YEAR IN REVIEW

ANNUAL 2017

HARVARD | BUSINESS | SCHOOL

DEAN OF THE FACULTY

Nitin Nohria

FACULTY LEADERSHIP

Bharat N. Anand
Senior Associate Dean, HBX

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

Srikant M. Datar
Senior Associate Dean for University Affairs

C. Fritz Foley
Senior Associate Dean, Strategic Financial Planning

Janice H. Hammond
Senior Associate Dean, Culture & Community

Paul M. Healy
Senior Associate Dean for Faculty Development

Das Narayandas
Senior Associate Dean for External Relations & HBS Publishing

Felix Oberholzer-Gee
Senior Associate Dean, Chair, MBA Program

Lynn S. Paine
Senior Associate Dean for International Development

Jan W. Rivkin
Senior Associate Dean for Research

David Scharfstein
Senior Associate Dean, Doctoral Programs

Luis M. Viceira
Senior Associate Dean, Executive Education

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

Brian Kenny
Chief Marketing & Communications Officer

Jana Kierstead
Executive Director, MBA & 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 alumni and friends,

As I reflect on the past year, I am struck by a sense of new beginnings. Even an institution with a 100-plus-year history must strive to anticipate and adapt to change—whether in management education, in the practice of business, or in the broader global context—and Harvard Business School is taking important steps to ensure not just its relevance but also its continued leadership.

You can experience this visually as you walk around the HBS campus. In recent years, we have invested significantly in enhancing the residential and learning environment. One key aspect of this was the reshaping of our Executive Education facilities, which included the addition of Tata Hall (providing important living and classroom space) and the Ruth Mulan Chu Chao Center (which quickly has become a vital hub of activity for the entire community), as well as the renovation of Esteves Hall. Our work also includes the build-out of the Harvard Innovation Lab ecosystem, which now includes, in addition to the i-lab, both the alumni Launch Lab and the new Pagliuca Harvard Life Lab. And this past year we celebrated the topping off for Klarman Hall, slated to open in fall 2018, which will be a remarkable new convening space for the School.

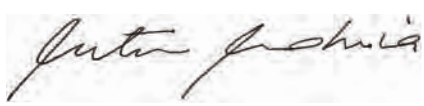
Another area where we have invested significant energy is in developing our relationship with the Harvard John A. Paulson School of Engineering and Applied Sciences (SEAS), in anticipation of the School's opening its new facility in Allston in 2020. Last spring, the HBS and SEAS faculties voted to approve two new programs: a joint MS/MBA degree and an online certificate program in business analytics. These efforts reflect the increasing intersection of business, engineering, entrepreneurship, and technology (including big data), and I am delighted to see our students, faculty, and alumni engaging in this arena to push our understanding forward.

Finally, we continue to refine and enhance—so that we can deliver at the highest levels of excellence—our core programs, from FIELD and new capstone offerings in the MBA Program to a dynamic suite of focused programs in Executive Education to curriculum review in the Doctoral Programs to new courses on the HBX platform.

Much of this has been enabled by the incredible support we have received from alumni and friends of the School in conjunction with The Harvard Business School Campaign, which continues through June 2018. I am deeply grateful for the engagement that the Campaign has generated in the School's efforts and for the faith it represents in our strategy.

I encourage you to learn more about the School's activities during 2016–2017 in the following pages.

Thanks to all of you who bring to life the HBS mission of educating leaders who make a difference in the world, each and every day.



NITIN NOHRIA
DEAN OF THE FACULTY

THE YEAR IN REVIEW

FY17

Enhancing the innovation ecosystem. Extending the impact and reach of the School through a powerful digital learning platform. Training future leaders of technology ventures. Engaging alumni around the world through The Harvard Business School Campaign. Across the "Five I" priorities—innovation, intellectual ambition, internationalization, inclusion, and integration—HBS continues to strengthen its core activities of teaching, research, and disseminating knowledge while investing in new initiatives that respond to society's greatest opportunities and most pressing challenges.

JUL—AUG

GLOBAL ALUMNI LEADERSHIP SUMMIT

Alumni of the School's comprehensive leadership programs—the Advanced Management Program, General Management Program, Program for Leadership Development, and Owner/President Management Program—returned to the revitalized Executive Education campus for three days to reconnect with one another and program faculty, attend plenary sessions and case discussions, and share ideas and insights.

550

Participants

FACULTY START

New teaching faculty begin their careers at HBS with an intensive three-day introduction to the School, including a behind-the-scenes tour featuring assets from the Library's Historical Collections, sessions on research and research support, and an immersion in teaching by the case method—including opportunities to prepare cases in learning groups and to practice a case opening and cold call.

21
Participants

BLOOMBERG HARVARD CITY LEADERSHIP INITIATIVE

Funded by a gift from Michael R. Bloomberg (MBA 1966), the Harvard Business School–Harvard Kennedy School collaboration aims to equip city leaders with the tools, skills, and support needed to tackle the complex leadership and management challenges faced in governing cities around the world. The effort encompasses executive training programs, new research and cases on innovative city government, and a coaching program through which successful mayors mentor newcomers.

300
Mayors and 400 top mayoral aides over four years

STUDENTS ARRIVE

Nearly 10,000 applicants sought a place in the MBA Program; Doctoral Program applications also were high, with almost 850 applicants yielding 25 accepted offers.

1,883
MBA students

43%
Women

35%
International

26%
Underrepresented minority

134
Doctoral students

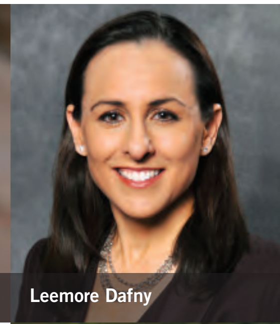
28%
Women

44%
International

8%
Underrepresented minority

New full professors


Julie Battilana


Leemore Dafny

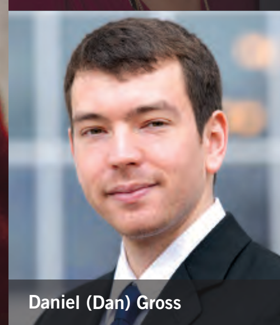

Karim Lakhani

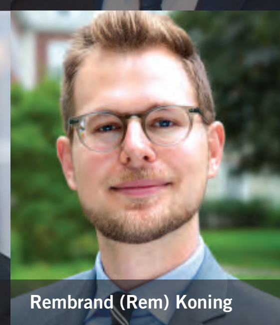

Ramana Nanda

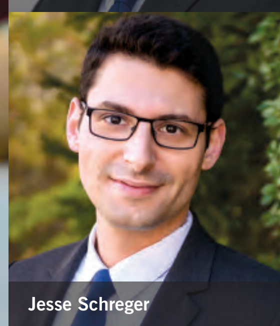
New tenure-track faculty


Katherine (Katie) Coffman


Marco Di Maggio


Daniel (Dan) Gross


Rembrand (Rem) Koning

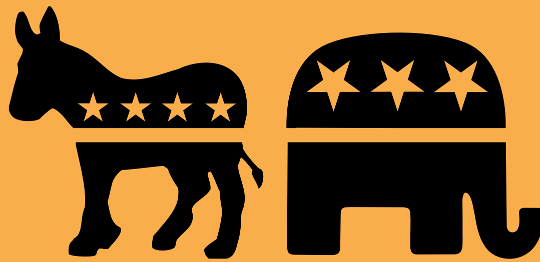

Jesse Schreger


Anywhere (Siko) Sikochi


Andy Wu

DOCTORAL PROGRAMS

A distinctive focus of the HBS Doctoral Programs is training scholars to do reality-based management research. To that end, Chair David Scharfstein worked with DBA and PhD program chairs on a proposal to deepen the engagement of students with management practice and research across a variety of fields, to provide more exposure to MBA teaching, and to strengthen relationships between students and program faculty.



PROBLEMS UNSOLVED AND A NATION DIVIDED

Michael Porter, Jan Rivkin, and Mihir Desai polled business leaders (including HBS alumni) and the general public on federal policy changes such as corporate tax reform and immigration reform that could improve competitiveness. Their report cites political dysfunction as the greatest barrier to strengthening U.S. competitiveness and lays out concrete steps that must be taken by the business community, state and local governments, and the federal government to improve the prospects of American workers and companies.

AT THE INTERSECTION OF SCIENCE AND ART

Drawing on the vast collection of some 1.5 million items from the corporate archives donated by the Polaroid Corporation to Baker Library Historical Collections in 2006, the exhibit "Edwin H. Land & the Polaroid Corporation: The Formative Years" opened to the public and included original Polaroid sunglasses, a Model 95 camera and accessories, and "vectograph" aerial photos using a process that created 3D images for wartime reconnaissance.

OUTSTANDING YOUNG BUSINESS LEADER

Social Enterprise Initiative Director Matt Segneri (MBA 2010) was honored on the *Boston Business Journal*'s "40 Under 40" list and the Boston Chamber of Commerce's list of 10 outstanding young leaders.

PAGLIUCA HARVARD LIFE LAB

The newest addition to the Harvard Innovation Lab (i-lab) ecosystem, the Life Lab—made possible by a gift from Judy (MBA 1983) and Steve (MBA 1982) Pagliuca—offers shared space for high-potential life sciences and biotech startups founded by Harvard faculty, alumni, students, and post-doctoral scholars. The 15,000-square-foot facility includes fully equipped and permitted laboratory and office space for early-stage companies and can house roughly 20 ventures.

9

Initial ventures: Akouos, Aldatu Biosciences, Beacon Genomics, Day Zero Diagnostics, GRO Biosciences, Riparian Pharmaceuticals, UrSure, Vaxess Technologies, and XGenomes

HBX

Three courses were launched on the School's digital platform in 2016–2017, including Leading with Finance (Mihir Desai), Negotiation Mastery (Mike Wheeler), and Becoming a Better Manager (David Garvin). Together with Disruptive Strategy (Clay Christensen) and CORe (Bharat Anand, Jan Hammond, and V.G. Narayanan), HBX offerings cumulatively now have engaged over 14,000 participants; completion rates—upwards of 80 percent—continue to significantly outpace those for Massive Open Online Courses (MOOCs). In the spring, HBX Live held Managing Your Career Development, a seven-session virtual course designed to help young professionals answer questions of career design, progression, and transition.

DOCTORAL STUDENT RESEARCH AWARDS

Five 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)

Andrew Brodsky (PhD, Organizational Behavior): workplace communication, including employee voice (idea raising), managerial communication, and virtual communication.

Curtis K. Chan (PhD, Organizational Behavior): how organizational culture can be double-edged.

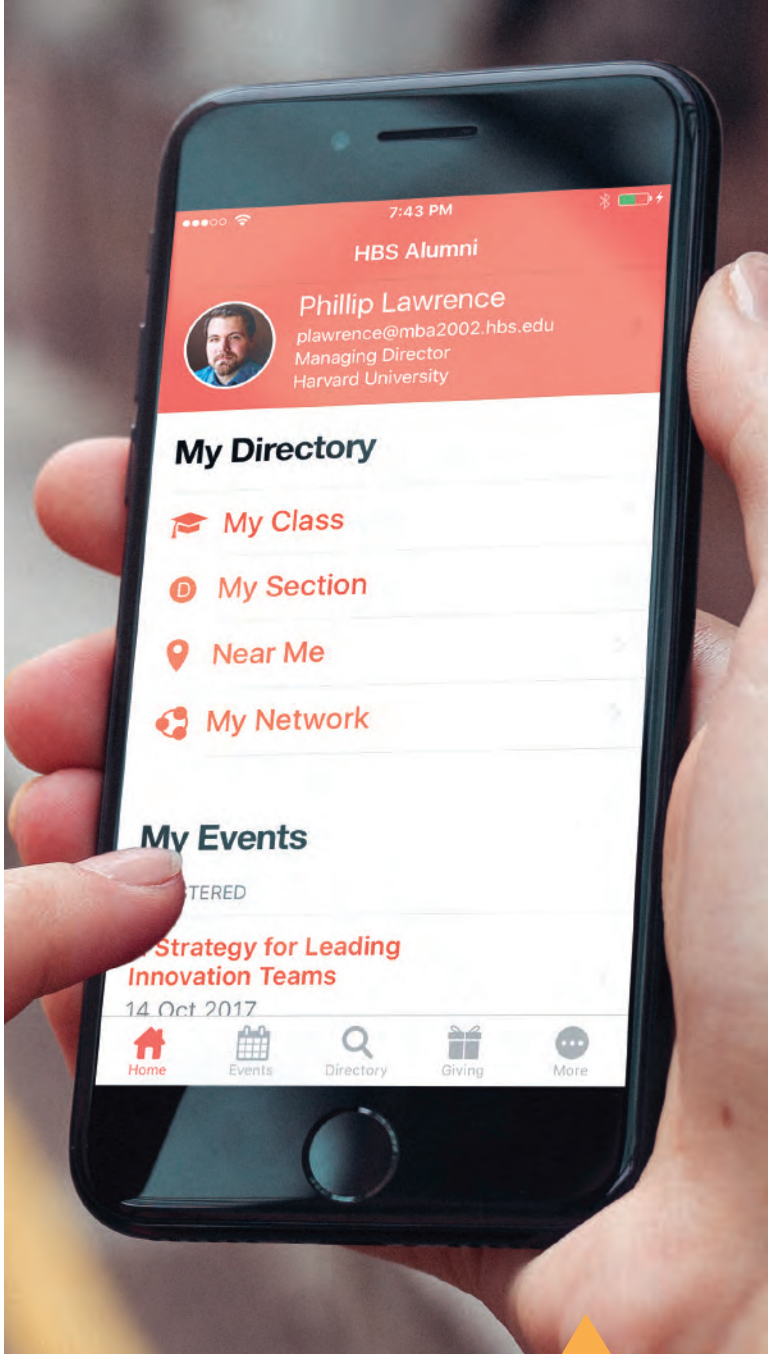
Ryann Manning (PhD, Organizational Behavior): the organizational and contextual factors that shape shared understandings of right and wrong and influence individual and collective behavior.

Ovul Sezer (PhD, Organizational Behavior): impression management tactics, including humblebragging, back-handed compliments, and name-dropping.

Martin Award for Excellence in Business Economics

(Established by Roger Martin, MBA 1981)

William F. Diamond (PhD, Business Economics): a model of how the financial system is organized to most effectively create safe assets, including its implications for asset prices, capital structure, and macroeconomic policy.



FACULTY IMMERSIONS

Faculty chairs Tom Eisenmann and Mitch Weiss developed one-day excursions for their ladder faculty colleagues. Offered in New York City and Boston, these intensive programs brought faculty into the field to see companies and meet with leaders in business and government.

ENHANCING TEACHING, LEARNING, AND RESEARCH

Information technology provides the backbone for all the School's core activities. The I.T. group partnered with faculty to develop six simulations and 12 multimedia cases, developed a new mobile application to enhance alumni engagement, launched a new myHBS student portal, and implemented an HBS network foundation for cloud services; these and other projects, including capital projects, represent an annual investment of nearly $40 million.

IMMERSIVE FIELD COURSES

Seven second-year MBA courses—in Los Angeles, London, the United Kingdom, Africa, China, Taiwan, and Japan—enabled more than 250 students to put theory into practice. Faculty leaders drew on their research and industry connections to design courses that engaged teams of students in field visits, discussions with key contacts, and project work. In the Behavioral Insights course, for example, one student team worked with the U.K. government to create a digital solution that would help young, low-income individuals increase their emergency savings.

FOCUS ON AFRICA

The newest research office opened in Johannesburg, co-located with Harvard's Center for African Studies. Headed by Pippa Tubman Armerding, it engages in case development and research with faculty members, develops and strengthens relationships with business and academic leaders across sub-Saharan Africa, and supports a range of other activities, including MBA admissions. Early in the new year Dean Nitin Nohria visited Lagos and Johannesburg, hosting an event for the HBS Club of South Africa. And, faculty co-chairs Ramon Casadesus-Masanell and Srikant Datar launched a new executive program, the Senior Executive Program—Africa, to help experienced executives design winning strategies and create competitive advantage.

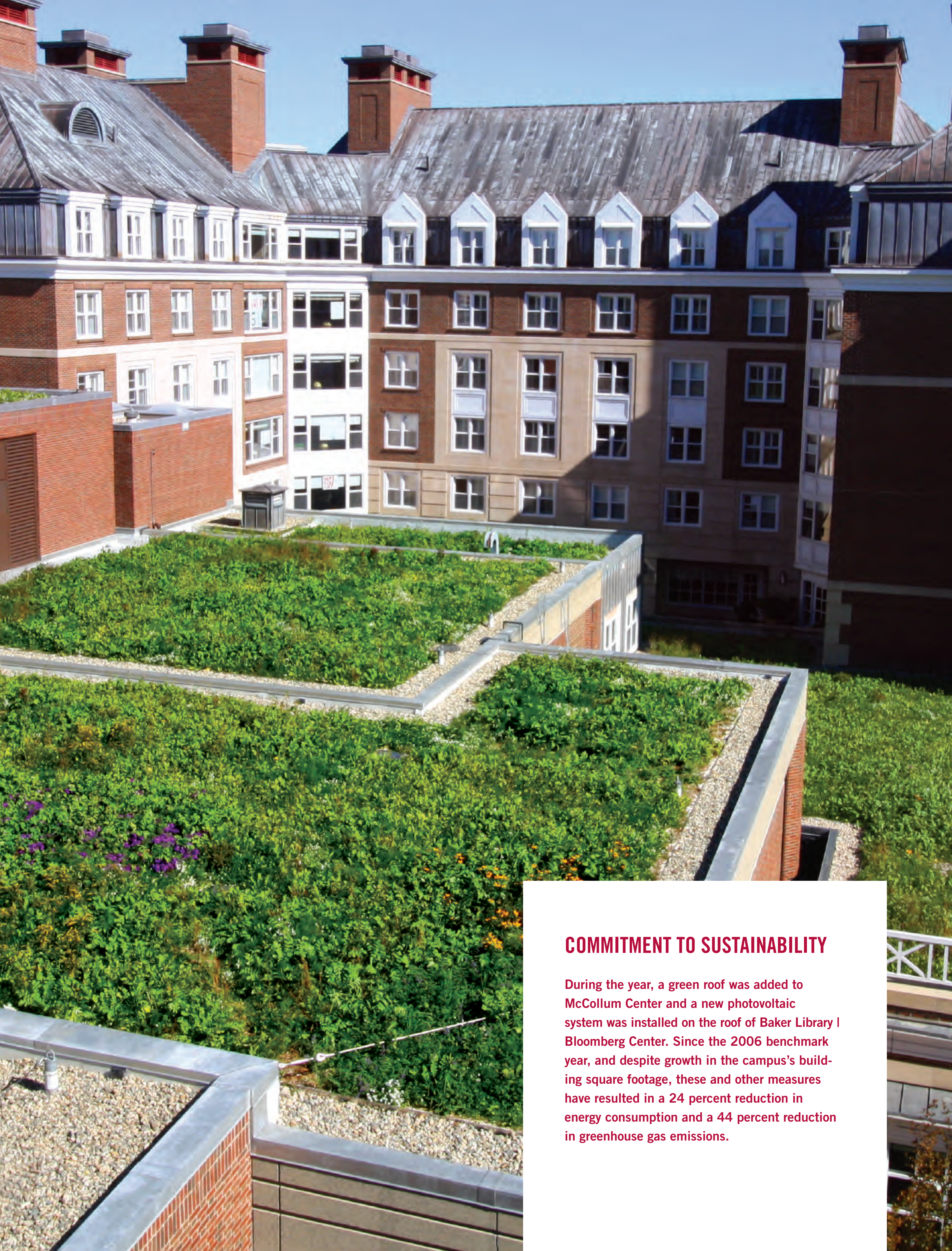
AASU
50 YEARS

PREPARING TO CELEBRATE A MILESTONE

In advance of marking the 50th anniversary of the founding of the African American Student Union (AASU), the Leadership Initiative undertook an effort to build a comprehensive data set of the School's 1915–2015 African American alumni, using public sources to supplement information on employment history. MBA student projects during 2017–2018 will analyze this data in advance of an on-campus conference in April 2018.

A LIVING MODEL

Two hundred and sixty-two staff positions were filled during 2017–2018. In total, the HBS workforce comprises approximately 1,050 FTEs, of whom 63 percent are women and 18 percent are minority. Governance at HBS includes a unique partnership of faculty and staff, with most programs and activities led by a faculty Senior Associate Dean and staff Executive Director.



COMMITMENT TO SUSTAINABILITY

During the year, a green roof was added to McCollum Center and a new photovoltaic system was installed on the roof of Baker Library | Bloomberg Center. Since the 2006 benchmark year, and despite growth in the campus's building square footage, these and other measures have resulted in a 24 percent reduction in energy consumption and a 44 percent reduction in greenhouse gas emissions.

20TH ANNUAL NEW VENTURE COMPETITION

Student Business Track Winners

Dubilier Grand Prize:
Veho
(shown) aims to replace large delivery trucks with a platform that enables anyone to deliver packages in their car.

Satchu-Burgstone Runner-Up Award:
CozyKin
pairs families seeking infant child care with in-home Montessori care offered by technology-enabled nannies.

Student Social Enterprise Track Winners

Peter M. Sacerdote Grand Prize:
Flare
seeks to reinvent personal security by offering technology-abled safety devices for women.

Sacerdote Runner-Up Award:
Juva Therapy
connects mental health patients to providers best suited to their needs.

Alumni Winners

Grand Prize:
Apli
a Mexican talent agency that delivers qualified on-demand workers in 24 hours.

Runner-Up:
Vention
allows businesses to design and order custom manufacturing equipment online via 3D printing.

5,000

Student participants in the Competition's two-decade history.

CASEWRITING WORKSHOP

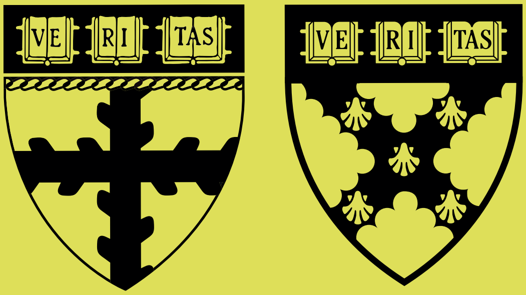
Baker Foundation Professor Bill Sahlman, the author of more than 250 case studies, teaching notes, technical notes, and exercises, offered sessions for new faculty aimed at helping them become effective case writers and course developers. Topics included finding a case site and engaging with management, what makes a case an effective learning vehicle, and how casewriting and course development relate to an overall research agenda.

TOPPING OFF

Construction on Klarman Hall reached the halfway point as the highest beam—signed by the construction workers and members of the community—was lifted into place. The building, made possible by a donation from Seth (MBA 1982) and Beth Klarman and designed by William Rawn Associates, will open in fall 2018 and will combine elements of a large-scale conference center, a performance space, and an intimate community forum.

"We look forward to Klarman serving as a hub for convening diverse groups for productive discussion on everything from the economy of the future to the potential of free enterprise to business ethics and corporate values."

Seth & Beth Klarman

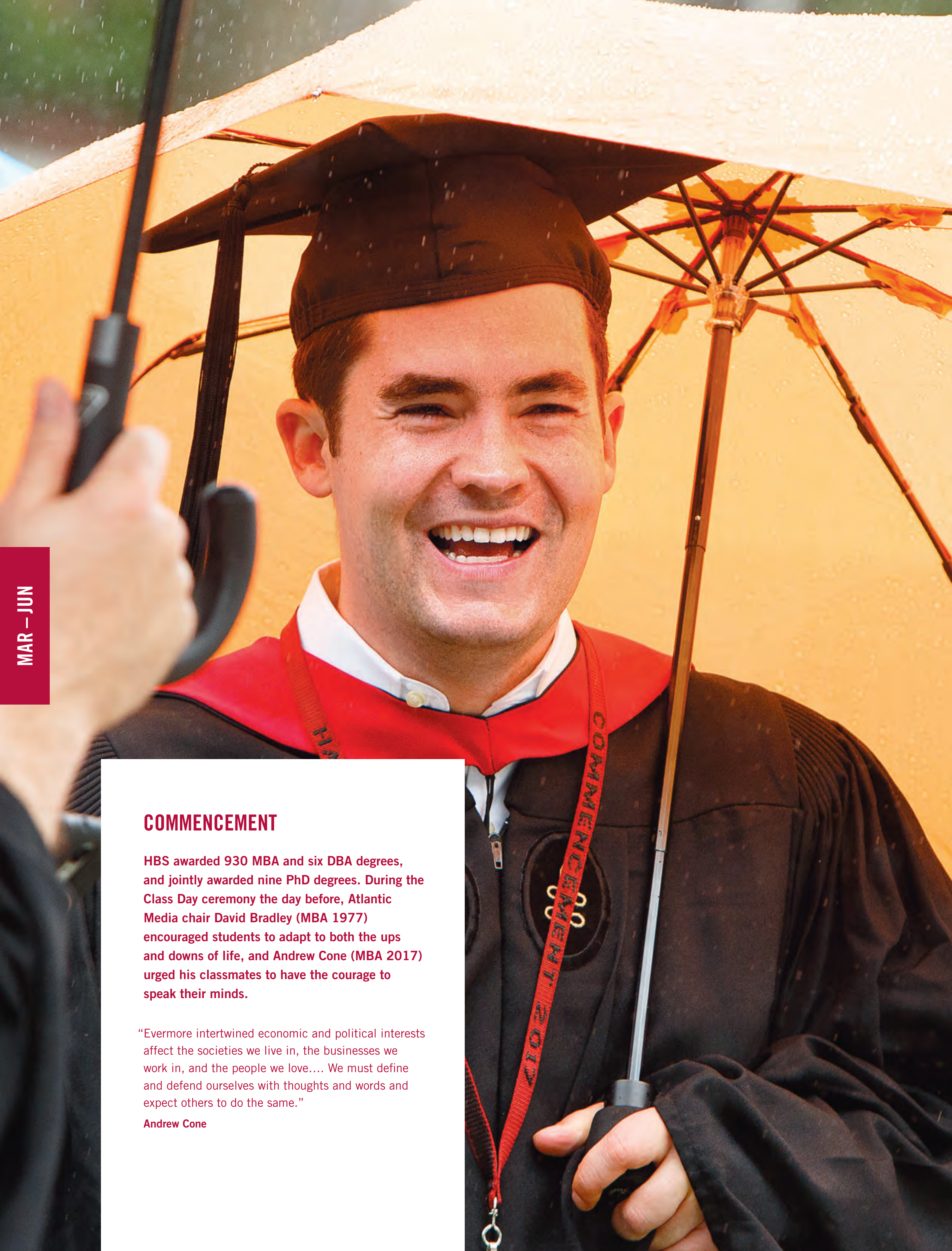


MS/MBA

A new joint master's degree, conferring a Master of Science (SM) in Engineering Sciences from the Harvard John A. Paulson School of Engineering and Applied Sciences and an MBA from HBS, was announced, with the first students—approximately 30 each year—expected to matriculate in August 2018. The program will train future leaders of technology ventures and provide a strong foundation in general management, build design skills, and extend understanding of engineering. The curriculum will use both existing and new, jointly designed and taught courses.

INCLUSION

Fellowships and financial aid are important means of attracting a diverse study body and ensuring that graduates go on to pursue careers where they feel their impact can be greatest. Beginning in June, HBS will waive the fee for active duty military applicants to the MBA Program. The Social Enterprise Initiative and MBA Program also announced an expansion of the Nonprofit/Public Sector Loan Assistance Repayment Program to include for-profit social enterprise positions, recognizing the growing number of graduates who pursue opportunities at these firms.



COMMENCEMENT

HBS awarded 930 MBA and six DBA degrees, and jointly awarded nine PhD degrees. During the Class Day ceremony the day before, Atlantic Media chair David Bradley (MBA 1977) encouraged students to adapt to both the ups and downs of life, and Andrew Cone (MBA 2017) urged his classmates to have the courage to speak their minds.

"Evermore intertwined economic and political interests affect the societies we live in, the businesses we work in, and the people we love…. We must define and defend ourselves with thoughts and words and expect others to do the same."

Andrew Cone

FACULTY AWARDS

Four faculty members were recognized by students for their excellence in teaching in the MBA Program: Joshua Margolis (Leadership and Organizational Behavior) and Julio Rotemberg (Business, Government and the International Economy) in the Required Curriculum, and Youngme Moon (Brand Strategy) and Tom Nicholas (The Coming of Managerial Capitalism) in the Elective Curriculum.

DEAN'S AWARD

Three students—Andrea Coravos (MBA 2017), Tami Kim (DBA 2017), and Ryann Manning (PhD 2017)—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.

ALUMNI ACHIEVEMENT AWARDS

David G. Bradley (MBA 1977)
Chairman, Atlantic Media

John J. Brennan (MBA 1980)
Chairman Emeritus, Vanguard Group

Angie Hicks (MBA 2000)
Cofounder & Chief Marketing Officer, Angie's List

Ilene H. Lang (MBA 1973)
Retired President & CEO, Catalyst

John H. McArthur (MBA 1959, DBA 1963)
Dean Emeritus, Harvard Business School

Adebayo O. Ogunlesi (JD/MBA 1979)
Chairman & Managing Partner, Global Infrastructure Partners

IN MEMORIAM

David A. Garvin
C. Roland Christensen Professor of Business Administration

Howard Raiffa
Frank P. Ramsey Professor of Managerial Economics, Emeritus

Julio J. Rotemberg
William Ziegler Professor of Business Administration

The HBS community was saddened to lose three beloved colleagues during 2016–2017. Esteemed scholars all, their contributions to management and management education were far ranging and they exemplified the School's mission of making a difference in the world.

FROM THE CHIEF FINANCIAL OFFICER

Fiscal 2017 was a strong financial year for Harvard Business School. Revenues grew faster than expenses for the third consecutive year, resulting in double-digit growth in cash from operations. This cash flow enabled HBS to continue executing on its strategic priorities and investing in core programs and activities, while ending the year with a stronger-than-expected balance of unrestricted reserves.

One of our financial goals is for HBS to serve as a living example of a well-run organization, embodying the skills, tools, and frameworks taught across the School's educational programs. Transparency is intrinsic to achieving this goal, and to this end our fiscal 2017 financial results are reported in detail in the Supplemental Financial Information section that begins on page 24.

The balance of this letter discusses the School's fiscal 2017 financial performance at a strategic level. It concludes with our financial forecast for fiscal 2018 and some thoughts on the longer-term outlook.

FISCAL 2017 IN REVIEW

The HBS economic model is unique among the Harvard University schools and in higher education. The model begins with our commitment to internally funded faculty research. Free from the constraints that can come with grants and other outside funding, HBS research budgets allow the School's faculty to stay close to practice—to travel wherever their work takes them and to interact in the field with leaders and managers who are confronting the most interesting business challenges and opportunities.

HBS disseminates the resulting intellectual capital to educate leaders and influence the practice of management on a global scale, both through its educational programs and through Harvard Business Publishing (HBP).

Completing the self-sustaining cycle, operating surpluses at Executive Education and HBP supplement revenues from MBA tuition and alumni gifts as the primary source of funding for faculty research. In short, the success of the HBS economic model starts with the value of the faculty's scholarship and the School's ability to translate this value into income for operations, which is then reinvested in future intellectual capital creation.

When we began implementing a range of strategic initiatives in fiscal 2011, we knew these efforts would put pressure on the School's economic model for the next several years. New Executive Education buildings would be under construction and HBX would be in launch mode. HBS would also be introducing the FIELD course in the MBA Program, establishing additional global research offices, opening the Harvard i-lab, and laying the groundwork for The Harvard Business School Campaign.

Near term, we expected the School's operating expenses to increase faster than revenues. We accepted the risk, however, in light of the potential for several of these strategic efforts to generate meaningful top-line growth over the long term. Fiscal 2017 may have been pivotal in this respect—an inflection point in the transition from a period of aggressive investment to a phase focused on leveraging the related benefits, ensuring the sustainability of what the School has recently built.

Fiscal 2017, then, marked a shift in the balance between revenue and expense growth rates at the School. The five-year compound annual rate of revenue growth exceeded the comparable growth in expenses for the first time in the past half-decade. For the period since fiscal 2012, the School's compound annual growth rates for revenues and expenses were 7.3 and 6.6 percent, respectively.

Total operating revenues for fiscal 2017 increased 5.1 percent year over year, exceeding our forecast by 2.6 percent, largely driven by Executive Education enrollment and alumni giving. The School's total operating expenses, however, were up just 3.8 percent—coming in below our forecast and rising at about half of last year's rate.

Driven by these positive revenue and expense dynamics, fiscal 2017 was a strong year for operating margins and internally generated cash at the School. Operating cash flow grew 21 percent, driven mainly by higher Executive Education margin contributions. The School's total net margin contribution as a percentage of revenue increased 1.1 percent to 8.6 percent from 7.5 percent last year, and 3.3 percent from 5.3 percent in fiscal 2012.

Together with this robust bottom-line performance, the School's net capital expenses dropped in fiscal 2017. There also was a large, positive balance sheet impact associated with other non-reserve activity during the year. As a result, HBS continued to fund its core programs and activities, drive innovation in teaching and research, and invest in strategic opportunities while still concluding fiscal 2017 with a substantially stronger unrestricted reserves balance.

Unrestricted reserves are crucial in providing HBS with sufficient financial flexibility to execute on its mission and sustain the campus through economic cycles over the long term. The School's cash flow and balance sheet are detailed beginning on page 22.

Fiscal 2017 was an exceptionally successful year for philanthropic revenue at HBS. The Campaign passed the midway point, spurring continued growth in current use giving and adding important new endowment funds for key priorities.

Driven by the extraordinary generosity of the School's alumni and friends, HBS received $233 million in new gifts and pledges in fiscal 2017—up 45 percent from $161 million a year ago—and cash gifts to the School increased 35 percent to $190 million. Approximately 60 percent of this cash giving was intended by the donors to sustain the School's core operations over the long term by funding new or existing endowment accounts, and to support the development of the HBS campus.

The balance of fiscal 2017 giving to HBS consisted primarily of restricted and unrestricted current use gifts, which continue to grow in importance to the School's economic model. Current use giving has more than doubled over the past five years, growing from $35 million, or 6 percent of total revenues, in fiscal 2012, to $74 million, or 9 percent of total revenues, in fiscal 2017. This revenue has a significant impact on the School's operating cash flow. It has proved vital as a flexible source of seed money to launch visionary initiatives such as FIELD, the Harvard i-lab ecosystem, HBX, and joint educational programs with other Harvard schools.

Having diverse sources of revenue—generous current use giving plus earned income from Executive Education and HBP—makes HBS less reliant on endowment distribution income to support its operations than all but one other Harvard school. Reflecting new gifts and prior years' investment returns, the School's endowment distribution revenue for fiscal 2017 increased 5.8 percent, year over year, representing 18 percent of the School's total revenue. This year's distribution from the endowment, as well as the endowment's investment performance, is discussed in detail beginning on page 26.

Approximately $30 million of fiscal 2017 cash giving to the School was earmarked for capital projects. The School's capital investments for fiscal 2017 totaled $78 million. This compares with $113 million in fiscal 2016, which marked the conclusion of a five-year period in which the School added nearly 200,000 square feet of occupied space to the campus—an increase of more than 12 percent. Capital activity during this period primarily focused on enhancing and expanding Executive Education facilities.

The School's fiscal 2017 capital activity centered on the construction of Klarman Hall, a new convening space slated to open in fall 2018. Additionally, HBS completed the Pagliuca Harvard Life Lab, designed to provide life scientists with lab space for entrepreneurial ventures. The School also continued to make substantial investments in facilities renewal and maintenance, energy efficiency projects, I.T. infrastructure upgrades, and digital technology across the campus.

Total operating expenses at HBS came in nearly 4 percent under budget in fiscal 2017. At both the faculty and staff levels, we continued to operate in as lean a manner as possible: making tradeoffs when necessary to leverage maximum impact from the School's available resources, and instilling greater rigor in our budgeting processes.

Compensation for faculty and administrative staff represents 45 percent of the School's total expense base, and therefore

Fellowship Spending (in millions)	**MBA**	**Total***
FY 17	**$ 36**	**$ 48**
FY 16	34	47
FY 15	32	44
FY 14	31	43
FY 13	29	40

** Includes Doctoral Programs and Executive Education*

Investment in Research (in millions)	
FY 17	**$ 136**
FY 16	131
FY 15	123
FY 14	117
FY 13	110

remains key to our cost-control strategy. We continued to use a disciplined gating process in fiscal 2017 for new full-time equivalent (FTE) requests, focusing staff headcount growth in functions that are strategically important to the School. The increases in total compensation expense and in the number of FTE positions for fiscal 2017 were in line with our plan, rising slightly less than 6 percent and 3 percent, respectively, year over year.

Driven by a group of major platform investments, I.T. has been a major contributor to the higher fixed costs at HBS in recent years. Slowing the rate of growth in I.T. expenses is one of our key financial objectives, and our work in this area was successful in fiscal 2017. Total I.T. spending was flat with fiscal 2016 and 3 percent below budget, which was key to the reduction in the School's total expense growth for the year. Looking forward, supporting strategic I.T. investment at HBS in a financially sustainable manner will remain high among our financial planning priorities.

Space and occupancy expenses for fiscal 2017 increased nearly 10 percent from the prior year, coming in 4 percent below budget. The Chao Center was occupied for the full year, the Life Lab was opened, and HBP moved into new, larger facilities—together leading to significant upward pressure on operating costs.

As we expected, this pressure was partially mitigated by designed-in building efficiencies at the Chao Center. It was also partially reduced by lower facilities operations, utilities, and energy expenses resulting from the ongoing modernization and upgrading of buildings and infrastructure across the campus. These positive factors, however, were partially offset by larger-than-expected costs for site remediation associated with Klarman Center construction.

FISCAL 2018 OUTLOOK

Thanks to top-line growth and fiscal discipline, for the past five years we have been able to execute on the School's mission, consistently generate operating surpluses, and conclude each year with a healthy reserves balance. Our goal is to continue delivering sound and consistent financial results going forward.

Innovation will remain important to the continued vitality of the School, but the pace of investment is likely to slow as our focus shifts toward sustaining recently launched activities over the long term. Consequently, we anticipate a period of greater stability in both revenues and expenses at HBS compared with the past half-decade.

Looking at fiscal 2018 specifically, we expect to be operating in an environment of uncertainty about the health of the global economy and how long the currently favorable conditions can extend their run. Our top-line growth expectations for fiscal 2018 are conservative, as a result.

We developed our fiscal 2018 financial plan with this backdrop in mind, and will continue to closely monitor the School's actual financial performance versus budget as fiscal 2018 progresses. Contingency plans are in place should revenues fall short and, as in recent years, the School's top-line performance may turn out better than we had anticipated.

Working our way down the income statement, we expect the School's total revenues for fiscal 2018 to be essentially level with the $800 million reported for fiscal 2017. Revenue from MBA tuition and fees is projected to rise 4 percent. At the same time, financial aid spending, representing MBA, Doctoral, and Executive Education student fellowships, is expected to increase 6 percent.

At HBP and Executive Education, revenue for fiscal 2018 is forecasted to be essentially flat with fiscal 2017 on a combined basis. Both groups continue to battle competitive headwinds. Additionally, Executive Education may see declines in enrollment should travel to the U.S. be curtailed for international participants. HBX plans to introduce several new courses, and the group's revenue is expected to grow 50 percent from fiscal 2017, but it will take several more years for HBX to become a surplus-generating activity.

Sustaining the School's multi-year record of strength in current use giving as the Campaign winds down will be another key challenge in fiscal 2018. HBS will continue to rely on the generosity of alumni and friends for the financial flexibility and security that current use gifts provide.

The 2 percent investment loss experienced by the Harvard endowment in fiscal 2016 also presents a challenge for HBS and other Harvard schools. Endowment investment returns drive the payout rate set by the University for a given year. This payout rate, plus any increase in the size of the endowment resulting from endowment gifts received during the prior year, determines the amount of income distributed from the endowment.

The Harvard endowment's negative performance in fiscal 2016 will limit growth in the endowment distribution across the University to essentially zero in fiscal 2018. The endowment posted a return of 8.1 percent for fiscal 2017, which will support modest growth in the endowment distribution across the University in fiscal 2019.

Moving down the income statement to operating expenses, our fiscal 2018 finan-

Publishing Revenue (in millions)

FY 17	**$ 221**
FY 16	217
FY 15	203
FY 14	194
FY 13	180

Executive Education Tuition (in millions)

FY 17	**$ 191**
FY 16	176
FY 15	168
FY 14	163
FY 13	146

I.T. Investment (in millions; excludes capital expenses)

FY 17	**$ 85**
FY 16	85
FY 15	72
FY 14	66
FY 13	57

cial plan assumes a larger increase in spending compared to the prior year. Driven by anticipated increases in salaries and benefits, we are forecasting 5 percent growth in total compensation cost. The School's other line item expenses, collectively, are expected to rise 7 percent from fiscal 2017. As a result, total operating expenses are expected to increase 6 percent.

This planned expense growth reflects our commitment to further strengthen core teaching and research programs across the School in fiscal 2018. As an example, eight Short Immersive Programs will be offered to MBA students in January 2018, an increase from three in 2017. Additionally, we plan to continue selectively expanding the range of programs offered jointly by HBS and other Harvard schools.

Fiscal 2018 will also be a year of robust faculty research investment. Our financial plan includes increased support for the School's Behavioral Research Services and lab for experimental research. Observing human behavior in a controlled setting has developed into one of the faculty's mainstream research methodologies. We expect our investments in this area to continue to grow.

Driven by the planned increase in Klarman Hall construction activity, the School's total capital budget for fiscal 2018 is $92 million, up $14 million year over year. Our fiscal 2018 capital plan also 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 HBS campus for future generations.

In summary, our financial outlook for fiscal 2018 is positive. The School's economic model and reserves balance are strong, positioning HBS to continue providing robust support for mission-driven innovation in teaching, research, and enhancing our residential campus as the year unfolds. We remain committed to extending the School's record of prudent resource stewardship, and look forward to rising to the challenges ahead.

RICHARD P. MELNICK, MBA 1992
CHIEF FINANCIAL OFFICER
OCTOBER 1, 2017

Capital Investment (in millions)	
FY17	**$ 78**
FY16	113
FY15	81
FY14	92
FY13	80

Building Debt Outstanding (in millions)	
FY17	**$ 64**
FY16	71
FY15	78
FY14	85
FY13	91

FIVE-YEAR SUMMARY

FOR THE FISCAL YEAR ENDED JUNE 30,

Financial Data (in millions)	2017	2016	2015	2014	2013
Revenues	**$ 800**	$ 761	$ 707	$ 676	$ 612
Expenses	**731**	704	660	645	571
Cash from Operations	**69**	57	47	31	41
Capital Investments	**78**	113	81	92	80
Building Debt Outstanding	**64**	71	78	85	91
Unrestricted Reserves	**145**	103	125	99	83
Endowment	**3,472**	3,209	3,309	3,210	2,828
Total Assets	**$ 4,821**	$4,508	$ 4,587	$ 4,409	$ 3,831
MBA Program					
Applications	**10,351**	9,759	9,686	9,543	9,315
Percent Admitted	**11%**	11%	11%	12%	12%
Yield	**91%**	90%	91%	89%	89%
Enrollment	**1,879**	1,883	1,865	1,859	1,838
Tuition	**$ 63,675**	$ 61,225	$ 58,875	$ 56,175	$ 53,500
Average Fellowship Aid per Student	**$ 37,312**	$ 35,571	$ 32,919	$ 31,710	$ 30,725
Doctoral Programs					
Applications	**915**	843	749	792	816
Percent Admitted	**4%**	5%	4%	4%	5%
Yield	**79%**	66%	53%	76%	71%
Enrollment	**132**	134	147	150	143
Executive Education					
Enrollment	**11,361**	10,855	10,614	9,993	9,992
HBX					
Participants	**8,143**	6,431	3,899	670	—
Faculty					
Faculty Positions (full-time equivalents)	**233**	233	231	234	227
Teaching Materials	**573**	566	544	617	684
Research Articles	**163**	160	183	193	181
Books	**14**	23	13	18	17
Staff					
Staff Positions (full-time equivalents)	**1,680**	1,631	1,541	1,447	1,335
Publishing					
Cases Sold	**14,859,000**	13,468,000	13,223,000	11,992,000	11,448,000
Harvard ManageMentor® Registered Users	**3,311,000**	3,478,000	3,226,000	2,987,000	—
HBR.org Average Monthly Visitors	**7,012,000**	5,511,000	4,629,000	3,656,000	3,627,000

FISCAL 2017 HIGHLIGHTS

- Operating revenues grew 5.1 percent to $800 million, while operating expenses increased 3.8 percent to $731 million.
- The largest revenue growth drivers were Executive Education (up $15 million) and the annual endowment distribution (up $8 million).
- The major areas of expense growth were salaries and benefits (up $18 million) and space and occupancy (up $6 million).
- In year four of The Harvard Business School Campaign, new gifts and pledges increased to $233 million, from $161 million in fiscal 2016.
- The return on the School's endowment increased to 8.1 percent, from -2 percent in fiscal 2016.
- The value of the School's endowment (net distributions and the addition of new gifts during the year) increased to $3.5 billion, from $3.2 billion a year earlier.
- Capital investments in campus facilities and new construction decreased to $78 million, from $113 million in fiscal 2016.
- The School generated an operating surplus of $69 million, compared with $57 million for the prior year.
- HBS ended fiscal 2017 with an unrestricted reserves balance of $145 million, compared with $103 million a year earlier.
- The School's total net assets increased to $4.5 billion, from $4.2 billion at the end of fiscal 2016, primarily reflecting the impact of growth in the market value of the endowment.

STATEMENT OF ACTIVITY & CASH FLOWS*

FOR THE FISCAL YEAR ENDED JUNE 30,

Revenues (in millions)	**2017**	**2016**	**2015**
MBA Tuition & Fees	**$ 133**	$ 127	$ 120
Executive Education Tuition	**191**	176	168
Publishing	**221**	217	203
Endowment Distribution	**146**	138	127
Unrestricted, Current Use Gifts	**42**	40	36
Restricted, Current Use Gifts	**32**	32	27
HBX	**12**	10	5
Housing, Rents, Interest Income, & Other	**23**	21	21
Total Revenues	**$ 800**	$ 761	$ 707
Expenses			
Salaries & Benefits	**$ 327**	$ 309	$ 294
Publishing & Printing	**70**	70	65
Space & Occupancy	**68**	62	68
Supplies & Equipment	**12**	14	7
Professional Services	**63**	65	52
Fellowships	**48**	47	44
University Assessments	**24**	22	20
Debt Service	**4**	4	5
Depreciation	**40**	38	34
Other Expenses	**75**	73	71
Total Expenses	**$ 731**	$ 704	$ 660
Cash from Operations	**$ 69**	$ 57	$ 47
Depreciation	**40**	38	34
Non-Cash Items	**1**	—	—
Cash Available for Capital Activities	**$ 110**	$ 95	$ 81
Capital Expenses	**$ (78)**	$ (113)	$ (81)
Change in Capital Project Pre-Funding	**19**	(12)	(9)
Use of Gifts for Capital Projects	**51**	20	38
Net Capital Expenses	**$ (8)**	$ (105)	$ (52)
New Borrowings	**$ 0**	$ 0	$ 0
Debt Principal Payments	**(8)**	(7)	(7)
Capitalization of Endowment Income	**(4)**	(3)	(3)
Decapitalization of Endowments	**3**	5	5
Other Non-Reserve Activity	**(51)**	(7)	2
Changes in Debt & Other	**$ (60)**	$ (12)	$ (3)
Increase (Decrease) in Reserves	**$ 42**	$ (22)	$ 26
Beginning Reserves Balance	**$ 103**	$ 125	$ 99
Ending Reserves Balance	**$ 145**	$ 103	$ 125

CONSOLIDATED BALANCE SHEET

FOR THE FISCAL YEAR ENDED JUNE 30,

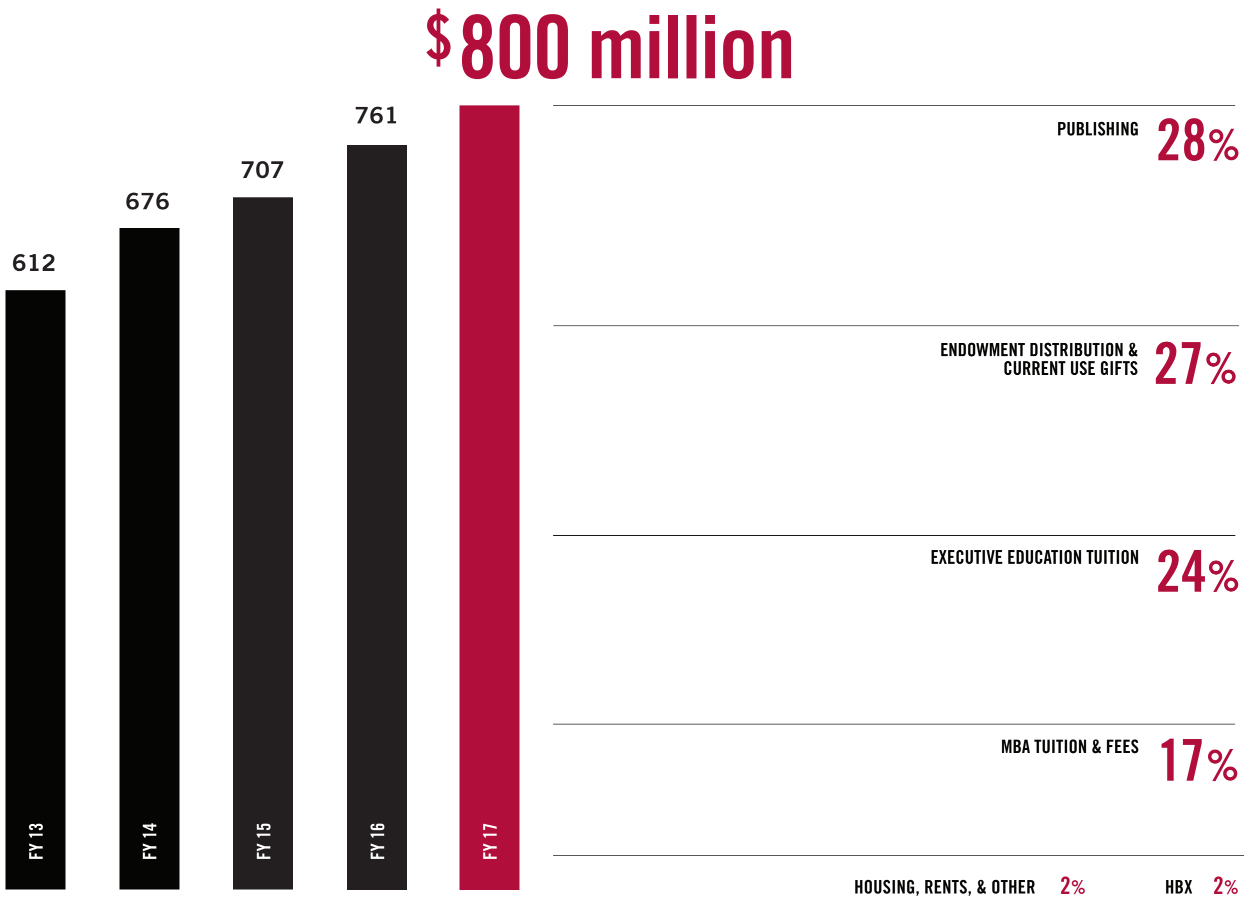
Assets (in millions)	**2017**	**2016**	**2015**
Cash	**$ 80**	$ 61	$ 62
Current Use Reserves	**145**	103	125
Receivables, Loans, & Other Assets	**177**	178	150
Invested Funds:			
Endowment	**3,140**	2,927	3,076
Endowment Interest in Trusts Held by Others	**157**	144	150
Endowment Pledges	**168**	127	66
Undistributed General Investment Income	**7**	11	17
Current Use Investments	**72**	107	93
Current Use Pledges	**151**	162	234
Facilities, Net	**724**	688	614
Total Assets	**$ 4,821**	$ 4,508	$ 4,587

Liabilities			
Deposits, Advances, & Other	**$ 69**	$ 76	$ 64
Deferred Revenue	**150**	126	110
Other Debt Owed to University	**26**	24	26
Building Debt	**64**	71	78
Total Liabilities	**$ 309**	$ 297	$ 278

Net Assets			
Current Use Reserves	**$ 145**	$ 103	$ 125
Endowment Funds	**3,472**	3,209	3,309
Current Use Funds	**223**	269	327
Unexpended Endowment Income	**1**	2	1
Student Loan Funds	**11**	11	11
Investment in Facilities	**660**	617	536
Total Net Assets	**$ 4,512**	$ 4,211	$ 4,309
Total Liabilities + Net Assets	**$ 4,821**	$ 4,508	$ 4,587

* 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 2017, the School's results for fiscal years 2015 and 2016 are presented in accordance with GAAP within the Statement of Activity and Cash Flows on page 22.

SUPPLEMENTAL FINANCIAL INFORMATION



REVENUES

HBS funds its operations with cash from three primary sources: MBA tuition and fees, earned income from Harvard Business Publishing (HBP) and Executive Education, and philanthropic revenues (including current use gifts and distribution from the endowment).

These latter two categories are sensitive to trends in the economy and the capital markets—trends which remained favorable overall for a seventh consecutive year in fiscal 2017. As a result, the School's total revenues increased by $39 million, or 5.1 percent, to $800 million, from $761 million a year earlier. The largest drivers were Executive Education and the annual endowment distribution.

MBA Tuition & Fees

Student tuition and fee revenue from the MBA Program grew to $133 million, from $127 million in fiscal 2016. First-year MBA tuition in fiscal 2017 was $63,675, compared with $61,225 last year. The School's combined tuition and fees for fiscal 2017 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

* 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 2017, the School's results for fiscal years 2013, 2014, 2015, and 2016 are presented in accordance with GAAP within the Statement of Activity and Cash Flows on page 22.

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

Reflecting competitive pressures in the global publishing market, HBP's fiscal 2017 top-line growth was slightly below the School's forecast and the slowest since fiscal 2010. While continuing to make strategic investments in future business growth, HBP shaved millions of dollars off its budgeted cost of goods sold and, as a result, delivered a healthy contribution margin for the year.

Total revenue at HBP grew by $4 million, or nearly 2 percent, to $221 million, from $217 million in fiscal 2016, driven by 11 percent growth in Higher Education group sales. Higher Education continued to gain share globally as the leading provider of course materials for participant-centered learning in business education, resulting in stronger market demand for HBS cases.

HBR group sales remained flat for the third consecutive year in fiscal 2017. The subscription model for *Harvard Business Review* changed from 10 to six issues annually, resulting in a slight decrease in circulation revenue. This decline was offset, however, by growth in revenue from reprints and advertising. *Harvard Business Review* subscription renewal rates and online readership were up substantially from the prior year.

Corporate Learning group sales were down 1 percent in fiscal 2017. Rising to marketplace challenges, the group introduced a new version of its flagship product, *Harvard ManageMentor®*, doubled the planned number of joint custom program proposals in collaboration with Executive Education, and completed numerous product enhancements designed to meet evolving client needs.

Sales in global markets are important to HBP's business model. With an eye toward accelerating its worldwide growth, the School's publishing unit executed an integrated international strategy across its three market groups in fiscal 2017. International sales grew 3 percent year over year in fiscal 2017, comprising 33 percent of HBP's total annual revenues.

Executive Education

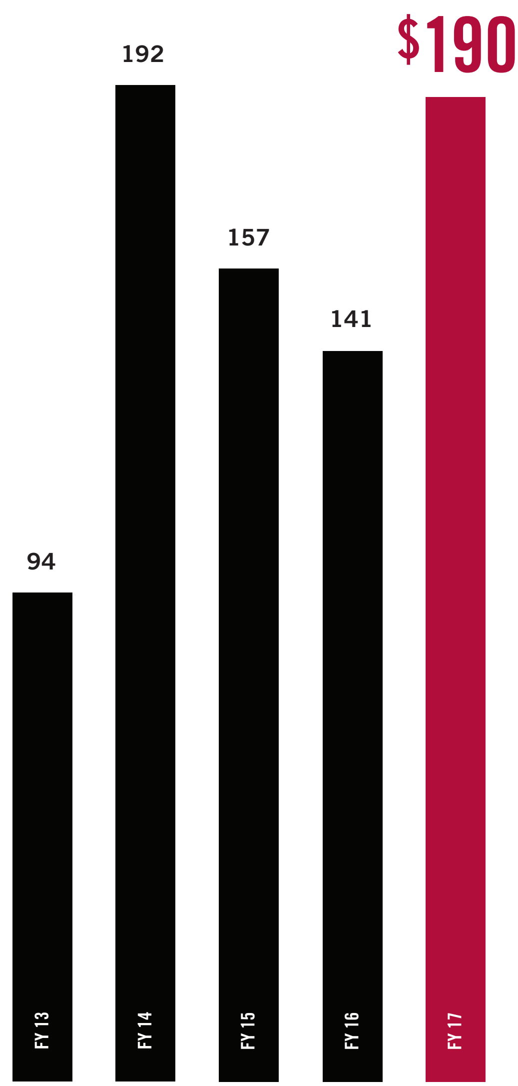
The Executive Education group delivered strong financial results in fiscal 2017. The group continued to leverage the new facilities constructed by the School over the past five years to enhance the executive program experience. Total enrollment increased nearly 5 percent from fiscal 2016 to approximately 11,400.

Executive Education tuition revenue increased by $15 million, or more than 8 percent, to $191 million—three times the School's forecasted growth rate—driven by higher enrollment and tuition increases.

Reflecting aggressive cost controls, the group's operating expenses came in $2 million lower than planned, resulting in a strong margin contribution for the year.

Custom program participation was the largest Executive Education revenue driver in fiscal 2017. In addition to introducing several new one- and two-day custom offerings, the group played a key role in launching the School's Client Solutions Council, a strategic effort to create high-impact engagements that integrate Executive Education residential learning modules with HBP courses and HBX modules for single corporate clients.

Tuition from global programs represented a growing percentage of the overall Executive



CASH RECEIVED FROM GIFTS (in millions)

Education revenue mix in fiscal 2017. The group offered the first Senior Executive Leadership Program in India, a new program granting alumni status upon completion, while embarking on a strategy focused on longer, modular programs. Additionally, Executive Education launched the Senior Executive Program—Africa, with participants across 19 countries and a wide range of industries.

Gifts & Endowment

Although income from HBP and Executive Education makes HBS less reliant on its endowment than other schools at Harvard, philanthropic revenues, including distribution from the endowment and current use gifts, provide financial stability and flexibility that are crucial to the School's ability to execute on its mission.

In fiscal 2017, total revenue from three philanthropic sources—endowment distribution as well as unrestricted and restricted current use gifts—increased nearly 5 percent to $220 million, from $210 million in fiscal 2016. This revenue amounted to 28 percent of the School's total operating revenues for both years. In contrast, for the University as a whole, philanthropic revenue for fiscal 2017 was 45 percent of total operating revenues.

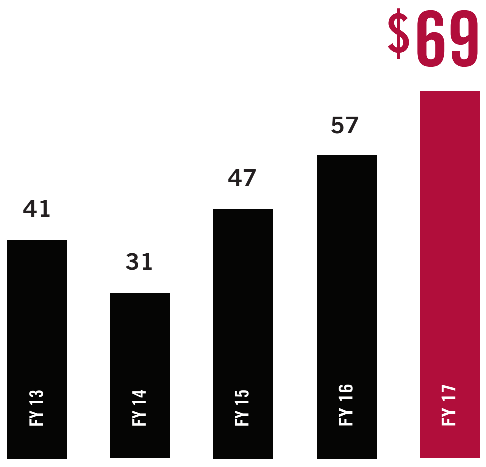
The largest of the School's philanthropic revenue sources is the annual endowment distribution. The endowment distribution for fiscal 2017 increased nearly 6 percent from the prior year to $146 million, amounting to 18 percent of the School's total revenue.

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.

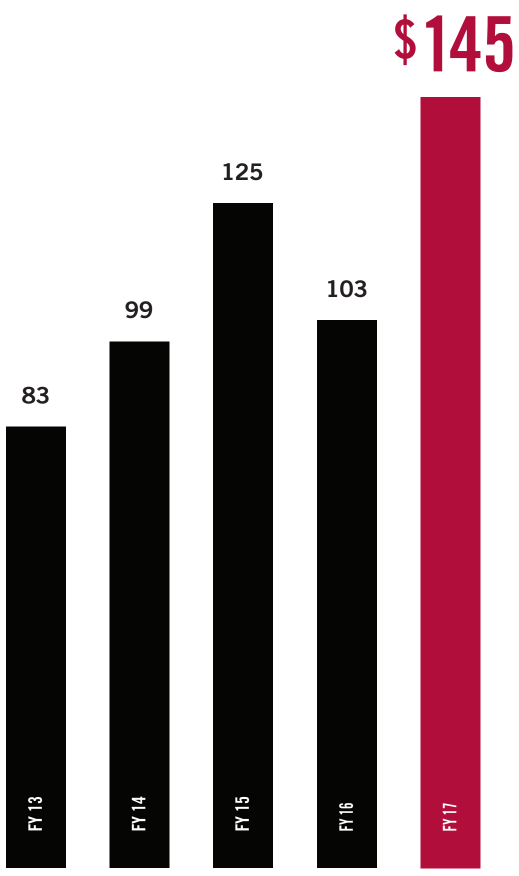
The University determines each year's endowment payout rate—that is, the percentage of the endowment's prior year-end market value withdrawn and distributed annually for operations and for one-time or time-limited strategic purposes. This rate applies to HBS and the other schools at Harvard.

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 5.0 to 5.5 percent. The payout rate for fiscal 2017 met that target at 5.4 percent, compared with 5.1 percent for 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,



CASH FROM OPERATIONS (in millions)



UNRESTRICTED RESERVES (in millions)

learning, and research for future generations. In managing the University's financial assets, HMC seeks to maximize returns, subject to the risk tolerance established by the University, in consultation with HMC's Board of Directors.

Fiscal 2017 was a more favorable year for endowment and pension investment returns than fiscal 2016, which was the worst since the 2008–09 financial crisis. The Harvard endowment generated an 8.1 percent investment return, net of all expenses and fees, compared with an investment return of –2 percent for the prior year.

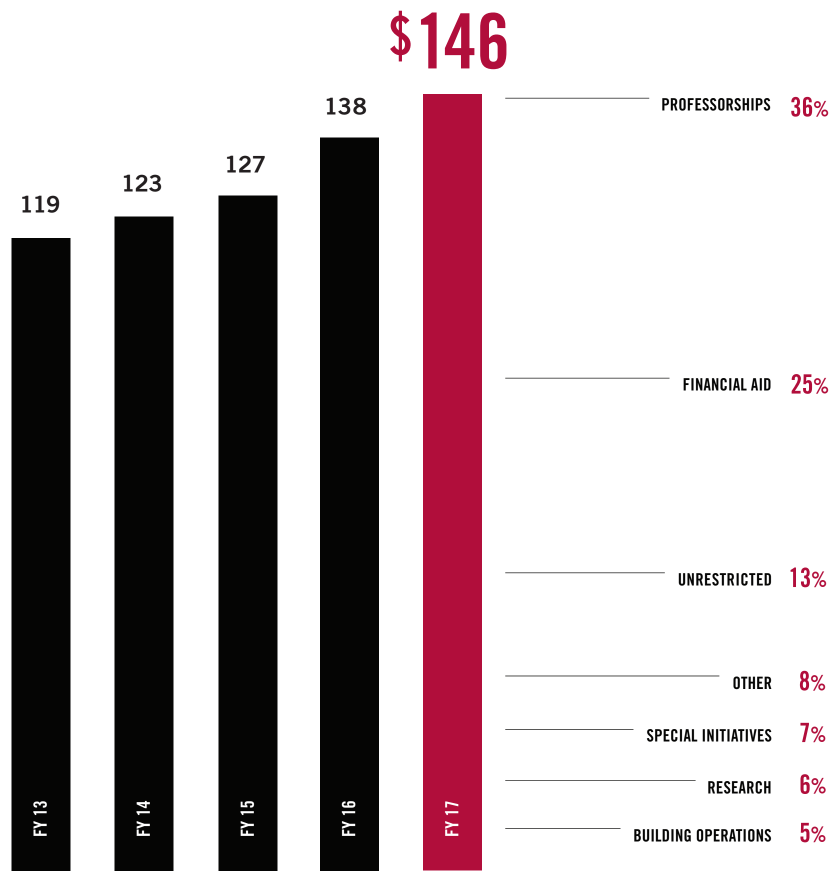
The fiscal 2017 year-end market value of the HBS endowment was $3.5 billion at June 30, 2017, compared with $3.2 billion a year earlier. This increase reflected the 8.1 percent net growth in market value and the subtraction of the School's annual distribution and decapitalizations, offset by the $85 million in endowment gifts received by HBS during the year. The School received $51 million in endowment gifts in fiscal 2016.

Harvard Endowment Returns

FY 17	**8.1%**
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

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 $233 million in new gifts and pledges to the School during the year. This compares with $161 million in fiscal 2016.

HBS received gifts from nearly 12,800 donors in fiscal 2017, including MBA,



ENDOWMENT DISTRIBUTION (in millions)

ENDOWMENT GROWTH (in billions)

Doctoral, and Executive Education program alumni, as well as friends of the School. As in the prior year, approximately 27 percent of the School's MBA alumni gave to HBS in fiscal 2017. 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 $190 million, compared with $141 million in fiscal 2016.

Current use giving—both restricted and unrestricted—has become increasingly critical in recent years as a source of funding for innovation across the School. Over the past five years, total giving in these categories has more than doubled from $35 million to $74 million. Fundraising expenses have increased at a slower rate.

As a result, this revenue growth has had a significant impact on cash from operations and, therefore, the School's ability to capitalize on emerging strategic opportunities such as FIELD, the Harvard i-lab, and HBX. Going forward, sustaining the HBS community's remarkable commitment to current use giving will be instrumental in achieving the mission of the School.

Looking specifically at 2017, unrestricted current use giving to HBS was up for the eighth consecutive year. Revenue from these flexible gifts increased 5 percent to $42 million, from $40 million in fiscal 2016. Restricted current use giving typically varies from year to year in line with the School's changing strategic needs, but revenue from these gifts was flat year over year at $32 million in fiscal 2017.

Additionally, cash giving to the endowment grew to $85 million, from $51 million in the prior year, and cash giving for construction projects nearly doubled to $30 million from $16 million. The results in both categories primarily reflect normal year-to-year variability in the timing of payments on pledges.

HBX

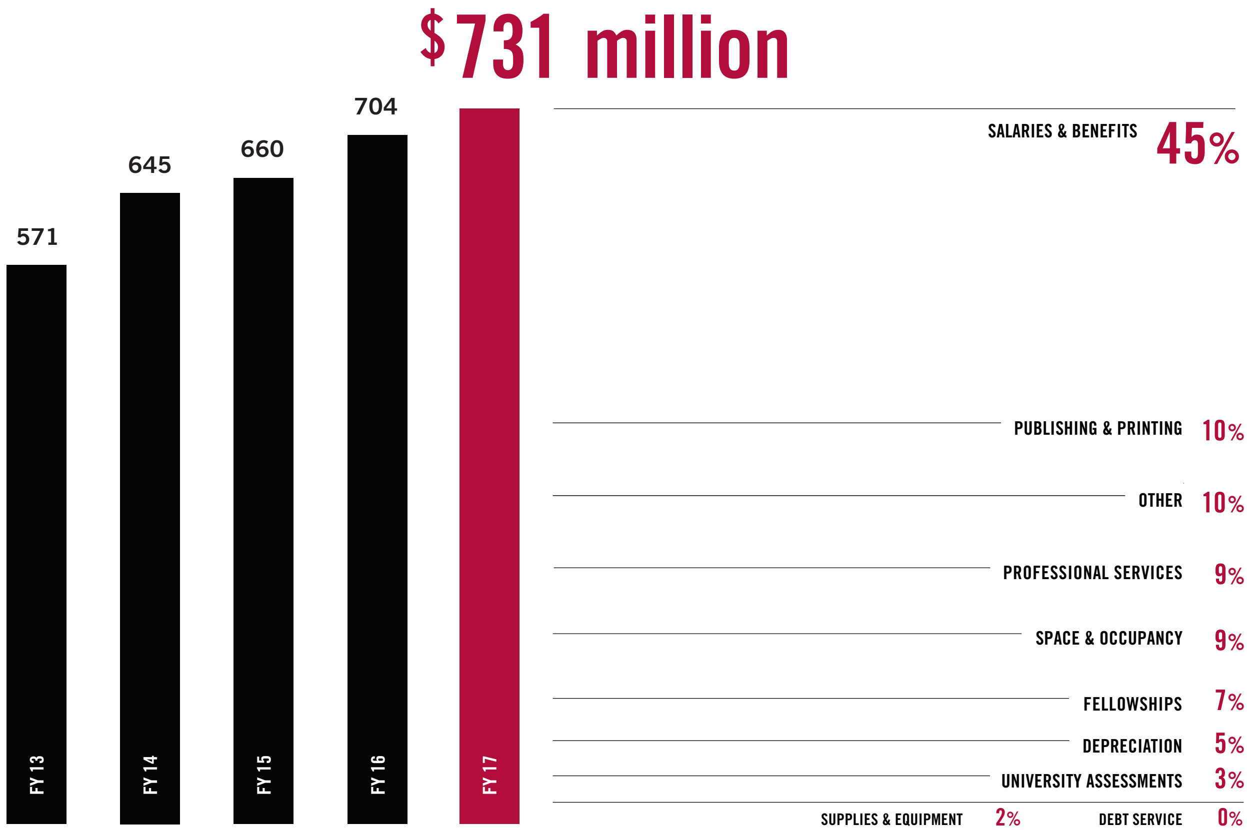
Fiscal 2017 was a year of strategic progress at HBX, the School's online learning group. While continuing to expand its course portfolio, HBX worked with HBP and Executive Education to share schoolwide sales resources beginning in fiscal 2018. HBX also began partnerships with other Harvard schools, including the Harvard Business Analytics Program in conjunction with the Harvard John A. Paulson School of Engineering and Applied Sciences, and the Principals Project with the Harvard Graduate School of Education.

HBX revenue increased to $12 million, from $10 million in fiscal 2016, coming in lower than planned. Growing enrollment in new individual courses such as Disruptive Strategy, Leading with Finance, and Negotiation Mastery was partially offset by slower-than-anticipated growth in CORe course participation. Recognizing the slowdown mid-year, the group acted decisively to trim strategic investments and growth in expenses. The resulting operating deficit was $11 million, compared with $12 million in fiscal 2016.

HBX is envisioned as an academic program that will develop over the long term, joining Executive Education and HBP in contributing to the School's earned revenue and income from operations. HBX remains in startup mode, however, and is expected to require continuing investment for the next several years.

Housing, Rents, Interest Income, & Other

Revenue in this category for fiscal 2017 increased to $22 million, from $21 million a year earlier. Reflecting a slight bounce off the historically low interest rates that have prevailed over the past few years, the School reported interest income of $1 million, compared with zero in fiscal 2016.



EXPENSES

The School's total operating expenses for fiscal 2017 were $731 million, up by $27 million, or nearly 4 percent, from $704 million for the prior year. The largest drivers were upward pressure on compensation costs; spending aimed at positioning HBP, HBX, and Executive Education for future growth; and investments in I.T. systems and platforms across the School.

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 I.T. and other functional areas, and marketing and residence expenses for executive program participants.

HBP and Executive Education continued to deliver solid operating leverage on sales growth in fiscal 2017. 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 2017 increased by $5 million, or nearly 4 percent, from the prior year to $136 million.

Salaries & Benefits

Employee compensation is the School's largest expense, comprising approximately 45 percent of total operating costs in fiscal 2017. Salaries and benefits expense increased nearly 6 percent year over year to $327 million, from $309 million in fiscal 2016, driven primarily by salary increases and a modest number of administrative staff positions added during the year.

The total number of faculty at the School, as measured in full-time equivalents (FTEs), can rise or fall in any given year reflecting retirements, departures, and recruiting activity. Net of retirements and departures, the size of the HBS faculty was unchanged at 233 FTEs in fiscal 2017.

At the same time, the School's administrative staff grew to a budgeted 1,680 FTEs, from 1,631 in fiscal 2016—the smallest increase in three years, primarily driven by scaled-back hiring at HBP in response to slower revenue growth. The majority of the approximately 50 staff positions added across the School in fiscal 2017 were focused on supporting the MBA Program, assisting faculty research and I.T. projects, and capitalizing on income growth opportunities in HBP, HBX, and Executive Education.

Fellowships

The School 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 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 record of annual increases in financial aid, total fellowship expense for fiscal 2017, including assistance for MBA and Doctoral students and a limited number of Executive Education participants, increased by $1 million, or 2 percent, from fiscal 2016 to $48 million.

Approximately half of the School's MBA students currently receive fellowships, which cover an average of more than 50 percent of their total tuition. Average fellowship support per student increased 5 percent in fiscal 2017 to $37,312 from $35,571 in the prior year. Over the past five fiscal years, the School's average two-year MBA fellowship award has grown from $60,620 for the Class of 2013 to $75,000 for the Class of 2018.

Funding for fellowships comes from restricted endowment and current use giving by HBS alumni and friends. These funds are supplemented by unrestricted funds as necessary, which totaled $4 million in fiscal 2017.

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 strategic investment in digital infrastructure and content.

While continuing to make growth-focused investments in fiscal 2017, HBP responded to a slowdown in revenue growth by taking aggressive steps to limit its operating costs. The publishing group used fewer contract resources than planned, while postponing certain capital projects and vendor agreements. As a result, the School's total publishing and printing expenses for fiscal 2017 were $70 million—unchanged from the prior year.

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. Additionally, 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 2017 increased by $6 million, or nearly 10 percent, from the prior year to $68 million. The increase reflected operating costs at the newly opened Chao Center, Life Lab, and HBP headquarters facilities, as well as higher-than-expected one-time costs for site remediation associated with Klarman Hall construction.

These new space-related expenses were partially offset by the School's underlying trend toward slower growth in building operating costs and utility bills, thanks to recent investments in facilities upgrades, renewal, and modernization.

Professional Services

A large portion of the School's professional services expense is related to spending that a for-profit business would categorize as cost of goods sold—including growth-focused investments at HBP and HBX, and compensation for faculty who teach Executive Education programs. Reflecting a slower pace of investment at HBP and HBX, partially offset by higher spending at Executive Education, the School's professional services expenses for fiscal 2017 were down by $2 million from the prior year to $63 million.

The School's professional services expenses also include costs for third-party I.T. resources. Fiscal 2017 was an active period for I.T. investment at HBS. The School launched a new common platform for the HBS global alumni club network, while continuing the campus wireless upgrade project—this year focusing on campus residence buildings.

Nonetheless, the School spent less for external I.T. support than in fiscal 2016. Fiscal 2017 marked the conclusion of several strategically important I.T. projects, chief among them new customer relationship and learning management platforms in Executive Education and the MBA Program, respectively. Spending for third-party resources to support these projects began diminishing during the year, setting the stage for future success in controlling professional services expenses at the School.

Supplies & Equipment and Other Expenses

These expenses for fiscal 2017 decreased by $2 million from the prior year to $12 million. The year-earlier amount was unusually high because of a one-time, $5 million recategorization from space and occupancy. Fiscal 2017 spending in the other expenses category, which includes items such as travel and catering, increased by $2 million from the prior year to $75 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 an AAA-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 2017. The School's total capital expenses decreased to $78 million, from $113 million in the prior year. As in fiscal 2016, these investments were primarily funded by internally generated cash, and there were no new borrowings. HBS paid down $8 million in building debt in fiscal 2017, compared with $7 million a year earlier.

As a result, the School's year-end fiscal 2017 building debt-to-asset ratio decreased to 1.4 percent, from 1.7 percent in the prior year. Other university debt—mainly consisting of repayment obligations to the University for mortgage loans made by HBS as a faculty recruiting incentive—increased by $2 million from fiscal 2016 to $26 million.

The School's debt service expense consists of interest payments to the University and is covered by using cash from operations. Fiscal 2017 debt service expense was unchanged from the prior year at $4 million. As in fiscal 2016, this expense was mainly associated with borrowings to finance prior years' campus expansion. Consistent with the three prior years, the interest portion of the School's debt service amounted to less than 1 percent of total operating expenses in fiscal 2017.

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 2017 for these assessments increased by $2 million from the prior year to $24 million.

Depreciation

The School computes depreciation using the straight-line method over the estimated useful lives of the assets. Depreciation expense for fiscal 2017 increased by $2 million, or 5 percent, from the prior year to $40 million. This increase primarily reflected the School's larger asset base following the opening of the Chao Center and Life Lab in the fourth quarters of fiscal 2016 and 2017, respectively.

CASH BEFORE CAPITAL ACTIVITIES

The School's cash from operations increased in fiscal 2017 by $12 million from the prior year to $69 million. As in fiscal 2016, 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 is a non-cash item that added back $40 million to the School's operating cash flow in fiscal 2017, compared with $38 million in the prior year.

NET CAPITAL EXPENSES

The School's total capital investment decreased to $78 million in fiscal 2017 from $113 million in fiscal 2016, which marked the conclusion of a multi-year period of intensive Executive Education facilities construction. Construction of Klarman Hall, which is scheduled to open in fiscal 2019, was the largest capital project during the year.

Fiscal 2017 capital activity also included completion of the Life Lab. At the same time, the School modestly reduced 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 greenhouse gas reduction goals.

The School's net capital expenses for fiscal 2017 were down substantially to $8 million, from $105 million for the prior year. Together with the $35 million decrease in capital expenses, there was a $31 million increase in the use of gifts for capital projects. In addition, a year-over-year reduction in capital project pre-funding represented a $19 million source of cash in fiscal 2017, versus a $12 million use of cash in the prior year.

CHANGES IN DEBT & OTHER

The School's debt and other cash activities decreased by $60 million in fiscal 2017, compared with a decrease of $12 million in the prior year. This was primarily driven by a cash transfer of $50 million to the HBS endowment.

Because gifts, internally generated cash, and unrestricted reserves have been available and sufficient to finance capital activities, fiscal 2017 marked the School's ninth consecutive year with no new borrowings. Reflecting slightly higher interest rates, debt principal payments increased by $1 million from the prior year to $8 million.

Capitalization of endowment income—or cash used to purchase endowment units—was a $4 million use of cash in fiscal 2017, compared with $3 million 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 $3 million source of cash in fiscal 2017, compared with $5 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 2017 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 $145 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 P. Melnick, Chief Financial Officer: rmelnick@hbs.edu or to the Office of the Dean: officedean@hbs.edu.

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