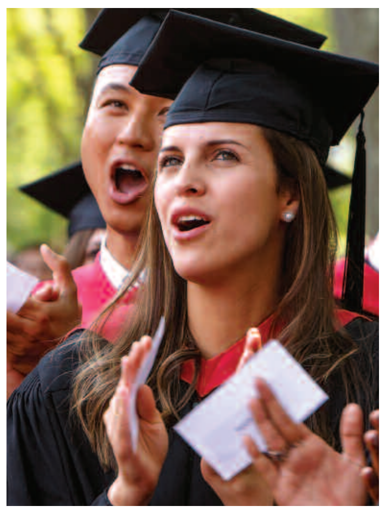
THE YEAR IN REVIEW

HARVARD | BUSINESS | SCHOOL

Annual Report 2016



DEAN OF THE FACULTY

Nitin Nohria

FACULTY LEADERSHIP

David E. Bell
Senior Associate Dean for Faculty Strategy & Recruiting

Srikant M. Datar
Senior Associate Dean for University Affairs

Amy C. Edmondson
Senior Associate Dean for Culture & Community

Frances X. Frei
Senior Associate Dean for Executive Education

Paul M. Healy
Senior Associate Dean for Faculty Development

Das Narayandas
Senior Associate Dean for External Relations & Harvard Business Publishing

Felix Oberholzer-Gee
Senior Associate Dean for the MBA Program

Jan W. Rivkin
Senior Associate Dean for Research

Luis M. Viceira
Senior Associate Dean for International Activities

ADMINISTRATIVE LEADERSHIP

Janet Cahill
Executive Director, External Relations

Angela Q. Crispi
Executive Dean for Administration

Jean M. Cunningham
Associate Dean for Faculty & Academic Affairs

Nancy DellaRocco
Executive Director, Executive Education

Stephen Gallagher
Chief Information Officer

Gabriel Handel
Assistant Dean for Administrative & Educational Affairs

Ralph James
Executive Director of University Affairs

Brian Kenny
Chief Marketing & Communications Officer

Jana Kierstead
Executive Director, MBA Program

John F. Korn
Executive Director, Doctoral Programs

Ellen Mahoney
Chief Human Resources Officer; Executive Director, HBS Initiatives

Richard P. Melnick
Chief Financial Officer

Patrick Mullane
Executive Director, HBX

Andrew O'Brien
Chief of Operations

Valerie Porciello
Executive Director, Division of Research & Faculty Development

Debra Wallace
Executive Director, Knowledge & Library Services

David A. Wan
President & Chief Executive Officer, Harvard Business Publishing

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 biannually and reports to Harvard University's Board of Overseers.

FROM THE DEAN

Dear Friends,

I am delighted to share with you the 2016 Annual Report for Harvard Business School. As you will see in the pages that follow, we continue to make remarkable progress on our strategic "5i" priorities of innovation, intellectual ambition, internationalization, inclusion, and integration. At the same time, we are investing in the core programs and activities that have distinguished the School since its founding.

In the MBA Program, for instance, you'll see examples of efforts to broaden the pipeline of outstanding young women and men, to further strengthen and refine the curriculum, and to ensure that our graduates are able to pursue their passions when they leave the School. In Executive Education, we now have amazing facilities – including the Ruth Mulan Chu Chao Center, which opened in June – that match the aspirations of the faculty. The Doctoral Programs attract the most promising future scholars, and we train them to be outstanding teachers and researchers.

And our newest educational platform, HBX, is expanding its portfolio of offerings to reach an ever-growing audience of learners.

Exciting opportunities are on the horizon. Work has begun in earnest on the new facility that will house the John A. Paulson School of Engineering and Applied Sciences across Western Avenue. In tandem with a growing i-lab ecosystem and University plans for an enterprise research campus, it's increasingly possible to see how Allston will be transformed over the next decade, making Boston a destination for innovation and entrepreneurship.

All of our efforts, past and future, are made possible by our generous alumni, and The Harvard Business School Campaign (launched in 2014) is helping shape the School's legacy for the 21st century. We are grateful for the support our alumni provide and the example they set.

I invite you to read further to learn about the initiatives and achievements of the past year.

NITIN NOHRIA
DEAN OF THE FACULTY

THE YEAR IN REVIEW

FY16

Exploring the intersection of engineering and entrepreneurship. Advancing precision medicine. Launching the Gender Initiative. Dedicating the Ruth Mulan Chu Chao Center. Engaging alumni around the world through The Harvard Business School Campaign. Through these and other activities, HBS strengthened its commitment to outstanding teaching, pathbreaking research, and the dissemination of knowledge, while pursuing innovative new initiatives to position the School for leadership in the 21st century.

JUL–AUG

PEEK

Aimed at rising juniors, seniors, and recent graduates, Peek Weekend was launched to help young women understand what business school is all about—at a time when they're thinking about the next steps in their lives. Peek Weekend has expanded to include men and women, specifically those with a STEM or family business background.

165

Participants from 76 colleges

SVMP

Designed to increase diversity and opportunity in business education, the Summer Venture in Management Program is a one-week management training program for rising college seniors that helps participants understand the impact they can have on their community and the world through business leadership.

87

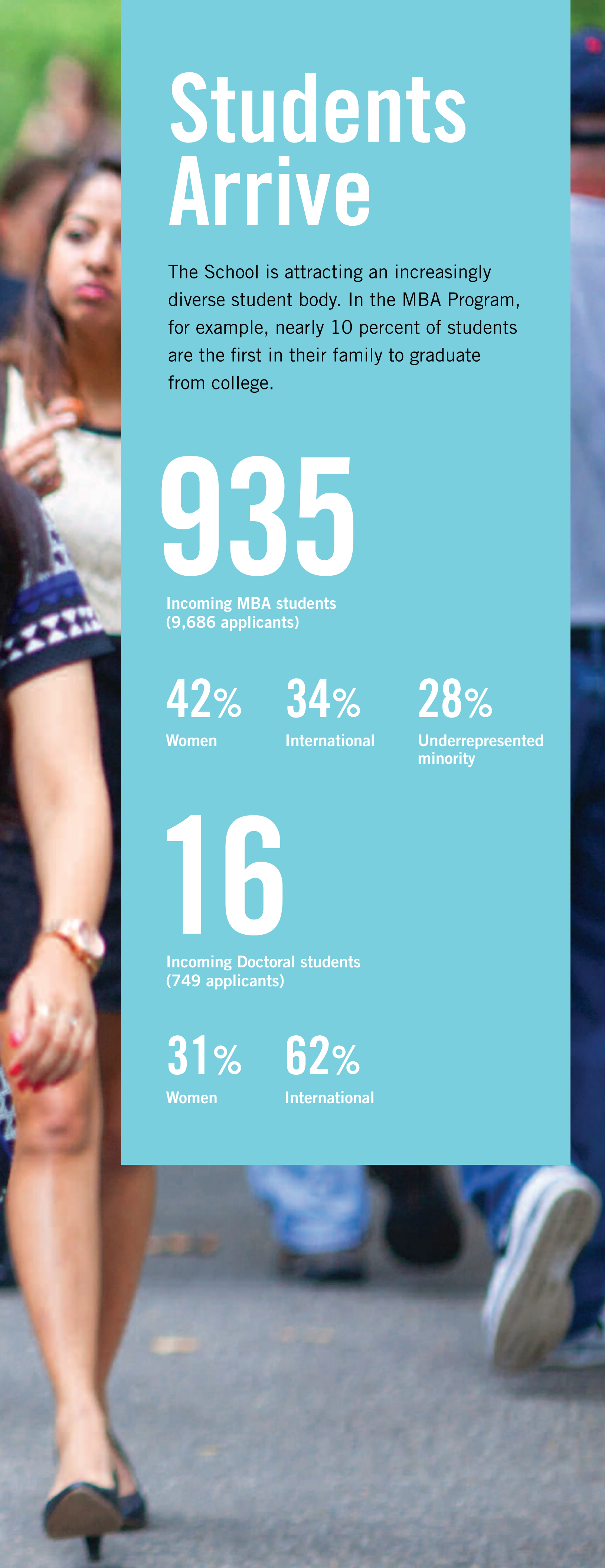
Participants

GLOBAL COLLOQUIUM ON PARTICIPANT-CENTERED LEARNING

GloColl seeks to build an international community of faculty members who are committed to participant-centered learning through innovative teaching and course design. Combining a weeklong on-campus module and a regional in-depth case-writing workshop, educators learn how to become more effective teachers using the case method.

705

Participants from 71 universities representing 23 countries since launch



Students Arrive

The School is attracting an increasingly diverse student body. In the MBA Program, for example, nearly 10 percent of students are the first in their family to graduate from college.

935
Incoming MBA students
(9,686 applicants)

42% Women

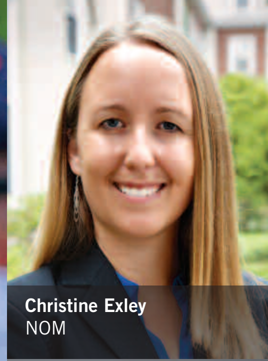
34% International

28% Underrepresented minority

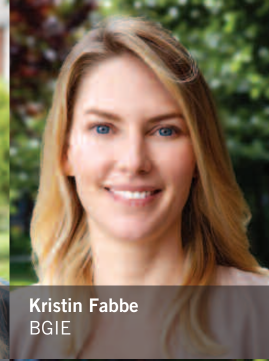
16
Incoming Doctoral students
(749 applicants)

31% Women

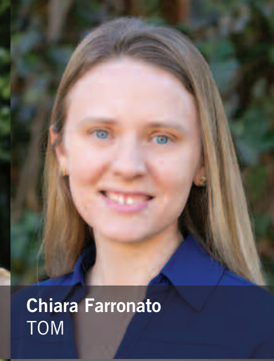
62% International



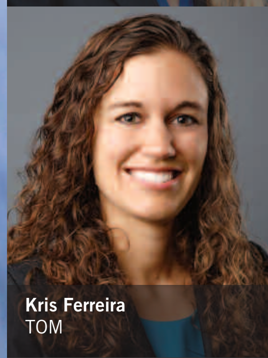
Christine Exley
NOM



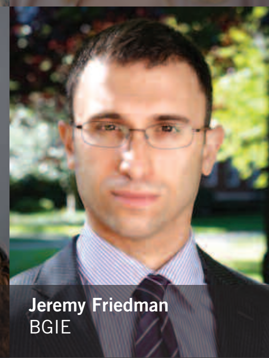
Kristin Fabbe
BGIE



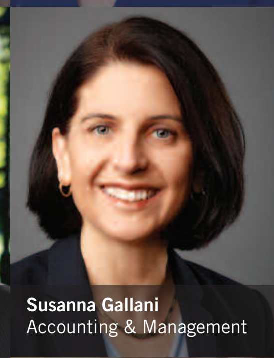
Chiara Farronato
TOM



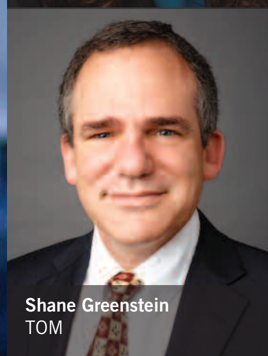
Kris Ferreira
TOM



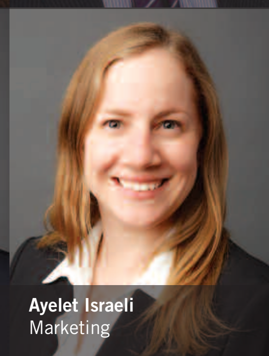
Jeremy Friedman
BGIE



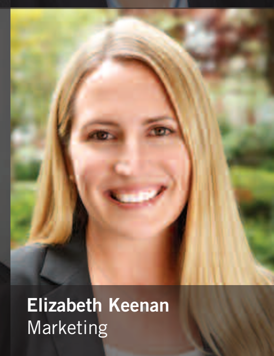
Susanna Gallani
Accounting & Management



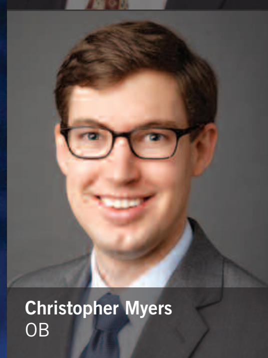
Shane Greenstein
TOM



Ayelet Israeli
Marketing

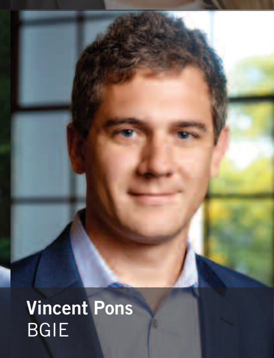


Elizabeth Keenan
Marketing

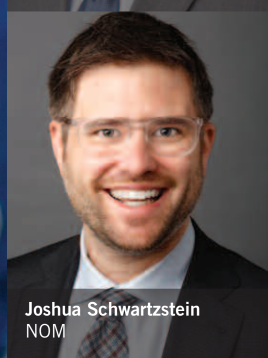


Christopher Myers
OB

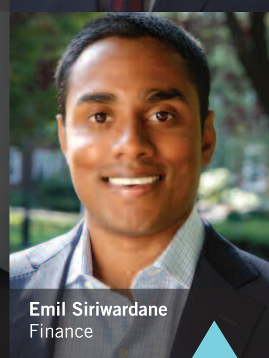
Gerardo Perez Cavazos
Accounting & Management



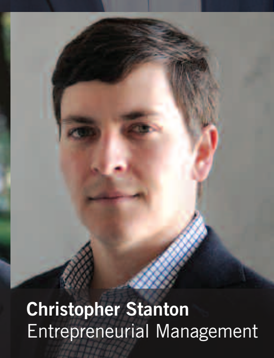
Vincent Pons
BGIE



Joshua Schwartzstein
NOM



Emil Siriwardane
Finance



Christopher Stanton
Entrepreneurial Management

Claudia Steinwender
Strategy

NEW FACULTY

16 New tenure track faculty

+19 New term faculty

COLD CALL LAUNCHED

This podcast, airing every two weeks, features HBS faculty members discussing cases they've written and the lessons they impart. In its first year, *Cold Call* explored topics ranging from "Who owns space?" to digitally enabled prescription medicine to cultured beef.

SEP—OCT

A VISION FOR THE 21st CENTURY

Alumni events were held in Seattle and Cleveland, two of six cities visited during FY16 as part of The Harvard Business School Campaign. Featuring local speakers, short films, and a presentation by the Dean, the programs in each location highlighted the impact of the School and its graduates, and facilitated engagement among alumni and between alumni and HBS.

Elective Curriculum FIELD Courses

Nearly a dozen field method courses were offered in the MBA Program during 2015–2016, including the HBS Neighborhood Business Partnership, an innovative course co-taught by Kristin Williams Mugford and Len Schlesinger that enabled students to apply the skills learned during the first year curriculum while partnering with a local entrepreneur. Businesses included a vegan fast-casual restaurant, a hair salon, a donut shop, and a hip burger restaurant, and students worked in small teams on problems such as marketing, finance, sales, and growth strategy.

MAKING ROBOTICS FLY

HUBweek, a civic collaboration founded by *The Boston Globe*, MIT, Harvard University, and Mass General Hospital, celebrated innovation in Greater Boston at the intersections of art, science, and technology. During its inaugural year, Mitch Weiss worked with counterparts at the Harvard John A. Paulson School of Engineering and Applied Sciences (SEAS) to host “Making Robotics Fly,” a day-long exposition that showcased technology and business formation in the area of unmanned aerial vehicles (UAVs) and a research symposium aimed at strengthening ties across thetwo schools in anticipation of the SEAS move to Allston in 2020.

SURVEY ON U.S. COMPETITIVENESS

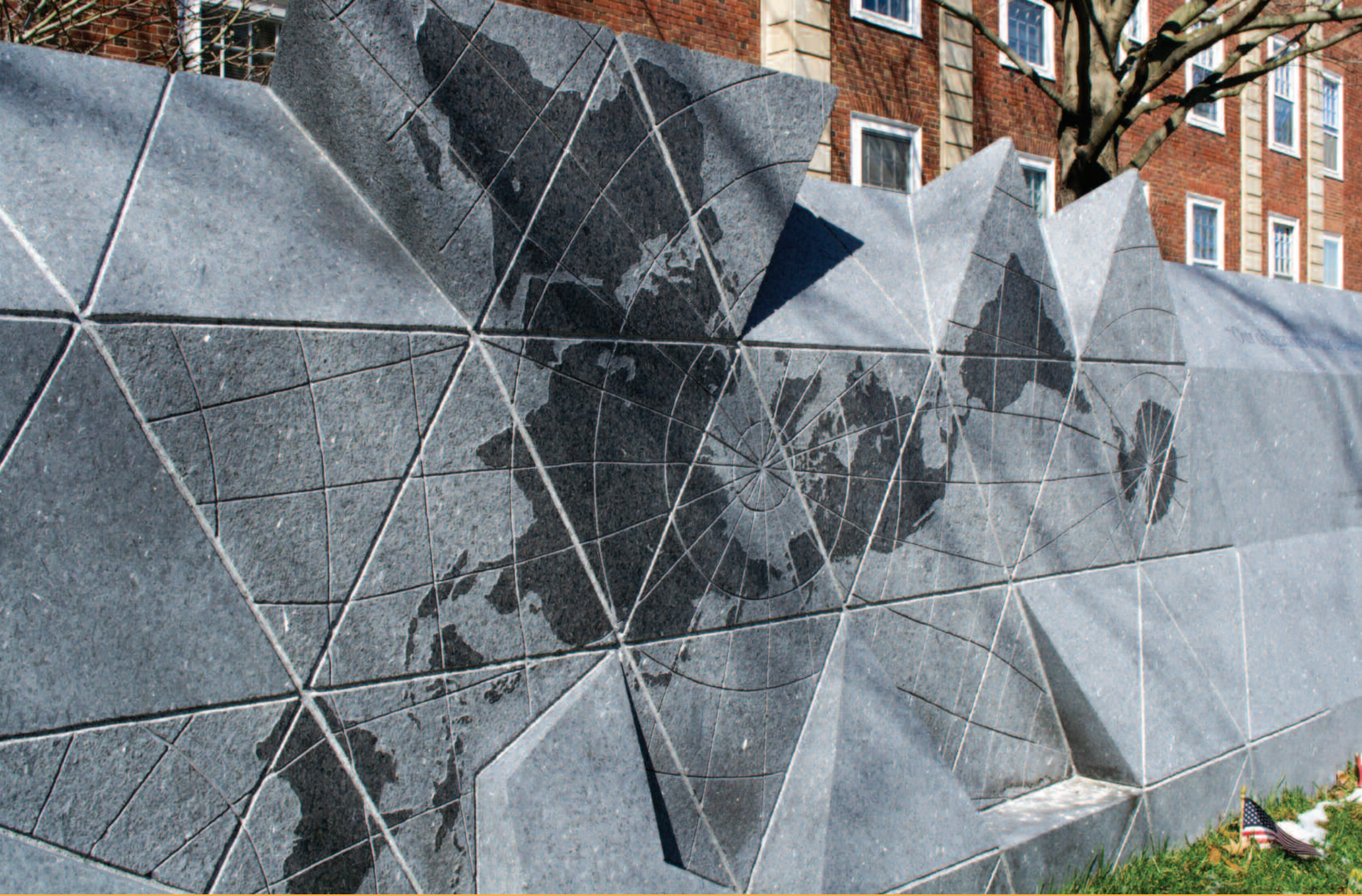
U.S. Competitiveness Project cochair Jan Rivkin discussed the findings of the fourth annual survey of HBS alumni, “The Challenge of Shared Prosperity,” which found that America’s leading companies are thriving but the prosperity they are producing is not being shared broadly among U.S. citizens. The report summarized alumni opinions on economic outcomes for Americans as well as business leader confidence in the current and future competitiveness of the American economy.

KRAFT PRECISION MEDICINE ACCELERATOR

The Robert and Myra Kraft Family Foundation, Inc., under the leadership of Foundation President Robert K. Kraft (MBA 1965), pledged $20 million to create an endowment for advancing precision medicine at Harvard Business School. Under the umbrella of the Healthcare Initiative, this new effort—cochaired by Richard Hamermesh and Kathy Giusti—convenes best-in-class leaders from the business, medical, scientific, and technological communities to identify and solve challenges slowing the advancement of precision medicine, disseminate best practices and models to overcome these challenges, and enable the faster commercialization of high-impact innovations.

NEW HBX EXECUTIVE DIRECTOR

Patrick Mullane (MBA 1999) was named to head HBS’s digital learning initiative. With significant experience in building and shaping businesses, Mullane serves as the operational leader for HBX. His focus is on managing its growth and expansion in global markets and helping develop and implement a strategy to build out a portfolio of HBX offerings for individual and corporate learners.



WALL OF RECOGNITION OF SERVICE TO COUNTRY

A new installation honors HBS community members, including students in the Armed Forces Alumni Association, who have served their country. The wall, made of black granite and located along Kresge Way, features a quote from US president John Adams (Harvard University AB 1755, AM 1758) and Buckminster Fuller's Dymaxion Map, the only flat map of the entire surface of Earth.

DOCTORAL STUDENT RESEARCH AWARDS

Six outstanding doctoral students were recognized for excellence and innovation in their dissertation research.

Wyss Award for Excellence in Doctoral Research

(named in honor of Hansjörg Wyss, MBA 1965)

Tami Kim (DBA, Marketing): implicit social contracts and how violations of such contracts influence interpersonal and consumer-firm relationships.

Juan Ma (DBA, Strategy): the opportunity of underdeveloped business infrastructure in emerging markets.

Patricia Satterstrom (DBA, Management): how teams can give voice to the voiceless, enabling team members to collaborate.

Martin Award for Excellence in Business Economics

(established by Roger Martin, MBA 1981)

Rohan Kekre (PhD, Business Economics): the role of unemployment insurance as a stabilization instrument in macroeconomic policy.

Benjamin Lockwood (PhD, Business Economics): optimal policy design in settings where people are not perfectly rational.

Filippo Mezzanotti (PhD, Business Economics): how corporate policies such as innovation or investment decisions are affected by the institutional and macroeconomic environment in which firms operate.

FIELD 2 Global Immersions

For the fifth year, all first-year students in the MBA Program tackled business problems in emerging markets around the world. Working in six-person teams, students applied the tools of design thinking (customer observation, brainstorming, and prototyping) to develop new products and services for global partner companies in locations ranging from China and Argentina to Turkey and Cambodia.

930
Students

157
Global partners

13
Countries

8
Days

"Students often surprise themselves by how creative they can be in coming up with novel product and service ideas. And for some, the most noteworthy changes are to themselves—they return from their immersion experiences more resilient, more adaptable, and more confident in their ability to successfully harness the talents of diverse teams while working through their challenges."

—Andy Zelleke, FIELD 2 Faculty Chair

NEW MANAGING DIRECTOR OF ADMISSIONS

Chad Losee (MBA 2013) was named Managing Director of MBA Admissions and Financial Aid. A Baker Scholar, Losee spent a year after graduation at the School as an HBS Fellow and worked on HBX and other strategic projects. He also served as a summer associate at BYU-Idaho and spent 2008–2011 and 2014–2015 at Bain & Company.

EMAAR: THE CENTER OF TOMORROW, TODAY

"Emaar: The Center of Tomorrow, Today," a case that explores the Dubai real estate company's exploration of growth opportunities abroad, is published with assistance from the Dubai Research Office. In FY17, research offices were opened in Dubai, Israel, and Singapore, further extending the network of nine regional research centers that support faculty research and a growing array of the School's activities—from MBA admissions and placement to Executive Education to alumni engagement.

HBS NY Startup Studio

The Arthur Rock Center for Entrepreneurship opened a new facility in New York City to help alumni create and develop new ventures. Initial teams could reside at the Studio for up to 18 months and take advantage of programming such as founder forums, subject matter and industry expert councils, and networking events.

Teams:

Archway Health
Booya Fitness
BringMeThat
Bundle Organics
Greenshield
Legal Hero
Show-Score
Summus
Tootelage

APR – JUN

19th Annual New Venture Competition

Student Business Track Winners

Dubilier Grand Prize:
RapidSOS
uses technology to revolutionize emergency response.

Satchu-Burgstone Runner-Up Award:
Be Mixed
a natural and zero-calorie beverage mixer.

Student Social Enterprise Track Winners

Peter M. Sacerdote Grand Prize:
FOCUS Foods Inc.
urban aquaponics farming that allows urban grocery stores to grow fresh produce on their rooftops.

Sacerdote Runner-Up Award:
Barakat Bundle
a newborn essentials kit to reduce infant and maternal mortality in South Asia.

Alumni Winners

Most Innovative:
BollyX Fitness
a Bollywood-style fitness workout to promote good health.

Greatest Impact:
Eve & Tribe
(shown above) focuses on revolutionizing fashion retail in Africa.

Best Investment:
StreetShares
an online marketplace for the financial technology industry that pairs small businesses with potential investors.

3,000

Alumni participants in 108 clubs in 48 countries

BREAKING GROUND

Construction began on Klarman Hall, a large-scale conference center, a performance space, and an intimate community forum slated to open in fall 2018. Made possible by a gift from Seth (MBA 1982) and Beth Klarman, the new facility—designed by William Rawn Associates—will be LEED Gold certified and will incorporate state-of-the-art technology.

HBX CONNEXT

Nearly 500 students from more than 20 countries met on the HBS campus to participate in faculty-led case studies, build relationships, hear a panel discussion on the future of online education, and learn about HBS. All were current or previous participants in an HBX offering. By June, HBX had served more than 8,000 learners and work was underway on three new programs—finance, negotiations, and becoming a better manager—planned for launch in 2016–2017. As the strong turnout for ConneXt demonstrated, engagement with HBX continued to be high: completion rates for CORe, for example, remained on average over 80 percent.

NEW GENDER INITIATIVE

Under the direction of faculty chair Robin Ely, the Gender Initiative is a new effort to support research, teaching, and knowledge dissemination that promotes gender equity in business and society. "We want to ground discussions about gender in rigorous research so that people can make better-informed decisions for themselves, their families, their companies, and their communities," Ely remarked at the Initiative's launch.

MEASURING IMPACT

Harvard's first Impact Study finds that nearly 40 percent of alumni have launched more than 146,000 for-profit and nonprofit organizations with an estimated $3.9 trillion in annual revenues and have created 20.4 million jobs around the world. The study aimed to quantify the economic and social contributions of the University's graduates and looked as well at board service and volunteerism. Survey results found that HBS alumni created 43,500 ventures with $2.4 trillion in revenues and 10.6 million employees.

10,600,000

Jobs created

43,500

Venutures

Commencemen

FACULTY AWARDS

Four faculty members were recognized by students for their excellence in teaching in the MBA Program: Julio Rotemberg and Gunnar Trumbull (Business, Government and the International Economy) in the Required Curriculum, and Kristin Williams Mugford (Creating Value Through Corporate Restructuring) and Matthew Weinzierl (The Role of Government in Market Economies) in the Elective Curriculum.

HARVARD MEDAL

John H. McArthur (MBA 1959, DBA 1963, and Dean of HBS 1980–1995) was among the recipients of the Harvard Medal, awarded since 1981 by the Harvard Alumni Association for extraordinary service to the University.

STUDENT AWARDS

Abdulaziz Albahar, Sara Gentile, and Needham Hurst received the School's Dean's Award. The annual award celebrates the extraordinary achievements of graduates who have made a positive impact on the School, University, or broader community.

nt

922
MBA degrees awarded

12
DBA degrees awarded

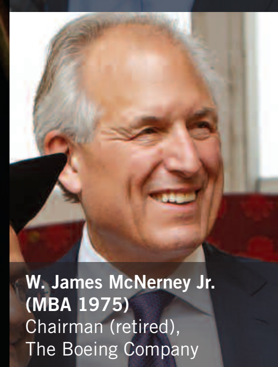
10
PhD degrees awarded jointly

ALUMNI ACHIEVEMENT AWARD WINNERS

Mary Callahan Erdoes (MBA 1993) CEO, J.P. Morgan Asset Management

Alan F. Horn (MBA 1971) Chairman, Walt Disney Studios

Thomas J. Tierney (MBA 1980) Chairman & Cofounder, The Bridgespan Group



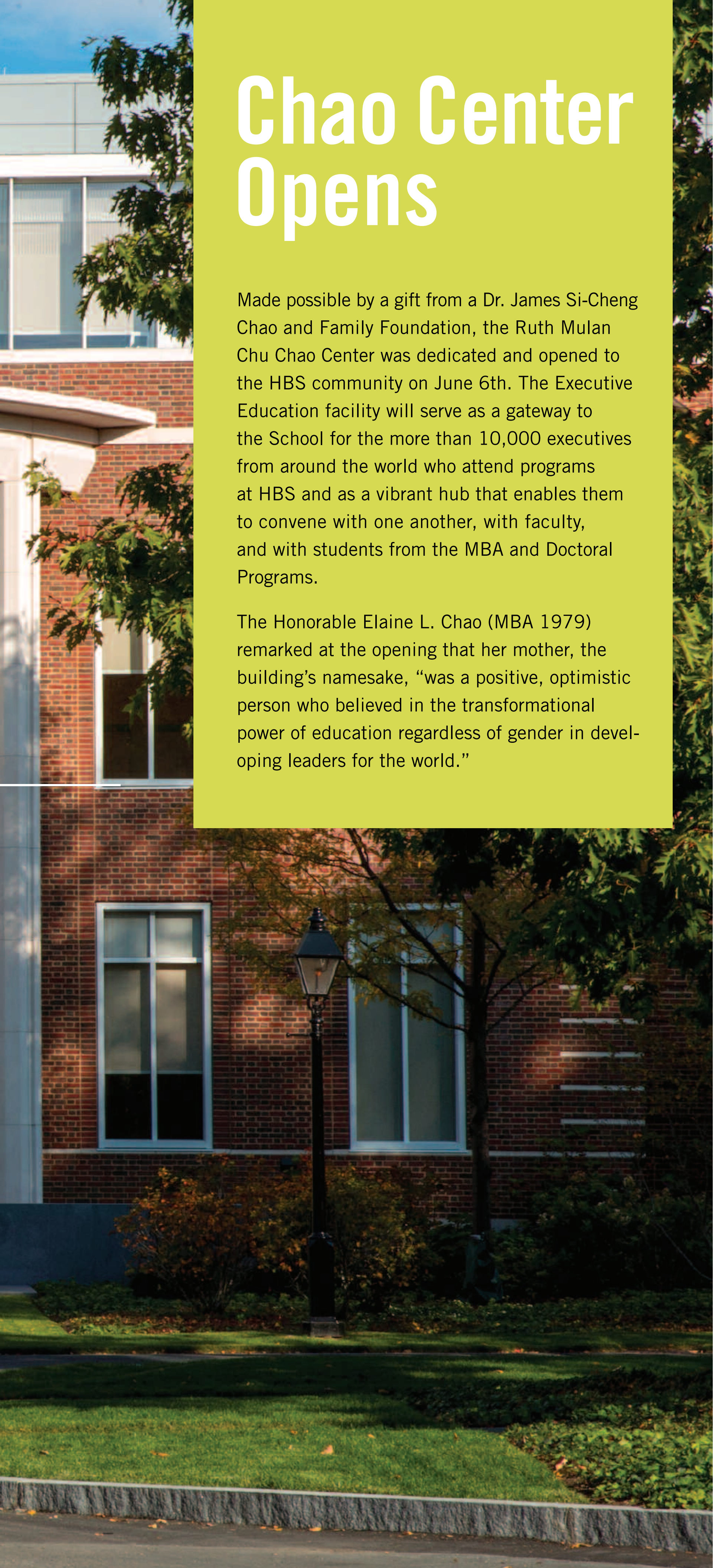
W. James McNerney Jr. (MBA 1975) Chairman (retired), The Boeing Company

Sunil B. Mittal (MBA 1999) Founder & Chairman, Bharti Enterprises

CLASS DAY

During the Class Day ceremony, student speaker Marcelle de Souza Goncalves Meira (MBA 2016) spoke about her experience at HBS following the death of her husband and classmate, Pedro Meira, in fall 2015. Former Bain & Company managing director and Bridgespan cofounder Tom Tierney (MBA 1980) reminded students it is more important to build a life than a resume.


CHAO



Chao Center Opens

Made possible by a gift from a Dr. James Si-Cheng Chao and Family Foundation, the Ruth Mulan Chu Chao Center was dedicated and opened to the HBS community on June 6th. The Executive Education facility will serve as a gateway to the School for the more than 10,000 executives from around the world who attend programs at HBS and as a vibrant hub that enables them to convene with one another, with faculty, and with students from the MBA and Doctoral Programs.

The Honorable Elaine L. Chao (MBA 1979) remarked at the opening that her mother, the building's namesake, "was a positive, optimistic person who believed in the transformational power of education regardless of gender in developing leaders for the world."

FACULTY IMMERSION

Faculty cochairs Juan Alcacer and Willy Shih, with Europe Research Center Executive Director Vincent Dessain, took 12 faculty members representing diverse academic units to Munich for meetings with 11 companies. They explored how small and mid-sized companies prevalent in German-speaking countries—the Mittelstand—remain so competitive globally, particularly in emerging markets, and how they have managed to innovate and rejuvenate themselves. Firms visited included fine-writing and art products giant Faber-Castell and ARRI, the world's largest manufacturer of professional motion picture equipment.

EXPANDING THE I-LAB ECOSYSTEM

Work begins on the Pagliuca Harvard Life Lab, a new facility that will offer shared space for high-potential life sciences and biotech startups founded by Harvard faculty, alumni, students, and postdoctoral scholars. With support from Judy (MBA 1983) and Steve (MBA 1982) Pagliuca and employing a unique modular design, the facility could be quickly assembled to open in less than six months.

FROM THE CHIEF FINANCIAL OFFICER

Harvard Business School (HBS) remained financially strong in fiscal 2016. Revenue exceeded our forecast, growing faster than expenses for the second consecutive year. The resulting growth in cash from operations enabled HBS to continue to make strategic investments in priority areas while still ending the year with a healthy unrestricted reserves balance.

One of our financial planning goals is for HBS 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. Achieving this goal starts with transparency. To that end, our fiscal 2016 financial results are reported in detail in the Supplemental Financial Information section that begins on page 26.

The balance of this letter recaps the School's fiscal 2016 financial performance in light of our key strategic challenges. It concludes with our financial forecast for fiscal 2017 and some thoughts on our longer-term outlook and strategy.

FISCAL 2016 IN REVIEW

HBS faced continued pressure on operating margins. Recent MBA curriculum innovation and new endeavors such as HBX added to the School's fixed costs. We remained committed to investing in information technology (I.T.) and campus renewal and maintenance, including new building construction. To ensure that the School continued to live within its means as the scope of activity at HBS expanded, our top financial priority was to ensure that revenue growth—including developing new sources of revenue—continued to exceed the rise in operating expenses.

We successfully executed on this priority in fiscal 2016, driven by notable successes in our revenue-generating units. Harvard Business Publishing (HBP) continued to manage volatility in its markets by enhancing its content offerings and investing in its digital platform. Executive Education leveraged expanded educational, living, and dining capacity to drive strong participant demand. HBX made solid progress in its efforts to strengthen and stabilize its platform and increase its portfolio of offerings.

In parallel with these operating revenue initiatives, The Harvard Business School Campaign produced double-digit growth in current use giving and added substantial new endowment funds for priorities such as associate professorships and student financial aid. With fiscal 2016 marking the Campaign's midway point, the School received more than $161 million in new gifts and pledges during the year.

The School's total operating revenues for fiscal 2016 rose 7.6 percent, year over year, exceeding our forecast by 360 basis points. Revenues at HBP were up nearly 7 percent from fiscal 2015, coming in higher than planned for the seventh consecutive year. Executive Education once again delivered upside, with revenues up nearly 5 percent against our forecast of 1 percent growth. At HBX, revenue doubled from last year to $10 million, resulting in a planned operating deficit of $12 million.

The HBS economic model relies on multiple revenue streams, including MBA tuition, distribution from the endowment and current use gifts, and income earned by HBP and Executive Education. This mix of revenue sources makes HBS less reliant on fluctuations in the endowment (and endowment distribution income) than all but one other Harvard school. The School's endowment distribution and current use gifts represented 18 percent and 9 percent, respectively, of total revenue in fiscal 2016. This year's distribution of income from the endowment, as well as the endowment's investment performance, is discussed in detail beginning on page 27.

Current use giving—unrestricted and restricted gifts intended to support near-term priorities—has grown in importance to the School in recent years. Together with endowment gifts and gifts for capital projects, current use giving has proved vital as a flexible source of seed money to launch visionary initiatives, such as FIELD, the Harvard i-lab, and HBX.

The HBS community has responded with impressive generosity. On a combined basis, restricted and unrestricted current use giving to HBS has grown from a total of $26 million in fiscal 2010 to $72 million—or 51 percent of total giving—this past year. Unrestricted giving was especially strong in fiscal 2016. Including Campaign, reunion, and annual giving, revenue from unrestricted current use gifts grew by $4 million, or 11 percent, from the prior year to a record $40 million.

The balance of this year's giving was intended to sustain the School's core operations over the long term by funding new or existing endowment accounts, and to support development of the HBS campus. Approximately $16 million of fiscal 2016 giving to the School was earmarked for capital projects.

Based on a comprehensive master plan for enhancing and expanding the campus to meet programmatic needs, capital activity at HBS has increased substantially in recent years. The School's plan focused on expanding Executive Education academic and residence space in the northeast section of the campus, culminating in the opening of the Chao Center in June 2016.

Construction also began on the 1,000-seat Klarman Hall, a new convening space slated to open in fall 2018, and the Pagliuca Harvard Life Lab, designed to provide life scientists with lab space as they pursue entrepreneurial ventures. Additionally, HBS made substantial investments in facilities renewal and maintenance, energy efficiency projects, I.T. infrastructure upgrades, and digital technology for newly built classroom space.

In fiscal 2016, HBS invested $113 million in capital activity, up from $81 million in the prior year and $19 million seven years earlier. The increase was primarily driven by construction activity at the Chao Center, Klarman Hall, and the Life Lab, plus the renovation of HBP's new headquarters adjacent to the campus in Allston.

Against this revenue and capital investment backdrop, we continued to tighten the reins on expenses in fiscal 2016. Careful budget discipline is part of our culture at HBS as we work to generate the greatest possible impact with the resources available. Our efforts are bearing fruit. Reflecting new strategic initiatives and revenue-focused investments in HBP and Executive Education, our fiscal 2016 financial plan assumed a 9 percent increase in total operating expenses, year over year. Actual operating expense growth, however, came in at 6.7 percent. Fiscal 2016 capped a three-year period during which the School's total revenues grew at a compound annual rate of 7.5 percent, while total expenses increased 7.2 percent.

Our expense control performance in fiscal 2016 was mainly attributable to lower-than-forecast spending at HBP and Executive Education. Driven by the resulting sales growth leverage, their combined operating margin contribution increased substantially, and the School's total operating margin grew to 7.5 percent, from 6.6 percent in fiscal 2015.

Information technology is vital to teaching, learning, and research at HBS, and I.T. spending fueled a large part of the School's expense growth in fiscal 2016, as it has for the past decade. HBP and HBX continued to make growth-focused investments in their digital platform offerings during the year.

These investments were accompanied by several large mission-driven I.T. projects, including a new Executive Education ecosystem, a major student information system upgrade, a new learning management system in the MBA Program, and enhanced wireless and digital video capabilities across the campus.

The School's I.T. spending has increased at a compound annual rate of 13 percent over the past decade, from $25 million in fiscal 2006 to $85 million this past year. I.T. expenses represented 12 percent of the School's total operating expenses in fiscal 2016, compared with 11 percent last year, and 7 percent on a significantly smaller expense base 10 years earlier. Careful management of I.T. spending therefore is essential to controlling future expense growth.

Faculty and administrative staff compensation represents 44 percent of the School's total expense base. Using a gating process

Fellowship Spending (in millions)	MBA	Total*
FY 16	**$ 34**	**$ 47**
FY 15	32	44
FY 14	31	43
FY 13	29	40
FY 12	27	37

** Includes Doctoral Programs and Executive Education*

Investment in Research (in millions)	
FY 16	**$ 131**
FY 15	123
FY 14	117
FY 13	110
FY 12	109

for new full-time equivalent (FTE) requests, we have focused staff headcount growth in key areas, including those that are mission-critical and generate additional revenue.

As a result, the School's fiscal 2016 revenue growth rate exceeded both the increase in compensation expense and the growth in the number of FTE positions. Although our fiscal 2016 financial plan assumed a 7 percent year-over-year increase in total compensation expense, the actual increase was 5 percent.

Driven by the healthy contribution margins from HBP and Executive Education, as well as increased alumni current use giving to HBS, the School's cash flow from operations was stronger than we expected in fiscal 2016. This internally generated cash enabled HBS to continue to fund its core educational programs, drive innovation in teaching and research, and invest in strategic opportunities, while still concluding the year with a stronger-than-expected balance of unrestricted reserves. These reserves are crucial in providing the School with sufficient liquidity to execute on its mission and to sustain the campus through economic cycles over the long term. Further, the HBS surplus contributes to the overall financial health of Harvard University.

FISCAL 2017 OUTLOOK

Looking ahead to fiscal 2017, our financial plan is focused, as always, on continuing to generate a healthy operating surplus as we work to fulfill the School's mission. HBS is making progress, but we need to remain diligent in monitoring the relative rates of expense and revenue growth, as there may be softness in the School's revenue streams at a time of continued strategic innovation and campus growth.

Our fiscal 2017 plan includes a commitment to further strengthening educational programs across the School and providing the faculty with generous research support. At the same time, we will continue to work toward the goal of evolving HBX into a self-sustaining and surplus-generating activity. Fiscal 2017 will be an active year for capital investment in the campus, primarily focused on ongoing projects, including Klarman Hall, the Life Lab, facilities renewal, and I.T. infrastructure upgrades. We will strive as always to maintain a balance of unrestricted reserves for initiatives and investments such as these, while maintaining the School's long-term financial security and flexibility.

In addition to sustained financial vigilance and discipline, this will require continued strength in unrestricted current use giving in fiscal 2017. It also will require continued endowment giving for activities such as associate professorships, fellowships, MBA Program enrichment, and cross-disciplinary global research. Giving for these purposes will remain a priority as the Campaign progresses.

We will carefully monitor the School's financial performance as fiscal 2017 unfolds, with contingency plans and processes in place to adjust spending if warranted by changing economic conditions. Given the increasing potential for an economic slowdown as the recovery approaches a decade in length, we are being cautious in planning for fiscal 2017 growth at HBP and Executive Execution. HBX is expecting to report growth in expenses as well as revenue, precluding a positive operating margin in the near term.

In addition, we are cognizant of the challenges associated with today's low-return investment environment, which directly affects income distributed from the University endowment to HBS and the other Harvard schools. The 2 percent annual investment loss experienced by the Harvard endowment in fiscal 2016 will limit growth in the endowment distribution across the University in fiscal 2018. As a result, the various parts of the University face a diverse set of challenges as they plan for fiscal 2018 and future years. Since HBS is a part of the University family, future pressures on endowment income are likely to have implications for the School.

With this as background, let me provide a brief look at our fiscal 2017 financial expectations. Starting at the top line, we expect the School's total revenues to increase in a range of 2 to 3 percent from fiscal 2016. Revenue from MBA tuition and fees is projected to increase 4 percent. This will be partially offset by a 4 percent increase in financial aid, primarily earmarked for MBA fellowships.

Revenue for fiscal 2017 at both HBP and Executive Education is forecasted to grow in the range of 2 to 3 percent. HBP faces ongoing revenue recognition impacts from an earlier shift by Harvard ManageMentor® from packaged software to a subscription service model. The upcoming year's revenue growth at Executive Education will compare with the strong results in fiscal 2016.

Philanthropic revenues will remain vital to the School's economic model in fiscal 2017. The University has advised HBS that its endowment payout will grow 4 percent from fiscal 2016. With this anticipated payout, as well as potential income from new gifts to the endowment, we expect the

Publishing Revenue (in millions)	
FY 16	**$ 217**
FY 15	203
FY 14	194
FY 13	180
FY 12	165

Executive Education Tuition (in millions)	
FY 16	**$ 176**
FY 15	168
FY 14	163
FY 13	146
FY 12	142

I.T. Investment (in millions; excludes capital expenses)	
FY 16	**$ 85**
FY 15	72
FY 14	66
FY 13	57
FY 12	48

School's total endowment distribution revenue for fiscal 2017 to increase 4 percent, year over year. Although the School will be starting the second half of a stronger-than-anticipated Campaign, we are confident that fiscal 2017 will be another successful year for total current use giving.

Moving down the Income Statement to operating expenses, we will be closely monitoring our budget performance, quarterly forecasts, and monthly dashboards in HBP, in Executive Education, and across the School as fiscal 2017 progresses. Reflecting anticipated salary increases and benefits costs, our financial plan assumes 6 percent growth in total compensation expense. The School's other line item expenses, collectively, are expected to climb 9 percent from fiscal 2016.

This anticipated increase reflects higher mission-driven spending on core I.T. projects. Fiscal 2017 operating costs also reflect the opening of the Chao Center and new research initiatives, as well as growth-focused I.T. and business capacity investments in Executive Education, HBP, and HBX.

The School's total capital budget for fiscal 2017 is $71 million. This is 37 percent below the $113 million invested in fiscal 2016, primarily because the Chao Center has been completed, and Klarman Hall construction activity is not scheduled to peak until fiscal 2018.

In addition to building Klarman Hall and the Life Lab, the fiscal 2017 capital plan includes continued investment in facilities maintenance, renewal, and upgrades. These smaller projects are designed to prevent deferred maintenance, improve energy efficiency, enhance sustainability, and preserve the value of the campus for future generations.

Capital Investment (in millions)

FY 16	**$ 113**
FY 15	81
FY 14	92
FY 13	80
FY 12	51

Building Debt Outstanding (in millions)

FY 16	**$ 71**
FY 15	78
FY 14	85
FY 13	91
FY 12	99

In summary, HBS begins fiscal 2017 with a healthy economic model and a strong reserves balance. Our financial plan provides flexibility for adjusting to changes in the economy, while continuing to invest in mission-driven innovation, faculty recruiting and retention, teaching and research, and campus development.

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, 2016

FIVE-YEAR SUMMARY

FOR THE FISCAL YEAR ENDED JUNE 30,

Financial Data (in millions)	2016	2015	2014	2013	2012
Revenues	**$ 761**	$ 707	$ 676	$ 612	$ 546
Expenses	**704**	660	645	571	504
Cash from Operations	**57**	47	31	41	42
Capital Investments	**113**	81	92	80	51
Building Debt Outstanding	**71**	78	85	91	99
Unrestricted Reserves	**103**	125	99	83	119
Endowment	**3,181**	3,323	3,224	2,880	2,665
Total Assets	**$ 4,508**	$ 4,587	$ 4,409	$ 3,831	$ 3,490
MBA Program					
Applications	**9,759**	9,686	9,543	9,315	8,963
Percent Admitted	**11%**	11%	12%	12%	13%
Yield	**90%**	91%	89%	89%	89%
Enrollment	**1,883**	1,865	1,859	1,838	1,805
Tuition	**$ 61,225**	$ 58,875	$ 56,175	$ 53,500	$ 51,200
Average Fellowship Aid per Student	**$ 35,571**	$ 32,919	$ 31,710	$ 30,725	$ 29,843
Doctoral Programs					
Applications	**843**	749	792	816	868
Percent Admitted	**5%**	4%	4%	5%	4%
Yield	**66%**	53%	76%	71%	68%
Enrollment	**134**	147	150	143	137
Executive Education					
Enrollment	**10,915**	10,614	9,993	9,992	9,891
HBX					
CORe Participants	**4,879**	3,508	621	—	—
Courses, Corporate Customers	**43**	21	1	—	—
Collaborating Colleges / Universities	**16**	13	1	—	—
Faculty					
Faculty Positions (full-time equivalents)	**233**	231	234	227	232
Teaching Materials	**566**	544	617	684	640
Research Articles	**160**	183	193	181	184
Books	**23**	13	18	17	23
Staff					
Staff Positions (full-time equivalents)	**1,631**	1,541	1,447	1,335	1,198
Publishing					
Cases Sold	**13,468,000**	13,223,000	11,992,000	11,448,000	10,603,000
Harvard ManageMentor® Registered Users	**4,179,000**	3,226,000	2,987,000	—	—
HBR.org Average Monthly Visitors	**5,511,000**	4,629,000	3,656,000	3,627,000	2,864,500

FISCAL 2016 HIGHLIGHTS

- Operating revenues grew 7.6 percent to $761 million, while expenses increased 6.7 percent to $704 million.
- The largest revenue growth drivers were Harvard Business Publishing (up $14 million), the annual endowment distribution (up $11 million), and current use gifts to the School (up $9 million).
- The major areas of expense growth were salary and benefits (up $15 million) and professional services (up $13 million).
- In year three of The Campaign for Harvard Business School, new gifts and pledges were $161 million, compared with $166 million in fiscal 2015.
- The return on the School's endowment was –2 percent, compared to +5.8 percent in fiscal 2015.
- The value of the School's endowment (after the net impact of distributions from the endowment and the addition of new gifts during the year) decreased to $3.2 billion, from $3.3 billion a year earlier.
- Capital investments in campus facilities and new construction increased to $113 million, from $81 million in fiscal 2015.
- The School generated an operating surplus of $57 million, compared with $47 million for the prior year.
- HBS ended fiscal 2016 with an unrestricted reserves balance of $103 million, compared with $125 million a year earlier.
- Total net assets decreased to $4.2 billion, from $4.3 billion at the end of fiscal 2015, reflecting the impact of negative endowment investment returns and the annual distribution from the endowment for operations.

STATEMENT OF ACTIVITY & CASH FLOWS*

FOR THE FISCAL YEAR ENDED JUNE 30,

Revenues (in millions)	2016	2015	2014
MBA Tuition & Fees	**$ 127**	$ 120	$ 113
Executive Education Tuition	**176**	168	163
Publishing	**217**	203	194
Endowment Distribution	**138**	127	123
Unrestricted, Current Use Gifts	**40**	36	28
Restricted, Current Use Gifts	**32**	27	37
HBX	**10**	5	—
Housing, Rents, Interest Income, & Other	**21**	21	18
Total Revenues	**$ 761**	$ 707	$ 676

Expenses			
Salaries & Benefits	**$ 309**	$ 294	$ 276
Publishing & Printing	**70**	65	66
Space & Occupancy	**62**	68	66
Supplies & Equipment	**14**	7	4
Professional Services	**65**	52	57
Fellowships	**47**	44	43
University Assessments	**22**	20	19
Debt Service	**4**	5	5
Depreciation	**38**	34	33
Other Expenses	**73**	71	76
Total Expenses	**$ 704**	$ 660	$ 645

Cash from Operations	**$ 57**	$ 47	$ 31
Depreciation	**38**	34	33
Non-Cash Items	**—**	—	9
Cash Available for Capital Activities	**$ 95**	$ 81	$ 73

Capital Expenses	**$ (113)**	$ (81)	$ (92)
Change in Capital Project Pre-Funding	**(12)**	(9)	16
Use of Gifts for Capital Projects	**20**	38	17
Net Capital Expenses	**$ (105)**	$ (52)	$ (59)

New Borrowings	**$ 0**	$ 0	$ 0
Debt Principal Payments	**(7)**	(7)	(6)
Capitalization of Endowment Income	**(3)**	(3)	(5)
Decapitalization of Endowments	**5**	5	21
Other Non-Reserve Activity	**(7)**	2	(8)
Changes in Debt & Other	**$ (12)**	$ (3)	$ 2

Increase (Decrease) in Reserves	**$ (22)**	$ 26	$ 16
Beginning Reserves Balance	**$ 125**	$ 99	$ 83
Ending Reserves Balance	**$ 103**	$ 125	$ 99

CONSOLIDATED BALANCE SHEET

FOR THE FISCAL YEAR ENDED JUNE 30,

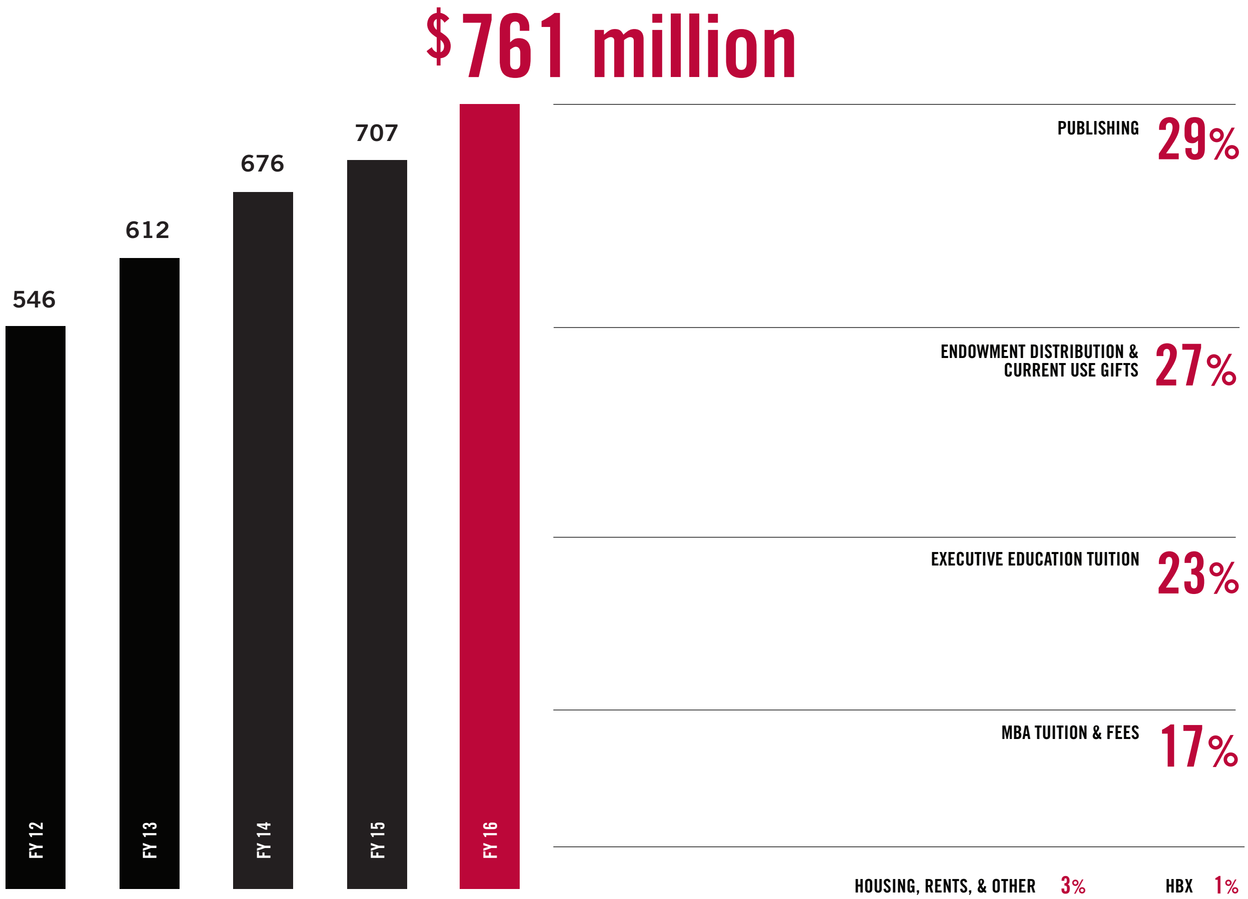
Assets (in millions)	**2016**	**2015**	**2014**
Cash	**$ 61**	$ 62	$ 44
Reserves	**103**	125	99
Receivables, Loans, & Other Assets	**475**	463	475
Invested Funds:			
Endowment Investments	**2,928**	3,076	2,970
Current Fund Investments	**107**	93	96
Interest in Trusts Held by Others	**146**	154	158
Facilities, Net	**688**	614	567
Total Assets	**$ 4,508**	$ 4,587	$ 4,409

Liabilities			
Deposits, Advances, & Other	**$ 76**	$ 64	$ 60
Deferred Revenue	**126**	110	88
Other Debt Owed to University	**24**	26	27
Building Debt	**71**	78	85
Total Liabilities	**$ 297**	$ 278	$ 260

Net Assets			
Reserves	**$ 103**	$ 125	$ 99
Undistributed Income & Other	**11**	13	16
Pledge Balances	**288**	301	317
Student Loan Funds	**11**	11	11
Investment in Facilities	**617**	536	482
Endowment & Current Use Funds	**3,181**	3,323	3,224
Total Net Assets	**$ 4,211**	$ 4,309	$ 4,149
Total Liabilities + Net Assets	**$ 4,508**	$ 4,587	$ 4,409

* In pursuit of greater comparability across the Harvard schools, the University has asked all the schools to report their net results in accordance with generally accepted accounting principles (GAAP) in the United States. In addition to results for fiscal 2016, the School's results for fiscal years 2014 and 2015 are presented in accordance with GAAP within the Statement of Activity and Cash Flows on page 24.

SUPPLEMENTAL FINANCIAL INFORMATION



REVENUES

At the core of Harvard Business School's economic model is internally funded faculty research. The resulting intellectual capital is disseminated through the School's educational programs (including MBA, Doctoral, Executive Education, and HBX) as well as through Harvard Business Publishing to students, academics, and managers around the world.

Completing a self-sustaining cycle, revenues—from MBA tuition, alumni gifts, and Executive Education and HBP (and eventually HBX) margin contributions—serve as the primary source of research funding. These funds also provide crucial support for innovation. Recent examples include the Harvard i-lab, experiments in teaching and learning such as FIELD, and HBX.

Philanthropic revenues, including distribution from the endowment and current use gifts, are equally important to the HBS 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 sixth consecutive year in fiscal 2016. As a result, the School's total revenues grew by $54 million, or 7.6 percent, from fiscal 2015.

* In pursuit of greater comparability across the Harvard schools, the University has asked all the schools to report their net results in accordance with generally accepted accounting principles (GAAP) in the United States. In addition to results for fiscal 2016, the School's results for fiscal years 2013, 2014, and 2015 are presented in accordance with GAAP within the Statement of Activity and Cash Flows on page 24.

MBA Tuition & Fees

Student tuition and fee revenues from the School's flagship educational program grew to $127 million, from $120 million in fiscal 2015. First-year MBA tuition in fiscal 2016 was $61,225, compared with $58,875 last year. The School's combined tuition and fees for fiscal 2016 were near the midpoint among the seven peer schools tracked by HBS.

Tuition and fee revenues do not fully recover MBA Program operating expenses at HBS, much less the School's long-term investments in academic innovation. The shortfall is offset primarily with income from gifts given by alumni and friends of the School whose generosity enriches the HBS educational experience for future generations of students.

Harvard Business Publishing

The School's publishing group leveraged new products and technologies to continue improving the customer experience and expanding its market reach in fiscal 2016. Despite the negative impact of the revenue recognition accounting transition for Harvard ManageMentor that began in fiscal 2015, HBP's total revenue grew by $14 million, or nearly 7 percent year over year, to $217 million—doubling our forecasted growth rate.

This growth was primarily driven by the Corporate Learning group, where sales increased 16 percent from fiscal 2015 on strong demand for Harvard ManageMentor. Higher Education group sales grew 5 percent, largely as a result of broader global distribution of HBS cases. HBR group sales were unchanged from the prior year's record high, reflecting continued strength in *Harvard Business Review* circulation and advertising revenue. International sales grew 4 percent, comprising 34 percent of HBP's total annual revenues.

Executive Education

Completing the Chao Center in fiscal 2016 capped a multiyear effort to add vitally needed Executive Education living, classroom, dining, project, and gathering space in the northeast section of the campus. The Executive Education group continued to capitalize on this expanded capacity during the year. Revenue grew nearly 5 percent to $176 million, reflecting higher enrollment and tuition increases.

Total Executive Education Program enrollment increased 3 percent from fiscal 2015 to approximately 10,900. This growth reflected an additional offering of an existing program in the School's comprehensive leadership program portfolio, as well as higher custom and global program participation. Enrollment in the School's focused programs was lower than in fiscal 2015—a not atypical fluctuation in this part of the Executive Education portfolio.

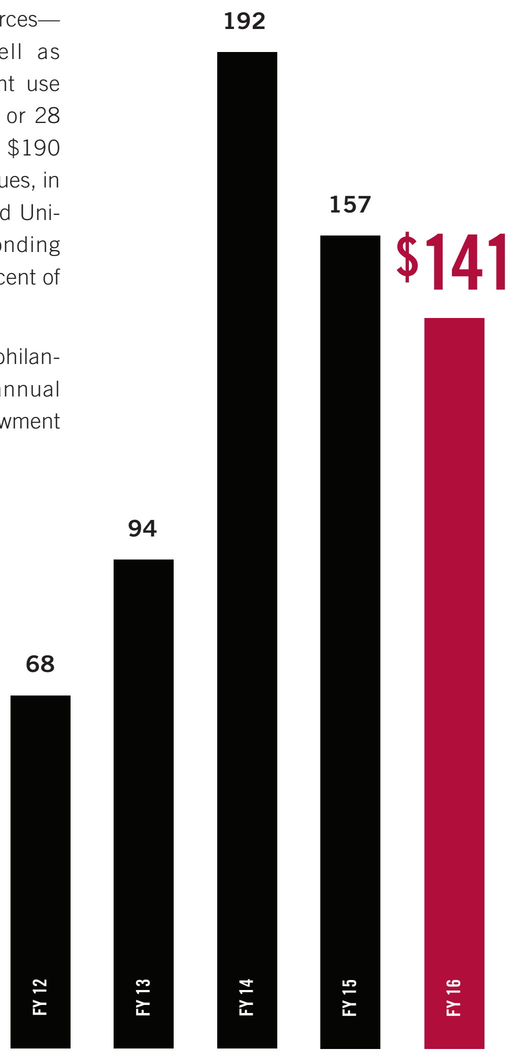
Gifts & Endowment

Although income from HBP and Executive Education makes HBS less reliant on its endowment than other schools at Harvard, philanthropic revenues are crucial to the School's economic model. In fiscal 2016, total revenue from three sources—endowment distribution as well as unrestricted and restricted current use gifts—increased to $210 million, or 28 percent of total revenues, from $190 million, or 27 percent of total revenues, in fiscal 2015. In contrast, for Harvard University as a whole, the corresponding amount for fiscal 2016 was 45 percent of total operating revenues.

The largest of the School's three philanthropic revenue sources is the annual endowment distribution. The endowment distribution for fiscal 2016 increased 9 percent from the prior year to $138 million, amounting to 18 percent of the School's total revenue.

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 in accordance with the donors' intentions and the terms of each gift.

The University determines each year's endowment payout rate—that is, the percentage of the endowment's prior-year market value withdrawn and distributed for operations and for one-time or time-limited strategic purposes. This rate applies to HBS and the other schools at Harvard.



CASH RECEIVED FROM GIFTS (in millions)

Consistent with the long-term goal of preserving the value of the endowment in real terms (after inflation) and generating a predictable stream of available income, the University's targeted annual payout range is between 5.0 and 5.5 percent. The payout rate for fiscal 2016 was 5.1 percent, unchanged from the prior year.

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. HMC's mission in managing the University endowment is to help ensure that Harvard has the financial resources to confidently maintain and expand its preeminence in teaching, learning, and research for future generations.

In executing on its investment mission, HMC is pursuing three key objectives that it believes are essential to delivering superior long-term risk-adjusted returns. These investment objectives, which measure HMC's performance against real, relative, and peer returns, are ambitious goals set to serve the University over the long term.

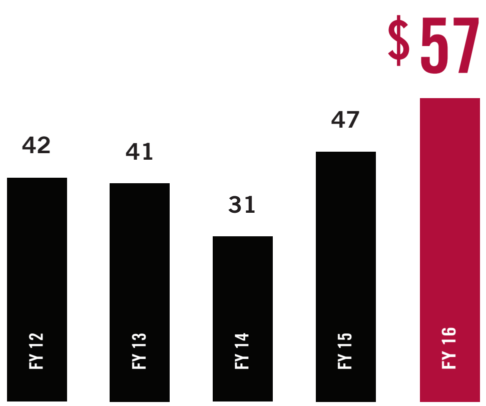
Fiscal 2016 was a difficult investment year for all endowments and pensions, the worst since the 2008–09 financial crisis. The Harvard endowment generated a –2 percent investment return, net of all expenses and fees, compared with a +5.8 percent investment return for the prior year.

The fiscal 2016 year-end market value of the HBS endowment, plus the School's current use gifts, was $3.2 billion at June 30, 2016, compared with $3.3 billion a year earlier. This decrease reflected the 2 percent net decline in market value and the subtraction of the School's annual distribution and decapitalization, offset by the $51 million in endowment gifts received by HBS during the year.

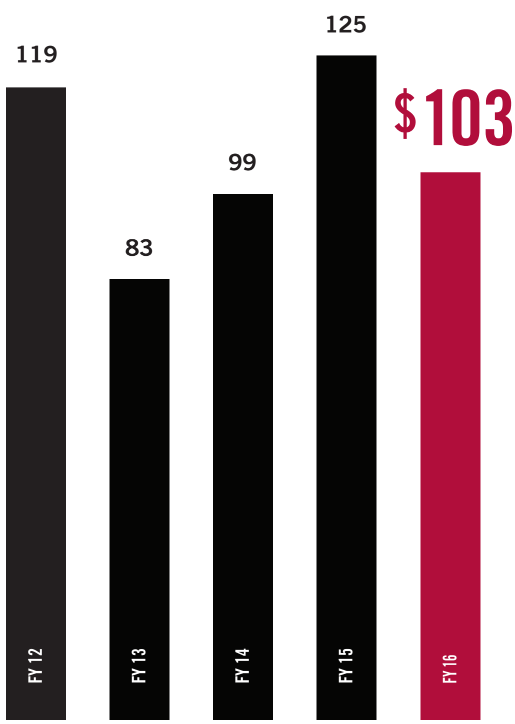
HBS raises its own funds, as do other Harvard schools. Through The Harvard Business School Campaign, the HBS community continued to demonstrate extraordinary involvement and generosity, giving $161 million in new gifts and pledges to the School during the year. This compares with $166 million during fiscal 2015.

HBS received gifts from more than 12,800 donors in fiscal 2016, including MBA, Doctoral, and Executive Education Program alumni, as well as friends of the School. Approximately 27 percent of the School's MBA alumni gave to HBS in fiscal 2016, unchanged from the prior 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, was $141 million, compared with $157 million in fiscal 2015.

Unrestricted current use giving to HBS grew in fiscal 2016 for the seventh consecutive year, providing critical funding for innovation across the School. Revenue from these flexible gifts was up 11 percent to $40 million, from $36 million in fiscal 2015. Revenue from restricted current use gifts increased more than 18 percent to $32 million, from $27 million a year earlier. Reflecting normal year-to-year variability in the timing of payments on pledges, cash giving to the endowment declined to $51 million, from $69 million in fiscal 2015, and cash giving for construction projects decreased to $16 million from $23 million.



CASH FROM OPERATIONS (in millions)



UNRESTRICTED RESERVES (in millions)

HBX

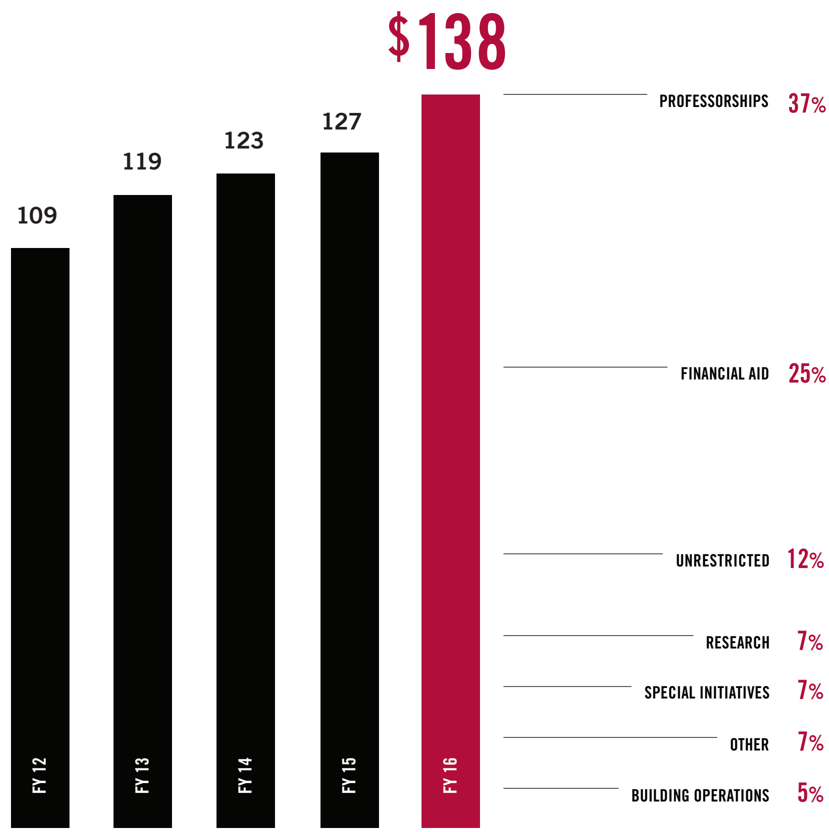
While HBX is envisioned as an academic program that will develop over the long term, joining Executive Education and HBP as a significant contributor to the School's earned revenue and income from operations, it remains in startup mode, and is expected to require continuing investment for the next several years. Although revenue at HBX doubled from fiscal 2015 to $10 million, higher expenses resulted in a $12 million operating deficit.

Housing, Rents, Interest Income, & Other

Revenue in the Housing, Rents, and Other category for fiscal 2016 was flat with the prior year at $21 million. Reflecting historically low interest rates, the School's interest income also remained flat, year over year, at zero.

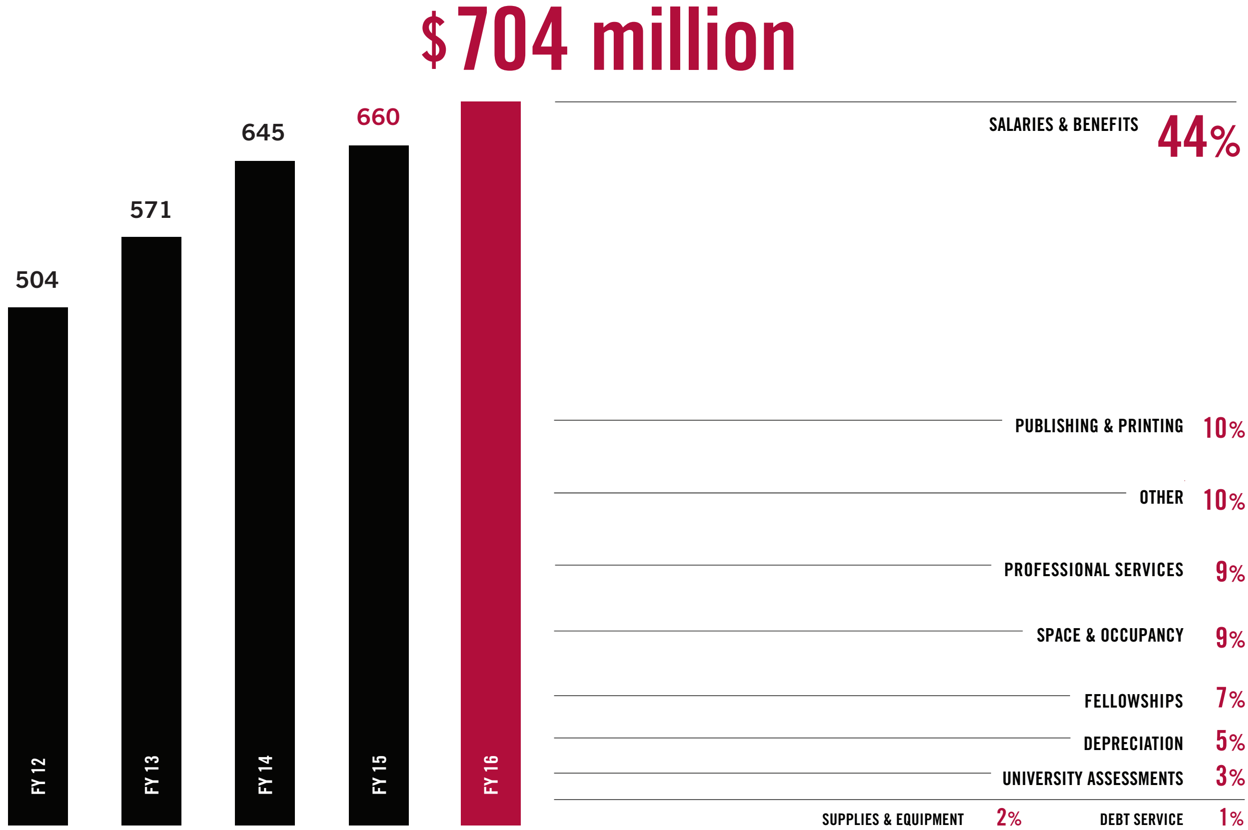
Harvard Endowment Returns

FY 16	**–2.0%**
FY 15	5.8
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
5-Year Growth	**5.9%**
10-Year Growth	**5.7%**



ENDOWMENT DISTRIBUTION (in millions)

ENDOWMENT GROWTH (in billions)



EXPENSES

The School's total operating expenses for fiscal 2016 were $704 million, up by $44 million, or 6.7 percent, from the prior year. The principal drivers were upward pressure on compensation costs, as well as spending aimed at positioning HBP, HBX, and Executive Education for future growth. The increase was partially offset by a year-over-year decrease in space and occupancy expense.

Although HBS characterizes its publishing, digital learning, and executive program costs as operating expenses, they would in large part be considered as cost of goods sold in a profit-seeking enterprise. Expenses charged to HBP, HBX, and Executive Education include direct costs for staff compensation, specialized outside professional services in functional areas such as information technology (I.T.), and marketing and residence expenses for executive program participants.

HBP and Executive Education continued to deliver solid operating leverage on sales growth in fiscal 2016. 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.

Faculty research expenses at HBS—nearly 19 percent of the operating budget—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. The School's total spending for faculty research support in fiscal 2016 rose by $8 million, or 6.5 percent, from the prior year to $131 million.

Salaries & Benefits

Employee compensation is the School's largest expense, comprising nearly 44 percent of total operating costs in fiscal 2016. Salaries and benefits expense increased 5.1 percent in fiscal 2016 to $309 million, from $294 million in the prior year.

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 two FTEs to 233 in fiscal 2016, from 231 FTEs a year earlier. HBS also continued to expand its administrative staff, which grew to a budgeted 1,631 FTEs, from 1,541 in fiscal 2015.

In addition to supporting core academic programs and assisting in I.T. infrastructure development, the majority of the staff positions added in fiscal 2016 were focused on realizing income growth potential in HBP, HBX, and Executive Education. Staff positions also were added to support the Harvard i-lab and Global Initiative, as well as in External Relations to help sustain Campaign-driven giving to the School.

Fellowships

HBS categorizes fellowships, or financial aid, as an expense line item on the Statement of Activity and Cash Flows. Making education at HBS affordable to a broad cross section of applicants, regardless of their country of origin or their financial resources, is a longstanding 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 can 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 strives to assist students in minimizing their debt at graduation by ensuring that fellowship support keeps pace with tuition and fees. Extending a long-term record of annual increases in financial aid, total fellowship expense for fiscal 2016, including assistance for doctoral candidates and a limited number of Executive Education participants, as well as for MBA students, increased by $3 million, or 6.8 percent, from fiscal 2015 to $47 million.

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. Average fellowship support per student increased 8 percent in fiscal 2016 to $35,571 from $32,919 in the prior year. Over the past five fiscal years, the School's average two-year MBA fellowship award has grown from $53,563 for the Class of 2012 to $69,000 for the Class of 2017.

Funding for fellowships comes from restricted endowment and current use giving by HBS alumni and friends, supplemented by unrestricted funds as necessary—$3 million in 2016.

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. HBP continued to make growth-focused investments in fiscal 2016. The scale of its operations further expanded as revenues grew. As a result, the School's total publishing and printing expenses for fiscal 2016 increased by $5 million from fiscal 2015 to $70 million.

Space & Occupancy

The HBS campus includes 36 buildings encompassing more than 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 under this category are expenses related to dining facilities and other campus services, and costs associated with leased space that houses operations at HBP and HBX, as well as the School's global research offices. In addition, residence costs for executive program participants are reported as space and occupancy expenses.

The School's space and occupancy expenses for fiscal 2016 were down by $6 million from the prior year to $62 million. Nearly $5 million of this decrease was caused by the recategorization of investments in new audio-visual, digital networking, and related I.T. systems as supplies and equipment expenses. The remaining $1 million primarily reflected the School's underlying trend toward slower growth in building operating costs and utility bills, as a result of recent investments in facilities upgrades, renewal, and modernization.

Professional Services

Professional services expense for fiscal 2016 rose by $13 million from the prior year to $65 million. Increased spending for third-party I.T. support was a major driver. In addition to upgrading digital information capabilities related to core operations, HBS updated its student information system, began implementing a new learning management system in the MBA Program, and implemented a new technology platform to support a wide range of Executive Education functions. The increase in professional services expense also reflected costs that a for-profit business would categorize as cost of goods sold, including growth-driven spending in HBP and HBX, as well as the School's decision to compensate faculty for teaching focused programs in Executive Education.

Supplies & Equipment and Other Expenses

Supplies and equipment expense rose by $7 million from the prior year to $14 million, primarily because of the aforementioned $5 million recategorization from space and occupancy. Spending in the other expenses category, which includes items such as travel and catering, increased by $2 million in fiscal 2016, to $73 million, reflecting planned expansion in these activities across the School.

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 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 HBS balance sheet historically has been only modestly leveraged, and debt leverage remained low in fiscal 2016. The School's total capital expenses increased to $113 million, from $81 million in the prior year. As in fiscal 2015, these investments were primarily funded by internally generated cash, and there were no new borrowings. HBS paid down $7 million in building debt in fiscal 2016, the same amount as in the prior year.

As a result, the School's year-end fiscal 2016 building debt-to-asset ratio decreased to 1.7 percent, from 1.8 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—decreased by $2 million from fiscal 2015 to $24 million.

The School's debt service expense consists of interest payments to the University and is covered by using cash from operations. Fiscal 2016 debt service expense decreased by $1 million from the prior year to $4 million. As in fiscal 2015, this expense was mainly associated with borrowings to finance prior years' campus expansion. Consistent with the two prior years, the interest portion of the School's debt service amounted to less than 1 percent of total operating expenses in fiscal 2016.

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 2016 for these assessments increased by $2 million from the prior year to $22 million.

Depreciation

The School computes depreciation using the straight-line method over the estimated useful lives of the assets. Depreciation expense for fiscal 2016 increased by $4 million, or 11.8 percent, from the prior year to $38 million. This increase primarily reflected the School's larger asset base following the completion of renovation work at Esteves Hall and the opening of the Chao Center in the fourth quarters of fiscal 2015 and 2016, respectively.

CASH BEFORE CAPITAL ACTIVITIES

The School's cash from operations increased in fiscal 2016 by $10 million from the prior year to $57 million. As in fiscal 2015, this cash was largely generated by margin contributions from Executive Education and HBP, as well as generous giving to the School by alumni and friends. In addition, depreciation contributed $38 million to the School's cash flow in fiscal 2016, compared with $34 million in the prior year.

NET CAPITAL EXPENSES

The School's total capital investment rose to $113 million in fiscal 2016, from $81 million a year earlier, primarily reflecting the completion of the Chao Center, renovation of new headquarters space for HBP, and the ongoing construction of Klarman Hall and the Pagliuca Harvard Life Lab. The School also stepped up its investments in facilities and I.T. upgrades, and renewal and maintenance projects across the campus, as well as energy efficiency measures to meet the University's ambitious greenhouse gas reduction goals.

Net capital expenses more than doubled to $105 million, from $52 million for the prior year. In addition to the $32 million increase in capital investment, fiscal 2016 net capital expenses were higher because of an $18 million decrease in the use of gifts for capital projects. In addition, pre-funding of fiscal 2017 capital projects totaled $12 million, compared with $9 million of capital project pre-funding in the prior year. This item is described in the accompanying Statement of Activity and Cash Flows as Change in Capital Project Pre-Funding.

CHANGES IN DEBT & OTHER

The School's debt and other expenses decreased by $12 million in fiscal 2016, compared with a decrease of $3 million in fiscal 2015. Because gifts, internally generated cash, and unrestricted reserves have been available and sufficient to finance capital activities, fiscal 2016 marked the School's eighth consecutive year with no new borrowings. Debt principal payments were flat, year over year, at $7 million.

Capitalization of endowment income—or cash used to purchase endowment units—was a $3 million use of cash in fiscal 2016, the same as in the prior year. In compliance with federal and state legal requirements, the School's objective is to spend as much of the endowment distribution as possible in any given year, according to the terms of each gift. Funds unspent as a result of gift restrictions are generally reinvested in the endowment.

In compliance with the law, HBS accesses the investment appreciation within existing endowment accounts when the terms of the gift require funds to be withdrawn at a rate higher than the University's payout rate in any given year. Decapitalization of endowment income—or cash drawn from endowment appreciation—was a $5 million source of cash in fiscal 2016, unchanged from the prior year.

Other non-reserve activity in fiscal 2016 was –$7 million, compared with +$2 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 50 percent of the School's revenues come from Executive Education and HBP—business units that are highly sensitive to the economy.

Consequently, maintaining an ample balance of unrestricted reserves outside of the endowment is crucial in providing HBS with sufficient liquidity to fulfill its educational and research mission on a long-term basis. Driven by the School's continued healthy cash from operations, fiscal 2016 was a successful year in this regard. HBS sustained its operations, executed on mission-driven initiatives, and increased its investment in the campus, while still concluding the year with a strong unrestricted reserves balance of $103 million.

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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 or downloaded at www.hbs.edu/annualreport.

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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