectives to its classrooms: The MBA Class of 2010 is 33 percent international, from 71 countries; 27 percent U.S. ethnic minorities; and 38 percent female. Fully half of all students qualify for fellowships from the School. In order to broaden the applicant pool still more, in recent years HBS has substantially decreased the cost of attendance for students with demonstrated need by raising the amount of tuition covered by the average fellowship from 30 percent for the Class of 2000 to 59 percent for the Class of 2009. As well, in 2008 the School began a merit-based fellowship program to recruit students from the life sciences.

2 + 2 = More

Many talented undergraduates do not even consider pursuing an MBA. Yet their aspirations to drive change through leadership could make them ideal candidates for HBS. To reach these high-potential students, in 2008 HBS inaugurated the 2+2 Program and admitted the first cohort of approximately 100 college seniors. The students will join the 2+2 online community as they finish their undergraduate degrees and then work for two years, spending part of each summer on campus for career coaching, skill building, and leadership development before entering the MBA Program.

Leaders for emerging sectors

Scientific discovery is driving business as never before, and the pace of innovation continues to accelerate. The fledgling HBS Science-Based Business Initiative prepares students to lead scientific enterprises, which are characterized by novel finance needs, broad external collaborations, and complex ethical issues. Drawing on scientific strengths across Harvard and throughout the Boston area, the initiative gives students unique opportunities for experiential learning, including the elective course Inventing Breakthroughs and Commercializing Science. This course brings together MBA students with those from other fields within and beyond Harvard to create business plans for advancing new science to the marketplace.



A Lab at Your Fingertip

Diagnostics-For-All is a small start-up with a big mission—to improve global health through a simple, low-cost, accessible diagnostic technology. The not-for-profit company, which grew out of the Inventing Breakthroughs and Commercializing Science course, won top honors in the 2008 business plan competitions at both HBS and MIT. Based on technology from the laboratory of Harvard Professor George M. Whitesides, DFA is advancing the development of an innovative paper-based chip that reacts to bodily fluids to indicate health or disease. This breakthrough technology has the potential to save countless lives in the developing world.

“Here, at a world academic center that gives birth to innovation, we are building a synergistic research and teaching initiative that crosses disciplines. The goal is to capture the value of that innovation by advancing Harvard research for the benefit of society and developing leaders for new kinds of enterprises.”

VICKI SATO

Professor of Management Practice
Harvard Business School

Professor of the Practice
Department of Molecular
and Cellular Biology,
Harvard University

Leaders for a global economy

For more than a decade, HBS has pursued a strategy of global engagement through the creation of regional research centers—six in total—that facilitate faculty research and course development and build ties with local alumni and business. In 2008, HBS began expanding the footprint of these centers to support a wider range of educational programs, from MBA Immersion experiences to Executive Education offerings.

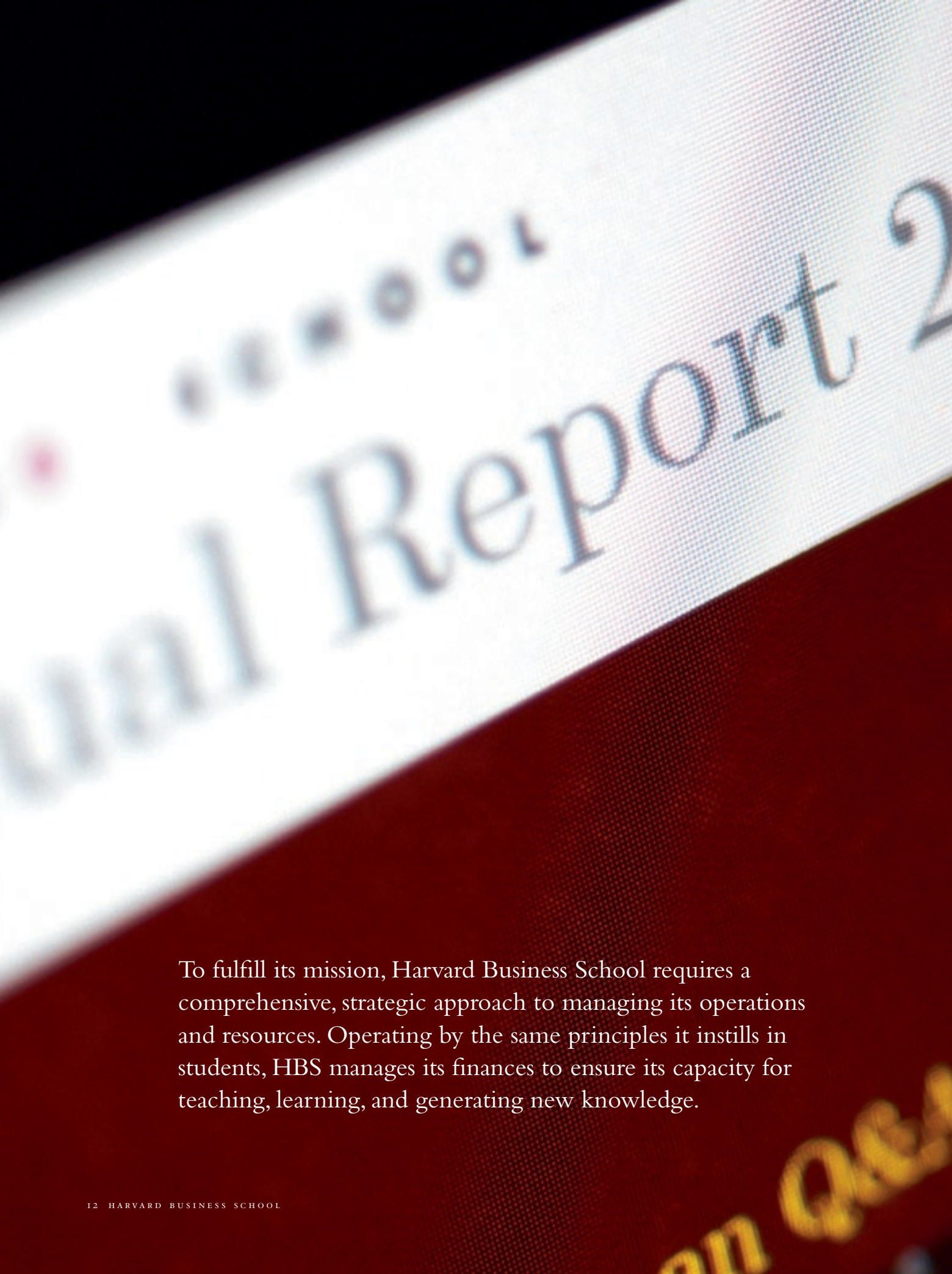
Open for Business in Shanghai

In a unique collaboration, in 2008 HBS and the Harvard China Fund opened an office on the Bund in Shanghai. For HBS, the office will extend the reach of the Hong Kong-based Asia-Pacific Research Center to support the School's research, educational programs, and publishing efforts. For the Harvard China Fund, it will provide Harvard students and faculty with on-the-ground services for regional study, internships, scholarly research, and teaching. Within a year, HBS and the HCF hope to open a larger facility in the Pudong district, including a classroom for executive programs and research colloquia, as well as meeting and office space.

"You can't pretend to know more than you do about the Japanese economy or use only U.S.-based cases when you're teaching a roomful of Asian executives. Teaching our programs around the world demands that we develop an in-depth understanding of global business issues and enables us to test our ideas in real time."

KRISHNA PALEPU

Ross Graham Walker
Professor of Business Administration
Senior Associate Dean for
International Development



To fulfill its mission, Harvard Business School requires a comprehensive, strategic approach to managing its operations and resources. Operating by the same principles it instills in students, HBS manages its finances to ensure its capacity for teaching, learning, and generating new knowledge.

Five-Year Financial Data Summary

IN MILLIONS

FOR THE FISCAL YEAR (FY) ENDED JUNE 30,	2004	2005	2006	2007	2008
Revenues	\$ 309	\$ 331	\$ 368	\$ 405	\$ 451
Expenses	294	307	345	375	423
Cash from Operations	15	24	23	30	28
Capital Investments	54	79	49	20	40
Building Debt Outstanding	70	74	108	108	121
Unrestricted Reserves	56	52	60	65	79
Endowment	1,766	2,065	2,340	2,821	2,971
Total Assets	2,367	2,693	3,018	3,500	3,684

Key Facts

	2004	2005	2006	2007	2008
MBA PROGRAM					
Applications	7,139	6,559	6,716	7,438	8,661
Percent Admitted	15%	16%	15%	14%	12%
Yield	87%	89%	91%	89%	91%
Enrollment	1,800	1,794	1,822	1,806	1,796
Tuition	\$ 33,650	\$ 35,600	\$ 37,500	\$ 39,600	\$ 41,900
Average Fellowship Aid per Student	\$ 11,543	\$ 13,299	\$ 15,647	\$ 17,605	\$ 21,591

DOCTORAL PROGRAMS

Applications	744	587	611	694	595
Percent Admitted	4%	4%	5%	5%	6%
Yield	70%	80%	64%	57%	81%
Enrollment	98	98	101	103	105

EXECUTIVE EDUCATION

Enrollment	7,360	8,133	8,239	9,281	9,345
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FACULTY

Faculty Positions (full-time equivalents)	204	201	215	206	219
Teaching Materials Produced	588	561	606	602	647
Research Articles Published	127	103	130	145	152
Books Published	23	36	31	24	24

STAFF

Staff Positions (full-time equivalents)	1,017	1,044	1,077	1,109	1,146
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PUBLISHING

Cases Sold	6,999,000	6,958,000	7,428,000	7,785,000	8,240,000
Harvard Business Press Books Sold	1,180,000	1,272,000	1,409,000	1,882,000	2,025,000
HBR Circulation	240,000	240,000	243,000	248,000	246,000
HBR Reprints Sold	2,910,000	2,929,000	3,112,000	3,061,000	3,123,000

CAMPUS

Buildings	33	33	33	33	33
Square Feet	1,476,041	1,512,753	1,512,753	1,512,753	1,512,753

Financial Highlights

TOTAL REVENUES

Total revenues increased by \$46 million, or 11.4 percent, from last year to \$451 million. Total revenues have risen at a compound annual growth rate of 8.9 percent for the past five years.

MBA PROGRAM REVENUES

MBA Program revenues grew by \$5 million, or 6.5 percent, to \$82 million as a result of normal increases in tuition and fees and increased enrollment in the prematriculation programs and Immersion activities.

EXECUTIVE EDUCATION AND PUBLISHING REVENUES

Revenues from Executive Education and Harvard Business Publishing (HBP) increased by a combined \$26 million, or 11.9 percent, to \$245 million. Executive Education continued to see strong returns on investments in corporate relations and marketing, and further expanded its program offerings. HBP revenue growth was led by \$11 million of increased eLearning and case sales, offsetting flat revenues in the *Harvard Business Review* and a decrease in press activity.

ENDOWMENT INCOME

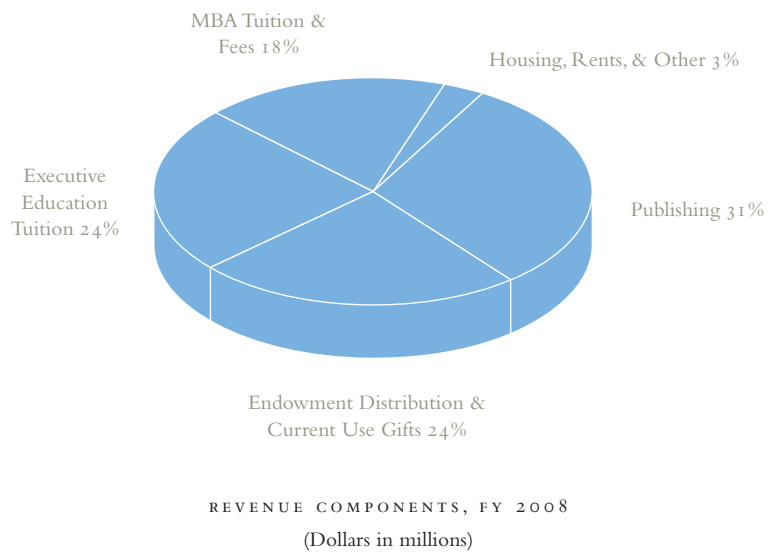
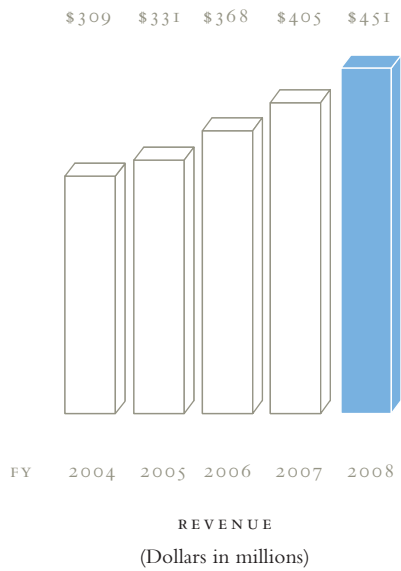
Endowment income distributed for operations rose by \$16 million, or 20.5 percent, the result of continued higher-than-usual increases in the endowment payout related to superior performance by Harvard Management Company. The increased distribution was used primarily to fund financial aid awards and faculty research.

OPERATING EXPENSES

Operating expenses increased by \$48 million, or 12.8 percent, to \$423 million, largely reflecting an increase in variable costs due to increased activity in Executive Education and HBP, as well as an 18.2 percent increase in total fellowship support.

CASH FROM OPERATIONS

Cash from operations decreased by \$2 million to \$28 million. Gifts from prior years, available to be spent pursuant to the donors' specifications, added \$41 million to the School's cash flow, compared with \$14 million last year. The increase is attributable to the School's \$26 million share of a University-wide strategic decapitalization from the endowment, drawn from appreciation resulting from the Harvard endowment's strong investment returns in recent years. Cash before capital activities thus increased by \$25 million, from \$44 million to \$69 million.



CAPITAL EXPENSES

Capital expenses for construction and renewal of campus facilities increased by \$20 million to \$40 million. The primary capital costs were renewal projects for Gallatin Hall and the McCollum classrooms, as well as investments in the School's central chiller facility. Additional funding came from gifts for specific capital projects amounting to \$5 million, as well as \$22 million in new borrowings. The new debt primarily reflects debt funding for the Gallatin work. The comparable fiscal 2007 amounts were \$3 million and \$7 million, respectively.

DEBT

Total building debt outstanding at June 30, 2008, increased from \$108 million to \$121 million, reflecting the \$22 million of new borrowings offset by \$9 million of principal repayments.

RESERVES

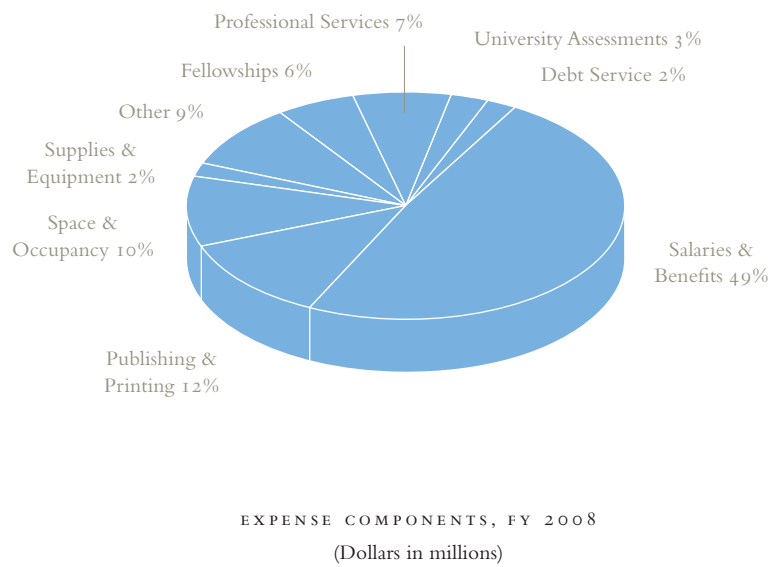
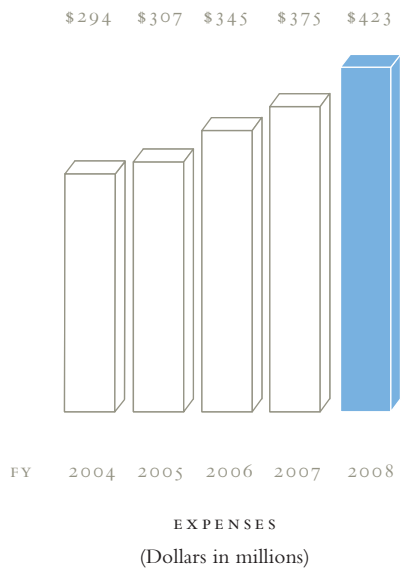
Unrestricted reserves increased by \$14 million to \$79 million at the end of fiscal 2008. In addition, HBS maintains endowment reserves, with a June 30, 2008, end-of-year value of approximately \$126 million, including a \$25 million transfer performed in fiscal 2008 (the majority of the \$33 million in "Other Activity").

ENDOWMENT

The market value of the HBS endowment and current use funds increased by approximately 7.1 percent to nearly \$3.0 billion as of June 30, 2008, from \$2.8 billion a year earlier, reflecting both solid returns and new endowment gifts. Total return on the Harvard University endowment for fiscal 2008 was +8.6 percent.

GIFTS

Alumni and friends continued to be generous in fiscal 2008. Cash from gifts was \$51 million, consistent with total giving from the prior two years. This generosity remained vital in fiscal 2008, as unrestricted current use gifts and endowment distribution together generated 24 percent of the School's revenues, up from 23 percent last year. Approximately 30 percent of the School's MBA alumni made a gift to the School in fiscal 2008.



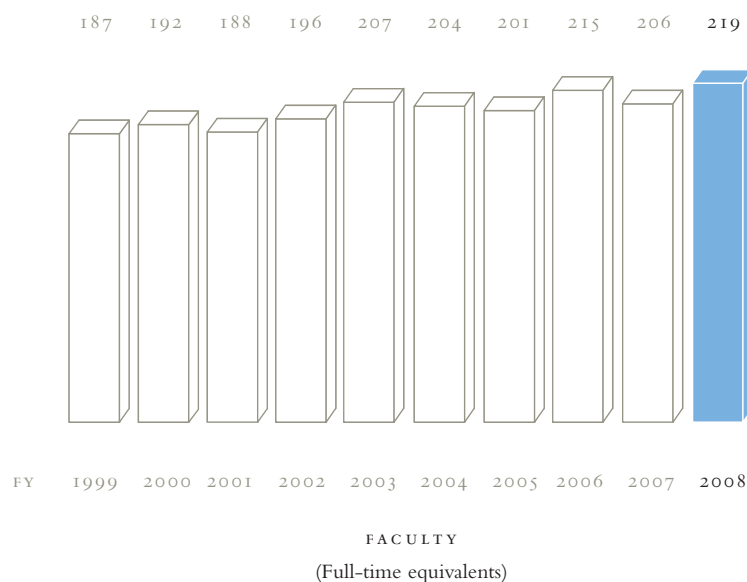
From the Chief Financial Officer

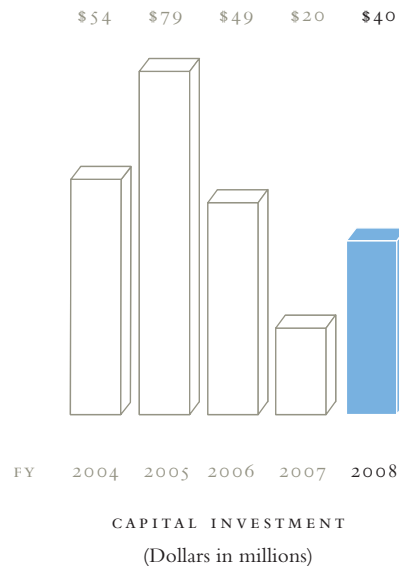
Harvard Business School performed well in fiscal 2008, despite the slowing economy. It was a record year for Executive Education, Harvard Business Publishing produced solid results, and income from the endowment increased substantially. Producing a third consecutive year of double-digit revenue growth, the School's business model continued to generate the cash flow we need to drive innovation in MBA education, maintain the physical integrity of the campus, and invest in strategic opportunities.

The HBS business model is rooted in a faculty whose research brings them into contact with leaders and managers of organizations around the world. Executive Education and Harvard Business Publishing (HBP) transform the resulting ideas into new programs and products that are offered in highly competitive academic and corporate markets worldwide. The income generated by this business activity is used to fund the faculty's research and enable them to stay close to practice, thus completing the cycle and allowing it to begin anew.

Fiscal 2008 was an exceptional period for Executive Education, reflecting the success of a strong push in corporate relations and marketing, as well as a review and expansion of program offerings, over the past two years. Executive Education posted both 14.8 percent growth in "participant days" and markedly higher classroom utilization in fiscal 2008, significantly improving margins. At the same time, Executive Education took an important step toward expanding its reach and impact globally by launching a number of new programs abroad.

Harvard Business Publishing has been working strategically for the past few years to reinvent its business as publishing becomes increasingly digital and global. Executing on this strategy, the publishing unit continued to expand its online content and product offerings in fiscal 2008. Among HBP's key initiatives in the corporate market was the release of two new online simulations and an advanced digital product and service-oriented architecture, as well as new premier content libraries. The publishing unit also improved its web site in ways that make it a more desirable information portal and destination for corporate and academic customers.





Although HBP continued to perform well on the top line, particularly in light of the economic slowdown and industry-wide weakness in print advertising, margins in the School's publishing unit contracted in fiscal 2008. To support its new business model, HBP is in the midst of a three-year, multimillion-dollar effort to transform the IT infrastructure that supports essentially all of its internal processes, from customer relationship management, to product delivery, to general ledger. HBP's expenses increased in fiscal 2008 as a result, and publishing margins are likely to remain challenged in fiscal 2009 as IT deployments continue.

In addition to revenues from executive programs and publishing, income from unrestricted current use gifts and distributions from the endowment are important sources of funding for the School. In fiscal 2008, total income from gifts and the endowment grew by nearly 14 percent from a year earlier, and represented 24 percent of total revenue. All of this growth came from endowment income, which was up more than 20 percent from last year to \$94 million. The higher distribution in fiscal 2008 reflected continued strength in the Harvard endowment's investment returns and the University-wide increase in the endowment distribution rate.

In fiscal 2008, as in prior years, HBS leveraged the income from executive programs, publishing, gifts, and the endowment to further strengthen education and knowledge creation across the School, and to enhance the diversity of the MBA student body. Applications to the MBA Program were up in fiscal 2008, and yield grew to 91 percent.

HBS remains committed to attracting strong MBA candidates who might not otherwise consider a degree in business. One of the School's long-standing objectives, therefore, is to ensure that MBA fellowship awards grow faster than increases in tuition and fees, thus reducing the real cost of the program for students receiving fellowships. In fiscal 2008, total MBA and Doctoral fellowship spending rose by 18.2 percent from last year, while MBA tuition and fees increased by 6.5 percent.

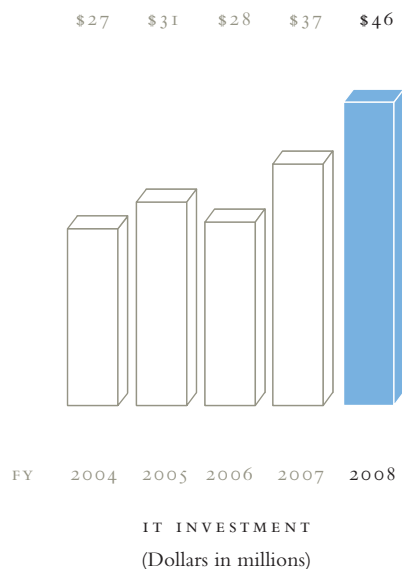
Since fiscal 2003, the School's total fellowship budget has grown at a compound annual rate of 13.2 percent. The average MBA fellowship size per recipient has increased by 15.6 percent, far in excess of the increase in MBA tuition and fees. As a result, the net cost of tuition for MBA fellowship recipients has declined by 5 percent. The increase in fellowships during this period reflected dramatic growth in the School's endowment resources, in turn driven by the School's capital campaign earlier this decade and compounded by larger annual distributions made possible by the Harvard endowment's strong investment returns.

Endowment resources, as well as growth in revenue from Executive Education and HBP, also serve as a crucial asset for the School in the competition for outstanding business school faculty. Winning this competition depends on a school's ability to offer prospective faculty attractive compensation, as well as support for ambitious and innovative research programs. HBS continues to be successful in both respects. The size of the HBS faculty, as measured in full-time equivalents, grew to a record 219 in fiscal 2008, from 206 in the prior year. At the same time, HBS has continued to invest in new research infrastructure and support staff services aimed at enhancing the faculty's research opportunities and productivity.

The School has been strategically focused for more than a decade on creating a network of research centers around the world to support the faculty's field-based research. As these centers have become better established in their regions, they have helped drive growth in total faculty research output. As measured by the number of cases and working papers published, output increased by 7.5 percent in fiscal 2008 from fiscal 2007.

The School continued to generate strong cash flow from operations in fiscal 2008. Operating cash is largely reinvested in the campus, providing crucial funding for baseline facilities maintenance, campus infrastructure and IT upgrades, and debt service for building renewal projects. As planned, the School's capital expenses doubled in fiscal 2008 to \$40 million.

Included in this spending was \$18 million toward a major renovation of Gallatin Hall. In addition, the School completed executive program classroom upgrades in McCollum Hall, and renewal of MBA residence space in Morris Hall. Large capital projects in fiscal 2008 also included the completion of a multiyear upgrading of the Technology Operations Center and modernizing of the heating and air-conditioning systems in several buildings. Approximately half of the School's fiscal 2008 capital budget was invested in smaller projects designed to prevent the accumulation of deferred maintenance and to maintain the long-term value of the campus.



HBS concluded fiscal 2008 with an unrestricted reserves balance of \$79 million—up \$14 million from last year and well within the School's long-term target. Reserves are one of the resources used by HBS to finance capital projects, and building our reserves balance will be a key strategic objective for fiscal 2009 as we pursue the School's comprehensive campus plan in the coming years.

The growth in reserves in fiscal 2008 was largely a result of greater use of endowment appreciation to fund the School's operations. During the year, HBS received \$26 million as its share of a University-wide strategic decapitalization from the endowment, made possible by the Harvard endowment's strong investment returns in recent years. These funds were used in accordance with the donors' intent to advance the School's long-term initiatives, allowing us to place more reliance on cash from operations to fund ongoing activities and capital projects.

A LOOK FORWARD

As foreshadowed by the quarter that ended in June 2008, the past three months have been difficult for the economy and severely challenging for the capital markets. Nonetheless, through the first quarter of fiscal 2009, demand for HBS executive programs has remained surprisingly strong. Harvard Business Publishing is holding its own, and the School's other sources of revenue have continued to perform well. Given the exposure of the HBS business model to the economic environment, however, our operational and financial plans for fiscal 2009 are grounded in caution and geared toward flexibility.

The School's fiscal 2009 operating budget calls for revenue growth to slow from 11.4 percent this past year to 6.4 percent, reflecting conservative top-line forecasts for Executive Education and HBP. Total expenses, meanwhile, are expected to rise by 8.7 percent. Although total cash flow should be sufficient to balance the budget and add modestly to the School's reserves, we expect to be somewhat constrained, as compared with last year, in our ability to rely on cash from operations to fund strategic priorities. As in fiscal 2008, these priorities are to enhance MBA student diversity, enrich the MBA experience, attract outstanding faculty, and expand the School's global research and teaching activities.

In the MBA Program, fiscal 2009 will be another year of curricular innovation. This year the successful Immersion Experience Program will expand from six offerings to nine. At the same time, in connection with the University-wide calendar initiative, the School will be developing initial January term programming for the 2009–2010 academic year.

The planned increase in MBA tuition for fiscal 2009 is 4.5 percent—the smallest on a percentage basis in many years—while fellowship awards are expected to rise more than 23 percent. This growth reflects, in part, the School's first merit-based fellowship award to address the growing need for management and leadership skills in the life sciences professions.

Building on the School's success in faculty recruiting in fiscal 2008, we expect faculty FTEs to grow from 219 this past year to 227 in fiscal 2009. The School's investment in faculty research is projected to rise by nearly 10 percent in fiscal 2009 to more than \$112 million. A significant portion of the incremental funding will be used to further strengthen the HBS regional research centers and thus better enable the faculty to remain close to practice around the world.

Harvard Business Publishing's plans for fiscal 2009 will focus on digital product rollouts and further globalization in terms of product content and operational reach, highlighted by the opening of a new office in India. Executive Education will be building on the momentum generated this past year by continuing to experiment with hybrid program components across its long program portfolio. Executive Education also expects to complete development of a new Healthcare Management Program for delivery in fiscal 2010. Program investments over the past two years enhanced the quality of the overall participant mix in fiscal 2008, and these efforts will continue in the year ahead.

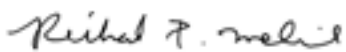
Fiscal 2009 will be an active year globally. Identifying a combined site for a new classroom space and office facility in China will be a key objective. We will continue to develop focused and custom programs in China and India, while supporting the School's and the University's strategic efforts around the world. Recreating the HBS experience thousands of miles from Soldiers Field is a challenging goal, but one that promises to be a milestone for the School and its mission in the 21st century.

The School's efforts to create an offsite space for executive programs are not only strategically driven, but also a response to space limitations at Soldiers Field. Improving executive program capacity utilization was a priority for fiscal 2008, and will remain so, but lack of physical space on campus will continue to constrain growth in Executive Education for some time to come.

Looking forward to 2010 and beyond, the School's capital investment strategy will be shaped by the comprehensive campus plan essentially completed this past year. MBA Program priorities are residence hall construction and renovation, and the creation of new spaces for team-based learning. The campus plan also includes construction of new office facilities to accommodate growth in the size of the faculty. In addition, we are planning to address the chronic shortage of assembly spaces at HBS—from small rooms for seminars to large auditoriums.

Renovating the Executive Education residence space in Baker Hall will be one of the School's near-term capital investment priorities, with the initial spending planned for fiscal 2009. Completing the renewal of Gallatin Hall and upgrading the life safety systems in McCulloch Hall are the other large capital projects anticipated for the upcoming year.

On behalf of the faculty and staff of Harvard Business School, I extend my sincere thanks to you, the School's alumni and friends, for your generosity and support. We pledge to reward your commitment to HBS with thoughtful, accountable management in fiscal 2009 and the years ahead.



Richard P. Melnick, MBA '92
Chief Financial Officer
September 30, 2008



A photograph of a person sitting on a white wooden bench in a park-like setting. The person is seen from behind, wearing a dark jacket and blue jeans. The bench is situated on a green lawn. In the background, there are large trees with green and yellowing leaves, and a red brick building. The scene is captured in a cinematic style with soft lighting.

Financial Review

Financial Review

THE HBS BUSINESS MODEL

The work of Harvard Business School is sustained by a unique business model. Eighteen percent of the School's revenue comes from MBA tuition, fees, and related student income. More than 50 percent of revenue is generated by Harvard Business Publishing (HBP) and Executive Education, both of which offer products and programs in highly competitive markets. Nearly all of the remaining 30 percent of revenue comes from gifts to HBS, whether in the form of unrestricted current use gifts or distributions from the School's endowment.

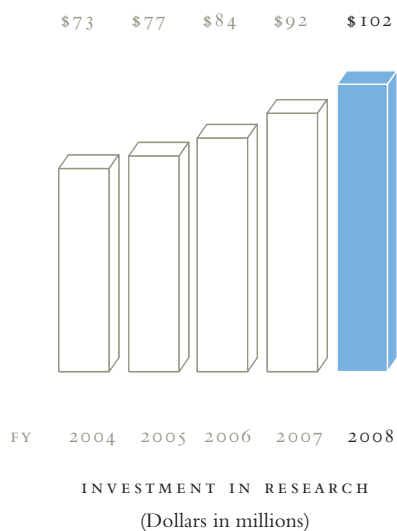
Unlike at other Harvard University schools, faculty at HBS do not seek grants from external sponsors such as government agencies, foundations, and corporations. Instead, their research is funded primarily by the School. Freedom from the constraints associated with outside funding allows faculty to pursue the research opportunities they believe have the greatest potential to create new knowledge.

In a self-sustaining cycle, the intellectual capital produced by the faculty is disseminated globally through Executive Education programs and HBP's portfolio of periodicals, books, cases and teaching materials, and eLearning products, enabling the School to advance the practice of management while generating significant operating margins. Completing the cycle, these margins serve as the mainstay source of funding for the faculty's research.

REVENUES

SUMMARY

Capping a five-year period in which the School's total revenue has grown at a compound annual rate of 8.9 percent, revenue for fiscal 2008 increased by 11.4 percent from the prior year to \$451 million. Executive Education and HBP together generated more than half of this \$46 million growth, reflecting their success in capturing corporate and academic demand for management education on an increasingly global scale. Driven by strong investment returns, a larger distribution of income from the School's endowment represented \$16 million of this year's revenue growth. As in prior years, MBA tuition and fees increased as well, generating an incremental \$5 million in revenue.



MBA TUITION AND FEES

The School continues to set MBA tuition at a level that recovers rising program delivery costs and investments in initiatives designed to enrich the HBS educational experience. As discussed later in this report, the incremental revenue from rising tuition is largely offset by considerable growth in fellowship spending.

Tuition and fees revenue from the School's core academic program increased to \$82 million in fiscal 2008, from \$77 million last year. First-year MBA tuition in fiscal 2008 was \$41,900—near the midpoint among the 10 comparable schools tracked by HBS—compared with \$39,600 last year. MBA tuition and fees declined to 18 percent of the School's total revenue in fiscal 2008, from 19 percent a year earlier.

EXECUTIVE EDUCATION

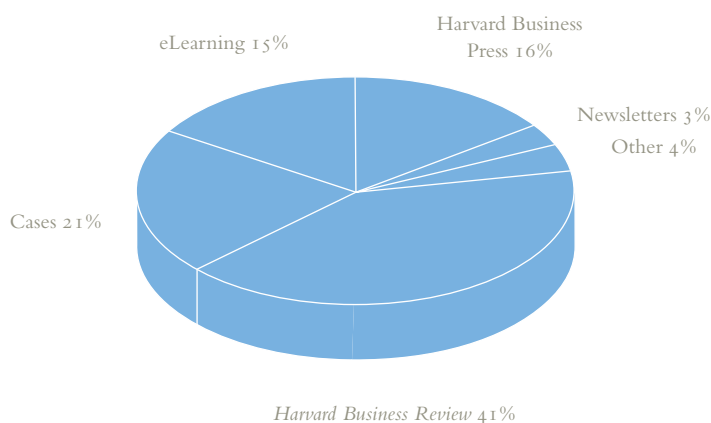
Tuition revenue from executive programs grew by 16.5 percent to \$106 million in fiscal 2008, from \$91 million last year. Executive Education tuition increased to 23.5 percent of total revenue, from 22.5 percent in fiscal 2007.

Executive Education restructured the Comprehensive Leadership Programs (CLP) portfolio of longer programs—including the Advanced Management Program, the General Management Program, and the Program for Leadership Development—two years ago, and market demand since then has been strong. In response, the School added new sections in two of the CLPs in fiscal 2008. Applications to CLPs grew by 11 percent from last year, and enrollment increased by 20 percent. Executive Education also added courses to its focused program portfolio, and delivered new programs in India.

Applications to the School's executive programs increased by 5.8 percent in fiscal 2008 to more than 12,900. Although total enrollment in fiscal 2008 was essentially level with the prior year, a larger proportion of participants attended the core long programs. The resulting increase in “participant days” drove the double-digit rise in Executive Education revenue for the year.

PUBLISHING

Revenue from HBP's sales of periodicals, books, cases and teaching materials, and eLearning products increased by 8.6 percent in fiscal 2008 to \$139 million, from \$128 million last year. The publishing operation generated 30.8 percent of the School's total revenue, compared with 31.6 percent in fiscal 2007.



PUBLISHING REVENUES, FY 2008

Harvard Business Publishing continued to produce top-line growth during a challenging time in the publishing industry. The ongoing transition to digital media, combined with the weakening global economy, led to a second consecutive year of declining demand for print advertising across the industry. Revenue from the School's flagship publication, *Harvard Business Review* (HBR), was level with fiscal 2007 at \$44 million, as continued growth in paid subscriptions and reprint sales was offset by the ongoing decline in print advertising. In addition, sales of Harvard Business Press books were down by 8 percent to \$23 million, reflecting the effects of the soft economy in the corporate market, as well as the absence of new blockbuster titles this year.

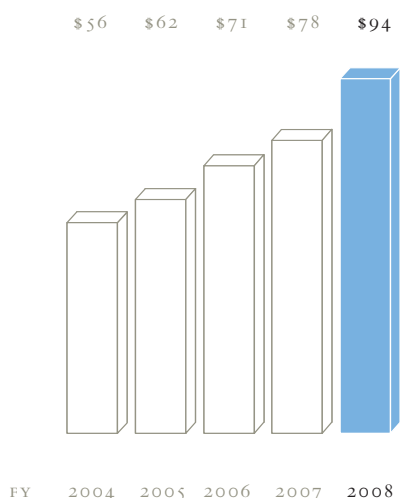
These headwinds were partially offset by HBP's academic business, which continued to produce solid revenue growth. Case and teaching materials revenue rose for the seventh consecutive year to a record \$30 million, from \$26 million in fiscal 2007. At the same time, HBP continued to make progress on its key strategic initiative to shift its business focus from domestic print publishing to a global digital platform. As a result, sales of eLearning products grew by \$7 million, or 46.6 percent, from last year to \$22 million, and HBP's total sales outside the United States grew by 14 percent.

GIFTS & ENDOWMENT

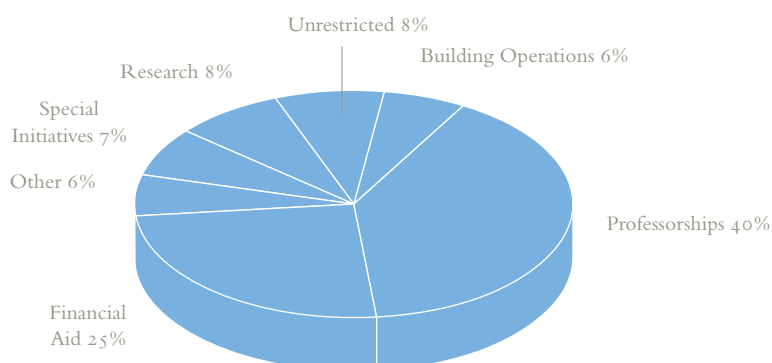
The annual distribution of income from the School's endowment, together with revenue from unrestricted current use gifts, accounted for \$108 million in funding in fiscal 2008, or 23.9 percent of the School's total revenue. This compares with \$95 million in fiscal 2007, or 23.4 percent of total revenue.

Endowment distributions increased by 20.5 percent, or \$16 million, to \$94 million in fiscal 2008, from \$78 million last year. In each of the five prior years, endowment distributions represented approximately 18 to 19 percent of the School's total revenue. The exceptional growth in fiscal 2008 was made possible by continued strength in the University's investment returns and the University-wide increase in the annual endowment distribution rate.

Unrestricted current use gifts, which have generated \$59 million in revenue over the past five years, serve as the primary source of innovation funding at HBS. Since the School's campaign concluded in fiscal 2006, encouraging unrestricted current use giving has been a key fundraising focus. Although unrestricted current use giving declined by \$3 million in fiscal 2008, from the record \$17 million posted for the prior year, it was the second-highest total in the history of the School.



ENDOWMENT DISTRIBUTION
(Dollars in millions)



ENDOWMENT COMPONENTS, FY 2008

Total cash received from all types of gifts was \$51 million in fiscal 2008, compared with \$56 million in fiscal 2007. HBS received gifts from more than 12,000 individual donors during the year, including alumni of the School's MBA, Doctoral, and Executive Education programs, as well as other friends of the School. Nearly 30 percent of the School's MBA alumni gave to HBS in fiscal 2008—a remarkable participation rate equal to those seen during the campaign years.

EXPENSES

SUMMARY

The School's total operating expenses increased by \$48 million, or 12.8 percent, in fiscal 2008 to \$423 million, from \$375 million in fiscal 2007.

As in prior years, the School's expense growth in fiscal 2008 was largely driven by variable costs associated with expanding business operations at HBP and Executive Education, as well as spending for fellowships and the faculty's increasingly global research activities. From a financial management perspective, these functional areas transect numerous line items on the School's Statement of Activity and Cash Flows.

For example, faculty research expense includes a significant portion of faculty salaries and benefits expense, as well as direct costs for research support staff, travel, and IT services. Also included in the cost of faculty research are allocated expenses for the School's network of global research centers, as well as library resources, campus facilities, technology, and administration. When viewed in this way, the School's annual investment in faculty research has increased at a compound annual rate of 7.2 percent for the past five years, growing to \$102 million in fiscal 2008, from \$72 million in fiscal 2003.

In HBP and Executive Education, expenses include direct costs for staff compensation, specialized outside professional services in areas such as IT and marketing, and residence expenses for executive program participants. These expenses have risen in line with growth in the HBP and Executive Education product and program portfolios, and in the physical scope of their operations. At the same time, by successfully controlling their fixed costs, both operations have delivered margins on the incremental revenue. In turn, HBS has reinvested these margins to fund the School's teaching and research activities.

SALARIES AND BENEFITS

Faculty and staff compensation is the School's largest expense. Amid increasing global demand for outstanding faculty, and with plans to expand the size of the faculty over the next decade, HBS recruits aggressively. The ability to offer competitive salary and benefits packages is crucial to success in the market for academic talent.

While growing the faculty remains a priority at the School, the total number of faculty, as measured in full-time equivalents (FTEs), can increase or decrease in any given year as a result of retirements, departures, and normal fluctuations in recruiting activity. In fiscal 2008, faculty FTEs grew to 219 from 206 last year, leading to a corresponding increase in compensation expense. Salaries and benefits for faculty and their research associates represented approximately 40 percent of the School's employee compensation costs in fiscal 2008, or approximately 19 percent of total expenses.

Including faculty and administrative staff, total employee salaries and benefits expense has risen at a compound annual rate of 8.8 percent over the past five years. This figure disproportionately reflects fiscal 2008 results, as the School's total compensation expense grew by \$27 million, or 15.1 percent, from the prior year, to \$206 million, and represented 48.6 percent of total operating expenses. The major cost drivers this year were the faculty and staff FTE increases, an-

nual employee compensation increases across the School, and one-time expensing of both historic vacation liability and faculty early retirement incentives.

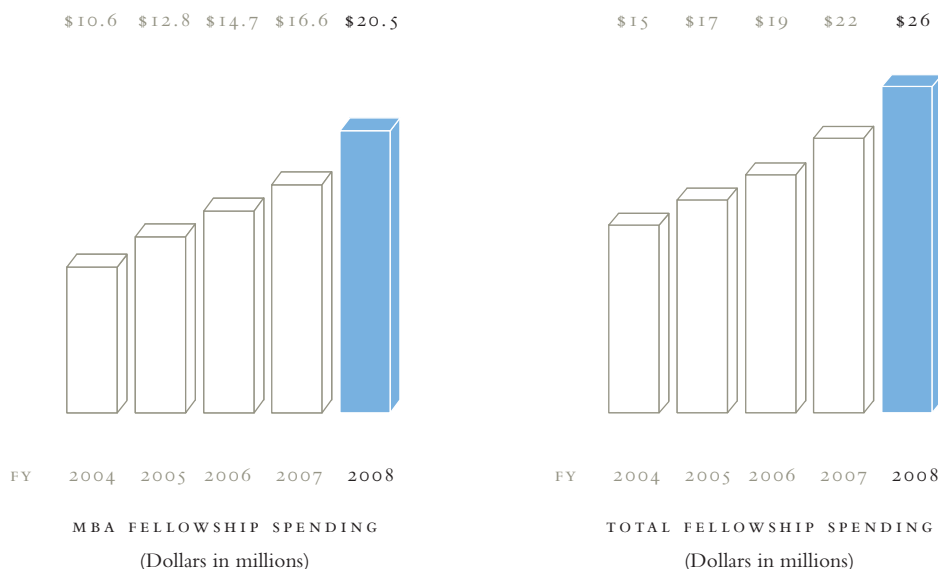
HBS tightly controls administrative staff levels, adding staff positions only when they are critical to achieving the School's teaching and research objectives. In fiscal 2008, administrative FTEs increased by 37 to a total of 1,146, from 1,109 FTEs at the end of fiscal 2007. Although the operational footprint of the School has expanded significantly in the past five years, the number of administrative FTEs has grown at a compound annual rate of only 1.5 percent.

FELLOWSHIPS

MBA and Doctoral fellowship spending, or financial aid, is treated as an expense line item on the School's Statement of Activity and Cash Flows. However, increasing financial aid support for students is a long-standing strategic objective at HBS.

The generosity of the School's alumni and friends, coupled with strong investment returns on the HBS endowment, have significantly increased the size of the School's endowed financial aid funds in the past five years. Total MBA and Doctoral fellowship spending has risen at a compound annual rate of 13.2 percent during this period. In fiscal 2008, the School's total financial aid expense grew by \$4 million, or 18.2 percent, from the prior year, to \$26 million.

Since fiscal 2003, the average two-year MBA fellowship award has grown from \$21,500 for the Class of 2004 to \$45,000 for the Class of 2009. HBS will continue seeking ways to assist MBA students in reducing their debt at graduation, thus broadening their career opportunities in both the private and the public sectors.



PUBLISHING AND PRINTING

Publishing and printing expense includes HBP production costs as well as a small amount of spending to produce the School's other printed materials and publications. Primarily reflecting higher costs for printing and paper, marketing, and author royalties at HBP, publishing and printing expenses rose by \$2 million to \$53 million in fiscal 2008.

SPACE AND OCCUPANCY

The HBS campus includes 33 buildings encompassing more than 1.5 million square feet of occupied space. The School is solely responsible for managing these physical facilities; campus maintenance and construction are not centralized University responsibilities as they are at many other large academic institutions. Space and occupancy expense includes costs related to maintaining and operating the School's buildings and associated campus infrastructure.

In addition, facilities improvement and renovation costs that do not qualify as capital expenses are generally 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 HBP's operations. Residence expenses for executive program participants—equivalent to cost of goods sold in Executive Education—also are reported under space and occupancy.

In the past five years, space and occupancy expenses have risen at a compound annual rate of 6.2 percent. The increase in fiscal 2008 was \$2 million, or 5 percent, driven primarily by higher campus-wide dining, parking, and security costs, as well as the aforementioned HBP and Executive Education expenses.

SUPPLIES AND EQUIPMENT

The School maintains rigorous control over expenses for supplies and equipment. Spending in this area increased by \$2 million, or 22.2 percent, in fiscal 2008, primarily reflecting variable costs incurred by HBP and Executive Education.

PROFESSIONAL SERVICES

Professional services expenses increased by 16 percent to \$29 million in fiscal 2008, from \$25 million in fiscal 2007. Harvard Business Publishing is engaged in a multiyear project to reconstruct its IT infrastructure. After focusing on deployment of a new platform to support its migration toward digital product offerings last year, in fiscal 2008 HBP invested in new IT systems to support internal processes ranging from customer relationship management at the front end of the business to general ledger at the back end. The School also made a significant investment in upgrading the MBA prematriculation platform. As in fiscal 2007, much of the increase in professional services expense this year reflected greater use of outsourcing to supplement the School's internal capabilities in these IT deployments.

UNIVERSITY ASSESSMENTS

Expenses for University assessments are primarily 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. University assessments increased by \$1 million in fiscal 2008 to \$12 million.

DEBT SERVICE

The School's debt service, which consists of interest payments to the University on building and other University debt, remained level in fiscal 2008 at \$7 million. In fiscal 2007, debt service increased by 75 percent from the prior year because of the accounting transfer of large amounts of debt from construction-in-progress to placed-in-service. This transfer reflected the completion of three of the School's largest recent capital projects: the restoration and renovation of Baker Library | Bloomberg Center and the renovation of Hamilton and Aldrich Halls. Debt service expense remained level in fiscal 2008 because of an increase in new borrowings to finance the renovation of MBA residence space in Gallatin Hall.

OTHER EXPENSES

Other expenses rose by 14.3 percent to \$37 million in fiscal 2008, from \$31 million last year. Increased international travel for the faculty, broader MBA recruiting outreach, direct costs for new executive programs, and expenses related to the School's Centennial activities were the major reasons for the growth in other expenses this year.

CASH FROM OPERATIONS

HBS relies on cash from operations, as well as endowment gifts and appreciation, to cover capital expenses and any related debt service over the long term. Cash from operations varies according to the health of the economy as well as the School's spending priorities. Levels of revenue from HBP and Executive Education, income from investment returns on the endowment, and unrestricted giving all are sensitive to economic conditions.

Meanwhile, HBS adds faculty, manages its research activity, and invests in its revenue-generating businesses and campus infrastructure on a long-term, strategic basis. While generally tracking these activities, the School's expenses also reflect strategic opportunities as they arise. As a result, cash from operations can fluctuate widely from year to year.

In 2002, the launch of The Campaign for Harvard Business School coincided with the start of an economic recovery, producing strong growth in revenue from gifts, HBP, and Executive Education. The School's operating cash flow nearly doubled year-over-year in fiscal 2004 to \$15 million, and reached a plateau of \$24 million and \$23 million in fiscal 2005 and 2006, respectively. Cash from operations increased to \$30 million in fiscal 2007, primarily as a result of the larger endowment distribution and income from unrestricted current use gifts.

In fiscal 2008, cash from operations declined by \$2 million from the previous year to \$28 million, reflecting a mix of factors. Growth in the endowment distribution and strong revenue from Executive Education were offset by slower growth in HBP, a decline in unrestricted current use giving, and higher operating expenses. The increase in expenses was largely attributable to growth in the size of the faculty, variable costs in HBP, and a one-time expensing of the historic vacation liability.

USE OF ENDOWMENT PRINCIPAL AND 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.

After remaining essentially level for the prior three years at \$14 million, use of endowment principal and appreciation grew to \$41 million in fiscal 2008. The increase reflected the School's \$26 million share of a University-wide strategic decapitalization from the endowment, drawn from appreciation resulting from the Harvard endowment's strong investment returns in recent years.

CASH AVAILABLE FOR CAPITAL ACTIVITIES

Fiscal 2008 marked the second consecutive year in which the School's cash flow exceeded net capital expenses. Although capital investment in the HBS campus doubled from fiscal 2007 to \$40 million, cash before capital activities grew to \$69 million, driven by the increase in use of endowment principal and appreciation related to the strategic decapitalization.

Looking forward, HBS plans to begin implementing its long-term campus plan in fiscal 2010. At that point, the School expects to see a return to the previous pattern of cash from operations falling short of net capital expenses. As in the past, HBS will ensure through its financial planning that sufficient resources—including unrestricted reserves—are available to service the School's debt and execute on its capital investment strategy.

NET CAPITAL EXPENSES

The most recent period of significant investment in the HBS campus concluded in fiscal 2005, when capital expenses reached \$79 million. The School's capital expenses declined to \$49 million in fiscal 2006 and to \$20 million in fiscal 2007 as the major projects initiated earlier in the decade neared completion. In fiscal 2008, capital expenses rose to \$40 million, largely reflecting the \$18 million invested in completing the majority of the renovations of MBA residence space in Gallatin Hall.

Other large capital projects in fiscal 2008 included the completion of a project to renew classroom space for executive programs in McCollum Hall, and the installation of new life safety systems in Morris Hall. The School also completed a multiyear upgrading of the Technology Operations Center and the replacement of an outdated and inefficient heating and air-conditioning infrastructure. Capital expenses for these projects totaled approximately \$8 million.

To protect the long-term value of the physical plant, HBS continues to invest in the renewal and maintenance of its buildings, facilities, and IT infrastructure. In fiscal 2008, the School's aggregate spending on these numerous smaller projects totaled \$7.6 million.

The \$40 million in fiscal 2008 capital expenses was funded with \$13 million in internally generated cash, substantially all of the School's \$22 million in new borrowings, and \$5 million in gifts for capital projects. In fiscal 2007, sources of funding for capital expenditures included \$10 million in internally generated cash, new borrowings of \$7 million, and \$3 million in gift payments for specific capital projects.

CHANGES IN DEBT & OTHER

HBS uses debt strategically as a means of optimizing its capital structure. The School borrows only on qualified capital projects, carefully considering 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.

New borrowings rose to \$22 million in fiscal 2008, from \$7 million a year earlier, primarily to finance the Gallatin Hall renovation. Debt principal payments rose to \$9 million, from \$7 million in fiscal 2007, reflecting scheduled payments as well as payments made possible by large restricted gifts received during the year.

Other non-reserve activity was \$33 million in fiscal 2008, compared with \$22 million in fiscal 2007. In fiscal 2008, as in the prior year, HBS transferred \$25 million of current use reserves to the unrestricted endowment reserve established several years ago in order to capture higher investment returns. Reflecting these additional funds and the performance of the endowment, the market value of this reserve grew to \$126 million at June 30, 2008, from \$94 million a year earlier. Other non-reserve activity for fiscal 2008 also reflected a one-time, non-cash accounting adjustment of \$8 million required by the University.

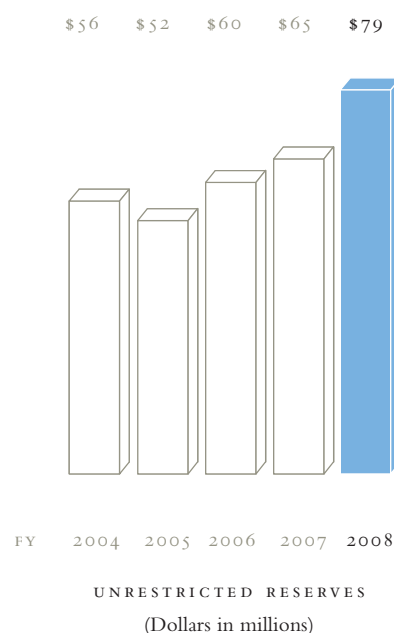
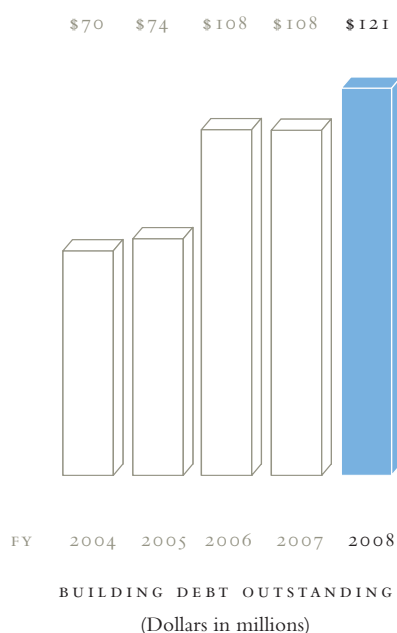
The School's balance sheet remains modestly leveraged. The University functions as a banker for HBS and the other Harvard schools, allowing HBS to borrow on a triple-A-rated tax-exempt basis. In fiscal 2008, the School's building debt increased by \$13 million to \$121 million, primarily reflecting construction-in-progress payments for the Gallatin Hall renewal project. Other University debt—mainly consisting of repayment obligations to Harvard for mortgage loans made by the School as a faculty recruiting incentive—rose by \$3 million to \$29 million.

Total debt has averaged only 3.7 percent of total assets for the past five years. The interest portion of the School's debt service amounted to 1.7 percent of total operating expenses in fiscal 2008, compared with 1.9 percent in fiscal 2007. At June 30, 2008, the School's building debt-to-asset ratio was 3.3 percent.

UNRESTRICTED RESERVES BALANCE

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. In fiscal 2008, the increase in cash available for capital activities outstripped growth in capital expenses. As a result, after the \$20 million impact of net debt activity and other non-reserve activity, the School's year-end reserves balance grew by \$14 million to \$79 million.

The decade beginning in fiscal 2010 promises to be a period of increased capital investment as HBS moves ahead with a comprehensive campus plan recently developed in concert with the University. Although the School's reserves have grown in the past few years, these funds are crucial not only for capital projects but also for pursuing emerging opportunities to advance the HBS educational mission. As a consequence, HBS plans to rely primarily on gifts for capital projects, as well as new borrowings, to finance long-term campus expansion.



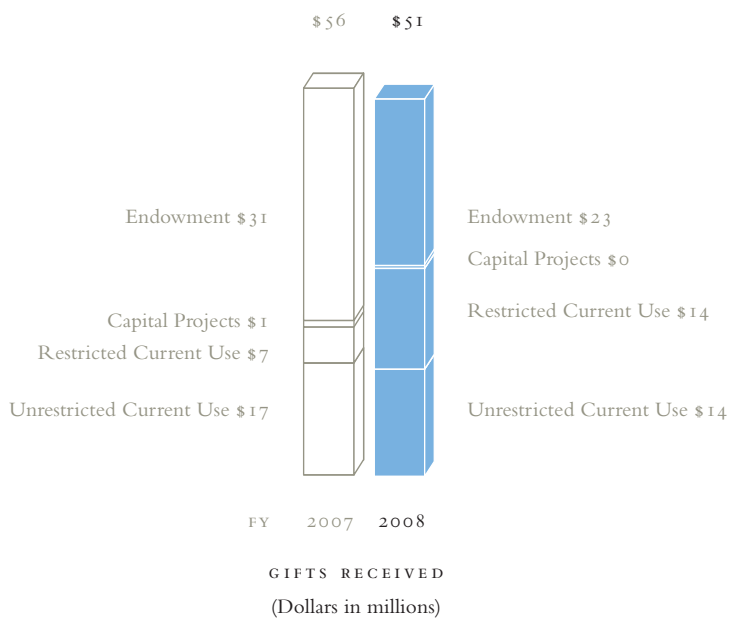
Managing the School's Gifts and Endowment

Endowment distributions and unrestricted current use gifts have become increasingly important to the HBS business model over the past five years. Since fiscal 2003, revenue from these combined sources has grown at a compound annual rate of more than 12 percent, from \$61 million to \$108 million, or 24 percent of total revenue, in fiscal 2008.

The HBS endowment, along with those of the other Harvard University schools, is managed by Harvard Management Company (HMC), a subsidiary governed and wholly owned by the University. Fiscal 2008 was a year of solid performance for the Harvard endowment, despite the capital market turmoil that deepened as the year unfolded.

The University endowment's total investment return for fiscal 2008 was +8.6 percent, net of all fees and expenses. At June 30, 2008, the School's endowment, plus current use funds, represented 8 percent of the total University endowment. The value of these funds was nearly \$3 billion, up \$150 million from a year earlier, after taking into account the annual distribution, strategic decapitalization, and receipt of new gifts.

Like other Harvard University schools, HBS raises its own endowment and current use funds, and independently budgets the use of its endowment distributions to support operations according to the terms of each gift. The School's endowment consists of more than 1,000 discrete funds established over the years by individual donors, corporations, foundations, and reunion classes.

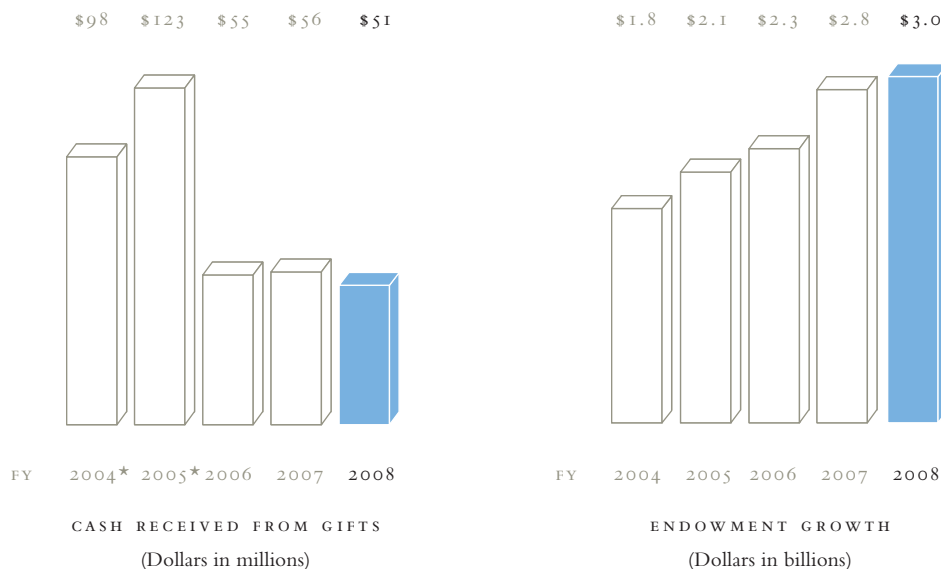


Although most endowment gifts are made in perpetuity, allowing little or no access to principal, some allow access to principal to provide the School flexibility in achieving the purposes for which they were designated. In addition, HBS occasionally draws upon capital appreciation associated with prior-year gifts. Funds from these decapitalizations are used to support key initiatives in keeping with donor intentions.

The primary function of the HBS endowment is to provide the long-term financial stability that allows the School to weather periods of economic turbulence and remain focused on its strategic mission. The University determines the amount that can safely be drawn from the endowment to spend in any given year. This calculation is based on a disciplined annual payout policy that reflects HMC's projections of future endowment returns.

The University's goals are to provide a reliable stream of operating income, to protect the purchasing power of the original gifts from erosion by inflation, and to build capital for the future by achieving superior risk-adjusted returns. Given these goals, Harvard's long-term target has been to distribute between 4.5 and 5 percent of the endowment's market value annually. Following the endowment's strong investment returns from fiscal 2003 through 2005, in fiscal 2006 the University decided to authorize distributions up to a level of 5.25 percent for the next several years.

Fiscal 2008 proved to be a challenging year for investors, as the majority of asset classes underperformed their long-term averages. As a consequence, the absolute return on the University endowment of +8.6 percent lagged the average annual returns achieved over the past five and ten years of 17.6 percent and 13.8 percent, respectively. After including all gifts received, netted against annual distributions and decapitalizations, at June 30, 2008, the University endowment was valued at \$36.9 billion, compared with \$34.9 billion a year earlier.



*Years coincide with The Campaign for Harvard Business School.

In terms of relative performance, however, fiscal 2008 was another strong year for the University endowment. Relative to the average institutional fund, the University endowment outperformed by 13 percentage points the negative 4.4 percent total return registered by the median of 165 large peer funds tracked by the Trust Universe Comparison Service (TUCS). The Harvard endowment's fiscal 2008 investment return also exceeded the +3.2 percent that marked the top-five percentile for this sample.

HMC extended its record of adding value across the majority of asset classes in which the University invests. The Harvard endowment outperformed in the domestic and emerging market equity and private equity asset classes. Liquid commodities, timber/agricultural land, and real estate, as well as domestic, foreign, and inflation-indexed bonds also outperformed. Underperforming asset classes were limited to foreign equity, high-yield investments, and absolute return investments.

The total investment return on the University endowment for fiscal 2008 exceeded HMC's policy portfolio aggregate benchmark by 170 basis points. This translated into \$612 million of additional value for the endowment. Looking back at the last 10 years, the Harvard endowment outperformed the TUCS median institutional fund by an average of 7.7 percent per year. If the University had earned the median fund return during this period, the value of the University endowment would have been approximately \$13.4 billion at June 30, 2008, or \$23.5 billion less than the actual total of \$36.9 billion.



Approximately 50 percent of the School's endowment has been earmarked by the donors to support professorships and faculty research, and 25 percent is in funds designated to provide income for MBA and Doctoral fellowships. Another 17 percent is restricted to existing strategic initiatives, building operations, and other ongoing operations of the School.

Because only the remaining 8 percent of the HBS endowment is dedicated to providing discretionary income for opportunistic investment, annual unrestricted giving is the School's primary resource for this purpose. These funds are used to nurture and accelerate new programs that are not endowed, and to support the School's emerging initiatives in research and teaching.

Reflecting the HBS community's continued generous class reunion and annual giving in fiscal 2008, income from unrestricted current use gifts totaled \$14 million, or 3 percent, of the School's total revenue. This amount is equivalent to the income from an endowment valued at approximately \$300 million. Income from unrestricted current use gifts supported every area of activity at HBS—from technology to case writing to faculty salaries.

Statement of Activity and Cash Flows*

IN MILLIONS

FOR THE FISCAL YEAR ENDED JUNE 30,

2008

2007

2006

REVENUES

MBA Tuition and Fees	\$ 82	\$ 77	\$ 73
Executive Education Tuition	106	91	81
Publishing	139	128	119
Endowment Distribution	94	78	71
Unrestricted Current Use Gifts	14	17	12
Housing, Rents, and Other	9	9	9
Interest Income	7	5	3
TOTAL REVENUES	\$ 451	\$ 405	\$ 368

EXPENSES

Salaries and Benefits	\$ 206	\$ 179	\$ 167
Publishing and Printing	53	51	42
Space and Occupancy	42	40	38
Supplies and Equipment	11	9	15
Professional Services	29	25	22
Fellowships	26	22	19
University Assessments	12	11	10
Debt Service	7	7	4
Other Expense	37	31	28
TOTAL EXPENSES	\$ 423	\$ 375	\$ 345

Cash from Operations	\$ 28	\$ 30	\$ 23
Use of Endowment Gifts or Appreciation	41	14	14
CASH BEFORE CAPITAL ACTIVITIES	\$ 69	\$ 44	\$ 37

Capital Expenses	\$ (40)	\$ (20)	\$ (49)
Use of Gifts for Capital Projects	5	3	12
NET CAPITAL EXPENSES	\$ (35)	\$ (17)	\$ (37)

New Borrowings	\$ 22	\$ 7	\$ 38
Debt Principal Payments	(9)	(7)	(4)
Other Activity	(33)	(22)	(26)
NET DEBT AND OTHER	\$ (20)	\$ (22)	\$ 8

Change in Unrestricted Reserves	\$ 14	\$ 5	\$ 8
Beginning Balance, Unrestricted Reserves	\$ 65	\$ 60	\$ 52
Ending Balance, Unrestricted Reserves	\$ 79	\$ 65	\$ 60

*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 \$32 million in fiscal 2008. Cash flows, however, would be equivalent under GAAP.

Consolidated Balance Sheet

IN MILLIONS

FOR THE FISCAL YEAR ENDED JUNE 30,

2008

2007

2006

ASSETS

Cash	\$ 14	\$ 16	\$ 25
Unrestricted Reserves	79	65	60
Receivables, Loans, and Other Assets	176	182	178
Invested Funds:			
Endowment Investments	2,804	2,654	2,190
Current Fund Investments	27	16	18
Interest in Trusts Held by Others	140	151	132
Facilities, Net of Accumulated Depreciation	444	416	415
TOTAL ASSETS	<u>\$ 3,684</u>	<u>\$ 3,500</u>	<u>\$ 3,018</u>

LIABILITIES

Deposits, Advances, and Other	\$ 38	\$ 39	\$ 39
Deferred Revenue	63	50	36
Other Debt Owed to University	29	26	25
Building Debt	121	108	108
TOTAL LIABILITIES	<u>\$ 251</u>	<u>\$ 223</u>	<u>\$ 208</u>

COMPOSITION OF NET ASSETS

Unrestricted Reserves	\$ 79	\$ 65	\$ 60
Undistributed Income and Other	18	33	36
Pledge Balances	33	40	56
Student Loan Funds	10	10	11
Investment in Facilities	322	308	307
Endowment and Other Invested Funds	2,971	2,821	2,340
TOTAL ASSETS NET OF LIABILITIES	<u>\$ 3,433</u>	<u>\$ 3,277</u>	<u>\$ 2,810</u>

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.

This report can be viewed and downloaded online at www.hbs.edu/annualreport.

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. Please direct correspondence to Richard Melnick, Chief Financial Officer: rmelnick@hbs.edu or to the Office of the Dean: officedean@hbs.edu.

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