



HARVARD | BUSINESS | SCHOOL



PRESERVING CORE ACTIVITIES

# 2009

POSITIONING FOR THE FUTURE

ANNUAL REPORT



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“I believe we have been successful in preserving the integrity of the learning experience, our commitment to financial aid for students, and our investments in faculty research. We’re staying true to our mission.”

DEAN JAY LIGHT

# A Conversation with Dean Jay Light

**Can you talk about how the School responded to the global economic crisis and what you've learned as a result?**

It was a pretty remarkable time to be on campus. One of the benefits of having a curriculum based on case studies is our ability to respond in real-time, so each week I'd hear new examples of how faculty were incorporating elements of the evolving crisis into their courses. One faculty member, for example, who was co-teaching a course on consumer finance with a colleague at the Law School, simply built a session around a pending piece of legislation on a proposed financial product safety commission. In the required curriculum, our Finance and our Leadership and Corporate Accountability faculty wrote and co-taught a case on JP Morgan and Bear Stearns, exploring issues such as capital and liquidity, and internal and external governance. Multiply these examples again and again, and you'll get a sense of the activity under way. Outside the classroom, faculty were writing op-eds and testifying in Washington, and our students were attending panel discussions and rethinking their postgraduation plans.

There definitely were some lessons. I think we saw quickly where we needed to strengthen the MBA curriculum, including areas such as risk management and understanding the increasingly connected interface of business and government. We'll need to find new ways to help our students think about these challenges without stifling innovation and entrepreneurialism.

And our faculty have been rethinking what they know and what they thought they knew. We had a series of what we called "deep dive" seminars through the spring where they could present early stage research; it turned out to be a good forum for people from different backgrounds to share their perspectives and experiences, and is leading to some important new research streams.

**The financial crisis prompted criticism of business leaders and raised questions about the relevance of the MBA. What are the implications for HBS?**

The financial crisis shined a light on leadership—good and bad. Clearly there are areas where business schools—HBS included—need to be doing more. At the same time, the crisis revealed just how deeply important the MBA and management education are in preparing students for an increasingly complex business world. As companies become more global, as they become more dependent on science and technology, as the pace of change increases, as organizations become flatter and more networked, much more is expected of corporate leaders. We see this as a huge opportunity, and indeed a responsibility, for the School.

So the need for leaders who know how to make a difference in the world has never been greater than it is today. The need extends beyond business to the social, government, and nonprofit sectors as well. We prepare students to become leaders by cultivating qualities that we believe are fundamental to good leadership. Things like judgment that leads to sound decision-making. An entrepreneurial point of view. The ability to listen and communicate effectively. A deep sense of one's values and ethics. And the courage to act, based on those values and ethics.

People with an MBA education are moving into positions of responsibility and leadership more quickly than in the past. And it's not just in large or medium-sized firms. It's in small companies, and entrepreneurial ventures, and hospitals, and education—it's everywhere you look.

**Even so, the spring of 2009 was a more difficult time for MBA recruiting. What did the School's graduating MBA class experience in their job searches?**

I've been on the faculty long enough to see both sides of the recruiting cycle—years when students have multiple job offers and recruiters are anxious about

who they'll get, and years when recruiters aren't posting many jobs and students are anxious about where they'll go. Last year threw a new twist into the experience, as entire sectors withdrew from the job market.

Our Career and Professional Development team had been watching signs and preparing for a down year, and we began investing in things like career coaches even before the year was fully under way. And then we waited for the anxiety to set in. Surprisingly, however, it didn't. Students were notably more thoughtful in approaching their job searches, and more willing to engage in long-term planning.

By the end of the year, our numbers were down but not as badly as we'd anticipated. Three months after graduation, 87 percent of the graduating students seeking a job had accepted an offer, compared with percentages in the low- to mid-90s for the few years before. Satisfaction with their offers dropped slightly, from 8.3/10 for the Class of 2008 to 8.0/10 for the Class of 2009. But judging by the many students I spoke to throughout the year, they were excited about the opportunities ahead of them, and the potential to make a difference. It was great to see.

**You've talked a fair bit about the MBA Program. How did the crisis affect the School's other programs—Doctoral and Executive Education?**

Well, our graduating doctoral students faced a difficult job market too. With most universities cutting budgets and in some cases reducing their faculty, tenure-track slots simply were hard to find. Fortunately, the majority of our students still were placed at top business schools.

In Executive Education, we feared a real drop-off in program attendance as companies scaled back on leadership development activities. The reality wasn't as bad, which we attribute at least in part to the investments we've made in corporate relations over the past 3–5 years. The decline we did experience was largely in custom programs, which makes sense. In difficult times, few companies would believe it's the right moment to send groups of management away, no matter how good the purpose.

Programmatically, we saw the same case and course development unfolding in Executive Education. We offered new programs on understanding the crisis and its causes and on managing in a downturn, among others,



as well as additional sessions of popular programs to ensure we could meet our revenue targets. That's important to us, because the revenue, in turn, is a key source of support for the faculty's research.

**The 2008–09 recession may have been the first truly worldwide economic downturn. Does this affect the School's global strategy?**

Having a global presence continues to be really important to the School's future. Our philosophy is that some knowledge can only be gleaned at the source. So our strategy is to get out on the ground where people are doing business around the world and bring that knowledge back to the campus. The School's global research centers are central to our success in that regard. They give faculty reach into every corner of the world. In the case of the financial crisis, we are able to study systemic issues on a global scale, which helps us think more comprehensively about how to prevent them from happening again. What kinds of organizational and managerial safeguards are necessary? What kind of culture guarantees that people are thinking about the risks involved? What kinds of compensation systems are appropriate in an environment of short-term volatility? These questions have relevance everywhere in the world.

Of course the global work of the faculty had relevance prior to the crisis, and it continues to be important. We need to understand how leaders of companies around the world engage in global competition, build global supply chains, and navigate global financial markets: for example, understanding how an Indian manufacturer of tractors and other farm equipment is thinking about competing in Eastern Europe, or here in the U.S. for that matter. You can't learn all these things from Boston.

As part of an expanded global strategy, we are planning to offer Executive Education programs in locations beyond Soldiers Field. For example, this coming year we will be using a new facility in Shanghai to serve as a place for our faculty to teach and to learn from executives from China and Asia. The space in Shanghai will also be a home base for our MBA students during the China immersion in January. We have been developing new programs in India and Europe as well.

**Turning to the financial position of the School, the Harvard endowment lost nearly \$11 billion in value in the year ended June 30, 2009. Are you facing leaner times at HBS?**

After the collapse of Lehman Brothers, the speed of the descent and the degree of the crisis were obviously surprises. We responded in the fall of 2008 by immediately reducing some of our operating expenses.

We made additional budget cuts in January 2009, and then in the spring of 2009, we launched a major cost reduction program in order to accommodate what was surely going to be a reduced endowment distribution in 2010 and possibly well beyond that. We tried to get all of that out of the way early, and I believe we have, so that our cost structure is now fully adjusted to a lower level of endowment distributions.

My view is that you need to react quickly and with measures large enough to make sure the reductions only have to be made once. What you don't want to do is to get in a position where you have to ask people to cut their budgets three years in a row. We also stayed away from making across-the-board cuts. We asked everyone in the HBS community to think about how we need to do things differently, and they responded to the challenge extremely well.

While we have reduced costs significantly, I believe we have been successful in preserving the integrity of the learning experience, our commitment to financial aid for students, and our investments in faculty research. We're staying true to our mission.

**What challenges, and opportunities, do you see ahead?**

We worked hard to reset our cost structure last year (and did), which is the good news. At the same time, there's a lot about the future we still can't predict.

Harvard Business Publishing, for example, is facing tremendous pressure—as is every other publishing company in the world—as consumers increasingly expect content free, in smaller online chunks, and ideally on their mobile device. We have a great team leading the organization, and they've retooled their infrastructure over the past two years to create a better platform for the innovations they now want to pursue. But rapid changes in the market will require us to be increasingly flexible and responsive.

We think there are new opportunities to enhance our Executive Education portfolio too, but they will require two things: more facilities and more faculty. On the facilities side, we need more beds, breakout spaces, and classrooms to accommodate participants in our short and long programs, even as we experiment with modular and online offerings. On the faculty side, we need experienced individuals with a deep connection to practice. Both of these will take time to develop.

Finally, we are citizens of and deeply connected to the broader Harvard community, and all the ships of the University will to some extent rise and fall in tandem. As the center of the University looks to recover from losses in the endowment, we anticipate we'll be asked to help—in ways tangible and not—in that effort. We are committed to doing so to the extent we don't lose focus on our own strategic priorities.

I think it's an important moment for the School. As I noted, the demand for management education, and for leaders, never has been stronger. We need to continue focusing on the core of what we do well—general management—but also look beyond the core, and apply management practices to address complex societal problems in areas like healthcare, social enterprise, and the environment. We are uniquely well positioned to do so, and to extend the impact of HBS in organizations both large and small around the world. I'm excited by what I see ahead.

# Five-Year Financial Data Summary

IN MILLIONS

FOR THE FISCAL YEAR ENDED JUNE 30,

	2005	2006	2007	2008	2009
Revenues	\$ 331	\$ 368	\$ 405	\$ 451	\$ 472
Expenses	307	345	375	423	438
Cash from Operations	24	23	30	28	34
Capital Investments	79	49	20	40	19
Building Debt Outstanding	74	108	108	121	119
Unrestricted Reserves	52	60	65	79	96
Endowment	2,065	2,340	2,821	2,971	2,117
Total Assets	2,693	3,018	3,500	3,684	2,826

## Key Facts

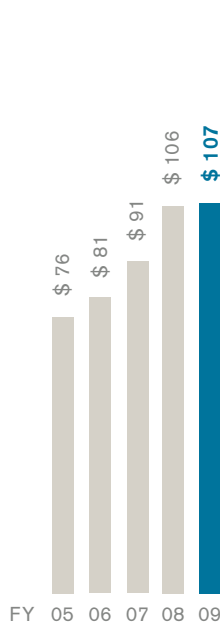
	2005	2006	2007	2008	2009
<b>MBA PROGRAM</b>					
Applications	6,559	6,716	7,438	8,661	9,093
Percent Admitted	16%	15%	14%	12%	12%
Yield	89%	91%	89%	91%	89%
Enrollment	1,794	1,822	1,806	1,796	1,809
Tuition	\$ 35,600	\$ 37,500	\$ 39,600	\$ 41,900	\$ 43,800
Average Fellowship Aid per Student	\$ 13,299	\$ 15,647	\$ 17,605	\$ 21,591	\$ 24,393
<b>DOCTORAL PROGRAMS</b>					
Applications	587	611	694	595	798
Percent Admitted	4%	5%	5%	6%	4%
Yield	80%	64%	57%	81%	69%
Enrollment	98	101	103	105	120
<b>EXECUTIVE EDUCATION</b>					
Enrollment	8,133	8,239	9,281	9,345	8,291
<b>FACULTY</b>					
Faculty Positions ( <i>full-time equivalents</i> )	201	215	206	219	228
Teaching Materials Produced	561	606	602	647	608
Research Articles Published	103	130	145	152	146
Books Published	36	31	24	24	20
<b>STAFF</b>					
Staff Positions ( <i>full-time equivalents</i> )	1,044	1,077	1,109	1,146	1,187
<b>PUBLISHING</b>					
Cases Sold	6,958,000	7,428,000	7,785,000	8,240,000	8,334,000
Harvard Business Press Books Sold	1,272,000	1,409,000	1,882,000	2,025,000	1,478,000
HBR Circulation	240,000	243,000	248,000	246,000	237,000
HBR Reprints Sold	2,929,000	3,112,000	3,061,000	3,123,000	2,863,000

# From the Chief Financial Officer

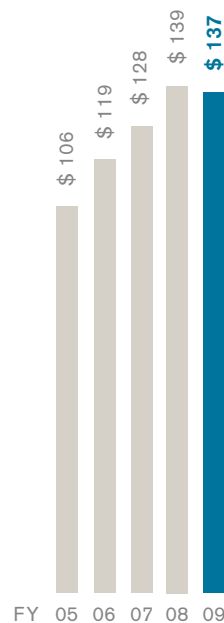
Any discussion of fiscal 2009, as well as fiscal 2010, must be put in the context of the 2008–09 financial crisis and recession. More than 75 percent of the School’s revenue comes from several sources that are sensitive to the global economy: Executive Education, Harvard Business Publishing, and the HBS endowment and alumni giving. Each has been deeply affected by the downturn.

From a financial perspective, the 12 months that began July 1, 2008, encompassed two profoundly different periods. The School’s initial fiscal 2009 budget, prepared in the spring of 2008 amid the first signs of broad economic weakness, reflected caution regarding the revenue outlook for Executive Education and Harvard Business Publishing (HBP). For the first five months of the fiscal year, the School’s revenues remained in line with our initial plan. Then, the operating environment changed radically.

Late in 2008, as the world’s capital markets collapsed, the University announced the prospect of a 30 percent decline in Harvard’s endowment for fiscal 2009. HBS and the other Harvard schools were asked to assume an 8 percent reduction in funds distributed from the endowment in budgeting for fiscal 2010. At the same time, both Executive Education and Harvard Business Publishing began seeing a drop-off in demand, and alumni current use gifts also declined.



EXECUTIVE EDUCATION REVENUE  
(dollars in millions)



HARVARD BUSINESS PUBLISHING REVENUE  
(dollars in millions)



We quickly responded with an aggressive effort to reduce the School's spending for the second half of fiscal 2009, and to develop a budget for fiscal 2010 that reflected both lower income and fundamental changes in our cost structure. The School's faculty and staff responded to the challenge with impressive resolve and creativity, enabling HBS to remain cash flow positive and conclude the fiscal year with a strong reserves balance.

Looking forward, however, both the School and the University anticipate that constrained revenue growth will continue. The HBS budget for fiscal 2010 acknowledges this new reality. The purpose of this letter is to provide insight into the School's key financial issues, accomplishments, and challenges in fiscal 2009 and, equally important, into what we see on the horizon for the coming fiscal year.

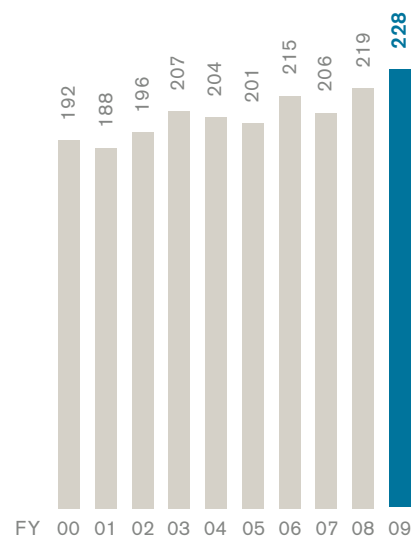
#### GENERATING REVENUE FOR OPERATIONS

Total Executive Education revenue for the year was essentially flat with fiscal 2008, but the changed economic environment significantly affected the program mix. Postponements and cancellations in custom programs in the second half of the fiscal year led to a double-digit percentage decline in revenue. This was offset by open-enrollment program revenue, which was up 8 percent from fiscal 2008.

The School's longer program offerings—including the Advanced Management Program and the General Management Program—posted record applications and enrollment for the fall 2008 term. This early momentum offset modest decreases in enrollment in the spring 2009 term. For the full fiscal year, applications to the longer programs grew 12 percent from fiscal 2008, and enrollment increased by 6 percent. Executive Education launched seven new short, focused programs in fiscal 2009. Among them were two courses related to the economic crisis that were popular enough to warrant additional sessions.

Harvard Business Publishing faced profound challenges in fiscal 2009. Few sectors of the economy have been more thoroughly transformed by the forces of digitalization and globalization than the publishing industry. HBP has been reinventing its business over the past few years to stay in front of these changes and ahead of its competitors, recruiting new staff members with exceptional talent and, in fiscal 2009, restructuring the editorial group to better serve both the School and its outside markets. At the same time, HBP has been investing heavily in its IT infrastructure as more of its internal processes, content, and customers move online.

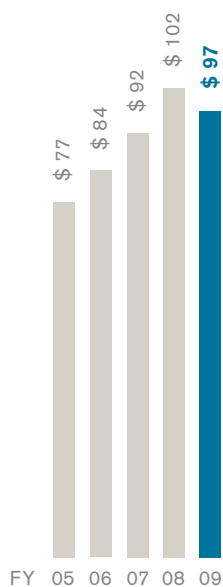
Although the School's publishing revenues have grown in recent years, these IT investments have limited the rise in HBP's operating margins. In fiscal 2009, the economic downturn prevented HBP from producing a sixth consecutive year of top-line growth. Sales were strong in the first half of the year, particularly in international markets, but weak in the second half. As a result, publishing revenue declined by \$2 million, or 1 percent, from fiscal 2008, pressuring margins even further.



**FACULTY**  
(full-time equivalents)

Alumni giving, a key revenue source for the School, was also affected by the recession. In particular, fiscal 2009 revenue from unrestricted current use gifts was down by \$2 million, or 14 percent, from last year. Over the past five years, this source had grown substantially, totaling \$71 million.

The decline in current use giving was more than offset by a larger distribution of income from the endowment, as revenue from this source grew by \$19 million, or 20 percent, from fiscal 2008. Although the investment return on Harvard’s pooled investments (including the endowment) was -27.3 percent for fiscal 2009, it was +8.6 percent for fiscal 2008. For the five years prior to fiscal 2008, the average annual return was +17.6 percent. The School’s endowment distribution for fiscal 2009, which the University determined early in calendar year 2008, reflected this strong historic performance.



**INVESTMENT IN RESEARCH**  
(dollars in millions)

#### MANAGING THE BUDGET

By late fall, it had become clear that our initial fiscal 2009 revenue projection was too bullish. It had also become clear that—even with skillful investment management and a rebound in the markets—it would likely be a long time before the University endowment recovered its steep losses.

HBS acted immediately to adjust to this new budget reality, imposing restraints on staff hiring, limiting the use of overtime, cutting back on the use of temporary employees and contractors, trimming catering and utility costs, and freezing salaries. At the same time, faculty and staff took the initiative to reduce spending in myriad ways across the School. The cuts at HBS were extensive, driven by aggressive expense management as well as reductions in variable costs as the publishing business contracted.

We also reduced administrative staffing levels. A combination of normal attrition, voluntary early retirements, and layoffs effective July 1, 2009, has pared the size of the School’s fiscal 2010 staff by 100 full-time equivalents (FTEs) or 8 percent. Those employees facing layoff were offered enhanced severance benefits as well as extended outplacement services to help ease their transition to a new position in a difficult job market, whether within or outside Harvard.

The size of the HBS faculty increased in fiscal 2009. The School ended the year with 228 faculty full-time equivalents (FTEs), up from 219 in fiscal 2008. However, the School begins fiscal 2010 with 10 fewer faculty FTEs than in fiscal 2009: fewer new faculty were recruited than planned, and short-term appointments—as visiting faculty or senior lecturers, for example—were lower than budgeted.

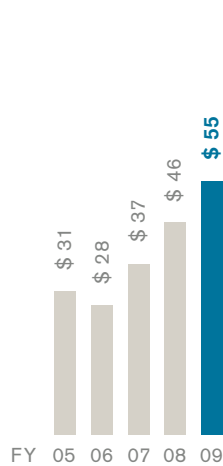
In addition, reflecting the difficult job market our MBA students were facing, the School committed additional career services resources to help with coaching, networked job searches, and other placement initiatives in fiscal 2009. As a result of these efforts, 87 percent of 2009 graduates seeking employment had accepted a job offer three months after graduation. This compares with an average of 93 percent during the prior five-year period.

**PROTECTING KEY PRIORITIES & INITIATIVES**

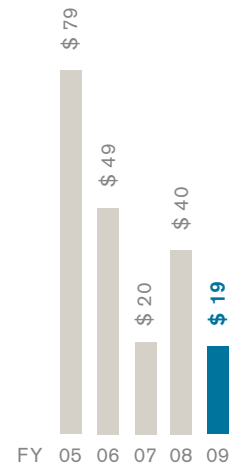
In developing budgets this past year, we have made it consistently clear that the key engines of the School—our educational programs and faculty research—should be protected. HBS achieved a number of notable accomplishments in fiscal 2009, even as our energies and attention have been focused on managing through the downturn.

With the launch of a University-wide academic calendar and a January term in fiscal 2010, we increased the number of MBA immersion programs, where faculty-led groups of students take a deep dive into a particular region or topic. Immersions launched in fiscal 2009 included new sessions on entrepreneurship in Silicon Valley, venture capital in Israel, business opportunities in emerging markets in Mexico, and value-based healthcare delivery in Boston. Several new immersions are planned for fiscal 2010.

For the past few years, HBS faculty working groups have been focused on driving MBA curriculum change at the School in the areas of leadership, globalization, and critical and analytical thinking. Leveraging work on the future of MBA education undertaken during the School's centennial early in fiscal 2009, these groups were charged with developing ideas to strengthen our students' development along these dimensions. We expect these ideas to begin driving curricular innovation at HBS in the years ahead.



**I. T. INVESTMENT**  
(dollars in millions)



**CAPITAL INVESTMENT**  
(dollars in millions)

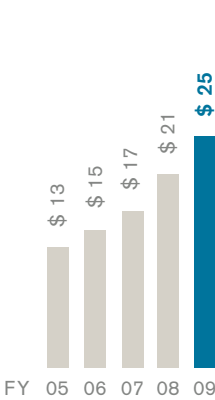
HBS has invested heavily over the past decade in fellowship support for students, increasing spending in this area at a compound annual rate of 14 percent and effectively reducing the real cost of attendance for students receiving aid. In fiscal 2009, fellowship spending increased nearly 27 percent from the prior year. Net student income—tuition and fees, minus the School’s spending for fellowships—decreased by \$5 million, or nearly 9 percent, from the prior year.

The School is planning continued—if more modest—fellowship growth in fiscal 2010 so that HBS can continue to attract outstanding students to its MBA and Doctoral programs, regardless of background or need. We expect this additional fellowship spending to reduce net tuition income even further, forcing even greater reliance on economically sensitive sources of revenue to fund the School’s operations. New restricted current use gifts designated for fellowships offset this need.

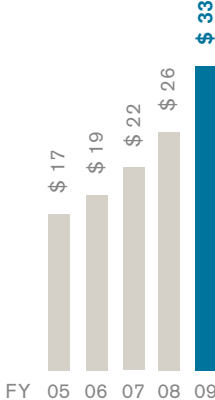
On the research side, protecting key priorities has meant helping faculty accomplish more with fewer dollars. The School’s total investment in faculty research was down roughly 5 percent from the prior year in fiscal 2009. In an environment of slower resource growth, the School’s key goal is to continue fostering ambitious faculty research, but with more focus on controlling costs and fully realizing the efficiencies of shared resources such as the School’s centralized research services.

More than 10 years ago HBS began launching a range of strategic initiatives, including global, healthcare, entrepreneurship, social enterprise, science-based business, leadership and, more recently, business and the environment. While their stage of development, scope, and other characteristics may be quite different, at their heart is a common group of faculty with shared research interests as well as students and often alumni with career interests or professional experience in the field.

These initiatives are becoming a means for increasing collaboration with other parts of Harvard, and a lens through which to address systemic societal challenges like education and the environment, and the School will continue to invest in them. Moreover, on the global front in particular, HBS is committed to deepening its engagement with China, and will be offering a range of programs—including Executive Education and MBA immersions—in Shanghai.



**MBA FELLOWSHIP SPENDING**  
(dollars in millions)



**TOTAL FELLOWSHIP SPENDING**  
(dollars in millions)

## LOOKING AHEAD

As we begin fiscal 2010, even the most optimistic forecasts call for a slow and uneven recovery from the recession. Although the economy appears to have stabilized, HBP in particular, as well as Executive Education, tend to be lagging indicators. Thus, it may take some time before two of the School's major sources of income recover their growth momentum. In addition, as predicted by the University nearly a year ago, the endowment's negative return for fiscal 2009 will lead to lower distributions beginning in fiscal 2010. Finally, alumni giving—an important source of revenue for the School—may also take time to recover.

The School's fiscal 2010 budget takes these anticipated headwinds into account and forecasts a drop in total revenues of \$40 million, or 8.5 percent, from fiscal 2009. To ensure that HBS continues to operate within its means, total expenses are budgeted to decline by \$18 million, or 4.1 percent, from fiscal 2009 actual spending. This represents a drop of \$40 million, or 10 percent, from fiscal 2009 budgeted spending. The decrease primarily reflects lower anticipated variable costs for HBP and Executive Education because of slower business activity, as well as a decline in salaries and benefits expenses because of reductions in faculty and staff.

One area where expenses may rise is University assessments. Given the endowment losses sustained in fiscal 2009, there is likely to be less endowment income available to support the University's central administrative functions for the next several years. As a result, HBS and the other Harvard schools may be asked to shoulder more of these costs.

Overall, we expect HBS to remain solidly cash flow positive in fiscal 2010. In addition, reflecting the growth in cash from operations in fiscal 2009, the School begins the new fiscal year with an unrestricted reserves balance of \$96 million, up \$17 million from last year, and well within our long-term target. Reserves are used by HBS to capitalize on strategic opportunities and, when needed, to finance construction of new campus facilities.

Our strong reserves balance positions HBS to continue enhancing the campus, even if we encounter constraints on the School's ability to borrow from the University. To enhance its flexibility, Harvard issued \$1.5 billion in taxable bonds in December 2008. In order to maintain

its AAA credit rating, the University's ability to assist HBS and other Harvard schools with debt financing may be limited.

Still, many questions remain about the underlying health of both the global economy and the School's sources of income. Given the past year's decline in the value of the endowment and the challenges facing HBP as it reinvents its business, the School's revenue trajectory is anything but definite.

We are committed to protecting the School's key priorities and strategic initiatives through this period of uncertainty. Broad conversations about the future of MBA education, the publishing industry's digital migration, and changes in the market for Executive Education all were under way at HBS long before the recession unfolded, and will persist once the economy is again on more solid footing.

We are thinking holistically about each of these topics in the context of the School's curriculum, faculty, research agenda, and the HBS campus and community to ensure that our planning leads us toward broader and longer-term goals in the years ahead. The School's MBA fellowship spending will continue to grow. The faculty will continue to drive innovation in MBA education and create new knowledge. HBS will continue to invest in academic innovation and in campus integrity and expansion.

We remain committed to thoughtful and responsible stewardship of the School's resources in pursuit of these goals.



RICHARD P. MELNICK, MBA 1992  
CHIEF FINANCIAL OFFICER  
SEPTEMBER 30, 2009

# Statement of Activity & Cash Flows\*

IN MILLIONS	FOR THE FISCAL YEAR ENDED JUNE 30,		
	2009	2008	2007
<b>REVENUES</b>			
MBA Tuition & Fees	\$ 84	\$ 82	\$ 77
Executive Education Tuition	107	106	91
Publishing	137	139	128
Endowment Distribution	113	94	78
Unrestricted Current Use Gifts	12	14	17
Housing, Rents, & Other	13	9	9
Interest Income	6	7	5
<b>TOTAL REVENUES</b>	<b>\$ 472</b>	<b>\$ 451</b>	<b>\$ 405</b>
<b>EXPENSES</b>			
Salaries & Benefits	\$ 212	\$ 206	\$ 179
Publishing & Printing	52	53	51
Space & Occupancy	42	42	40
Supplies & Equipment	12	11	9
Professional Services	31	29	25
Fellowships	33	26	22
University Assessments	13	12	11
Debt Service	6	7	7
Other Expenses	37	37	31
<b>TOTAL EXPENSES</b>	<b>\$ 438</b>	<b>\$ 423</b>	<b>\$ 375</b>
Cash from Operations	\$ 34	\$ 28	\$ 30
Use of Endowment Gifts or Appreciation	11	41	14
<b>CASH BEFORE CAPITAL ACTIVITIES</b>	<b>\$ 45</b>	<b>\$ 69</b>	<b>\$ 44</b>
Capital Expenses	\$ (19)	\$ (40)	\$ (20)
Use of Gifts for Capital Projects	0	5	3
<b>NET CAPITAL EXPENSES</b>	<b>\$ (19)</b>	<b>\$ (35)</b>	<b>\$ (17)</b>
New Borrowings	\$ 3	\$ 22	\$ 7
Debt Principal Payments	(5)	(9)	(7)
Other Activity	(7)	(33)	(22)
<b>NET DEBT &amp; OTHER</b>	<b>\$ (9)</b>	<b>\$ (20)</b>	<b>\$ (22)</b>
<b>CHANGE IN UNRESTRICTED RESERVES</b>	<b>\$ 17</b>	<b>\$ 14</b>	<b>\$ 5</b>
<b>BEGINNING BALANCE, UNRESTRICTED RESERVES</b>	<b>\$ 79</b>	<b>\$ 65</b>	<b>\$ 60</b>
<b>ENDING BALANCE, UNRESTRICTED RESERVES</b>	<b>\$ 96</b>	<b>\$ 79</b>	<b>\$ 65</b>

\* This statement presents a managerial view of Harvard Business School operations focused primarily on cash available for use. It is not intended to present the financial results in accordance with generally accepted accounting principles (GAAP). A presentation in accordance with GAAP would report higher operating revenues for gifts and endowment distribution and would include depreciation expense, yielding income from operations of \$31 million in fiscal 2009. Cash flows, however, would be equivalent under GAAP.

# Consolidated Balance Sheet

IN MILLIONS	FOR THE FISCAL YEAR ENDED JUNE 30,		
	2009	2008	2007
<b>ASSETS</b>			
Cash	\$ 8	\$ 14	\$ 16
Unrestricted Reserves	96	79	65
Receivables, Loans, & Other Assets	161	176	182
Invested Funds:			
Endowment Investments	1,971	2,804	2,654
Current Fund Investments	33	27	16
Interest in Trusts Held by Others	113	140	151
Facilities, Net of Accumulated Depreciation	444	444	416
<b>TOTAL ASSETS</b>	<b>\$ 2,826</b>	<b>\$ 3,684</b>	<b>\$ 3,500</b>
<b>LIABILITIES</b>			
Deposits, Advances, & Other	\$ 37	\$ 38	\$ 39
Deferred Revenue	52	63	50
Other Debt Owed to University	26	29	26
Building Debt	119	121	108
<b>TOTAL LIABILITIES</b>	<b>\$ 234</b>	<b>\$ 251</b>	<b>\$ 223</b>
<b>COMPOSITION OF NET ASSETS</b>			
Unrestricted Reserves	\$ 96	\$ 79	\$ 65
Undistributed Income & Other	5	18	33
Pledge Balances	39	33	40
Student Loan Funds	10	10	10
Investment in Facilities	325	322	308
Endowment & Other Invested Funds	2,117	2,971	2,821
<b>TOTAL ASSETS NET OF LIABILITIES</b>	<b>\$ 2,592</b>	<b>\$ 3,433</b>	<b>\$ 3,277</b>

# Supplemental Financial Information

The work of Harvard Business School is sustained by a business model that is unique among the Harvard University schools and in higher education. In a self-sustaining cycle, HBS globally disseminates the intellectual capital produced by the faculty through Executive Education programs and Harvard Business Publishing.

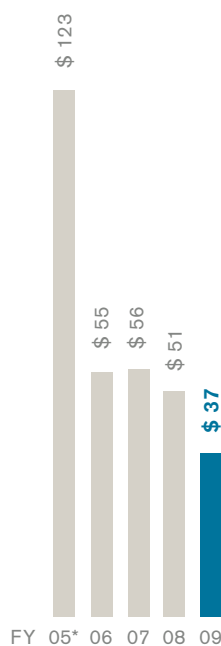
Sales of these offerings enable HBS to advance the practice of management, while typically generating more than 50 percent of the School's total annual revenues. Completing the cycle, contributions from Harvard Business Publishing (HBP) and Executive Education serve as the mainstay sources of funding for the faculty's research.

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

Revenue from gifts to HBS—in the form of endowment distributions and current use giving—has grown in recent years to more than 25 percent of the School's total income. This growth has been driven by strong long-term investment returns on the endowment prior to fiscal 2009 and new endowment gifts, as well as the HBS community's generous class reunion and annual giving. In general, though, HBS relies far less on endowment income as a source of revenue than other Harvard schools.

At less than 20 percent of total revenues, MBA tuition, fees, and related student income also play a relatively smaller role in the HBS business model compared with the other Harvard schools and with higher education generally.

Harvard's schools and other operating units face a range of challenges that differ in magnitude, and thus need flexibility to shape solutions locally. Consequently, HBS sets strategic goals, administers operations, and manages its finances independently. At the same time, the School strives to ensure that local decisions take shape within a set of overarching University considerations—both academic and financial. These considerations significantly affect annual operating budgets and capital investment planning at HBS.



**CASH RECEIVED FROM GIFTS**  
(dollars in millions)  
\*Campaign year



## ENDOWMENT INCOME

Like other Harvard schools, HBS raises its own endowment and current use funds. The School independently budgets the use of endowment distributions to support operations according to the terms of each gift. The HBS endowment, along with those of the other Harvard schools, is managed by Harvard Management Company (HMC), a subsidiary governed and wholly owned by the University.

The HBS endowment consists of more than 1,000 discrete funds established over the years by individual donors, reunion classes, corporations, and foundations. Although most endowment gifts are made in perpetuity, allowing little or no access to principal, some allow access to principal to provide the School flexibility in achieving the purposes for which they were designated. In addition, the School occasionally draws on capital appreciation associated with prior-year gifts. Funds from these decapitalizations are used to support key initiatives in keeping with donor intentions.

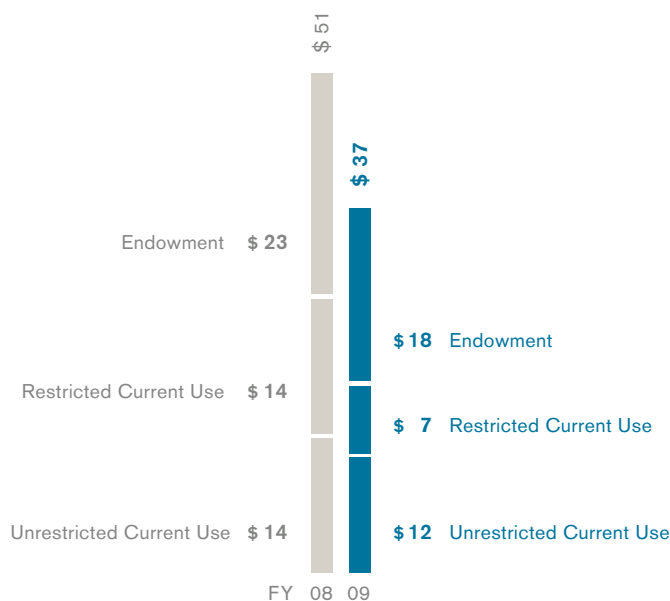
Harvard determines the amount that can prudently be drawn from the endowment to spend in any given year. This calculation is based on a rigorous payout policy that reflects past endowment performance and HMC's projections of future investment returns. The University's long-term target has been to distribute between 5 and 5.5 percent of the endowment's market value annually. The distribution includes an assessment of .5 percent of the year-end market value to cover a portion of university central administration costs.

The University's endowment spending percentage of 4.6 percent for fiscal 2009 was determined early in calendar year 2008—more than six months before the worldwide market correction began—and reflected the endowment's strong absolute and relative performance in the preceding years. Reflecting this spending percentage and growth in the market value of the

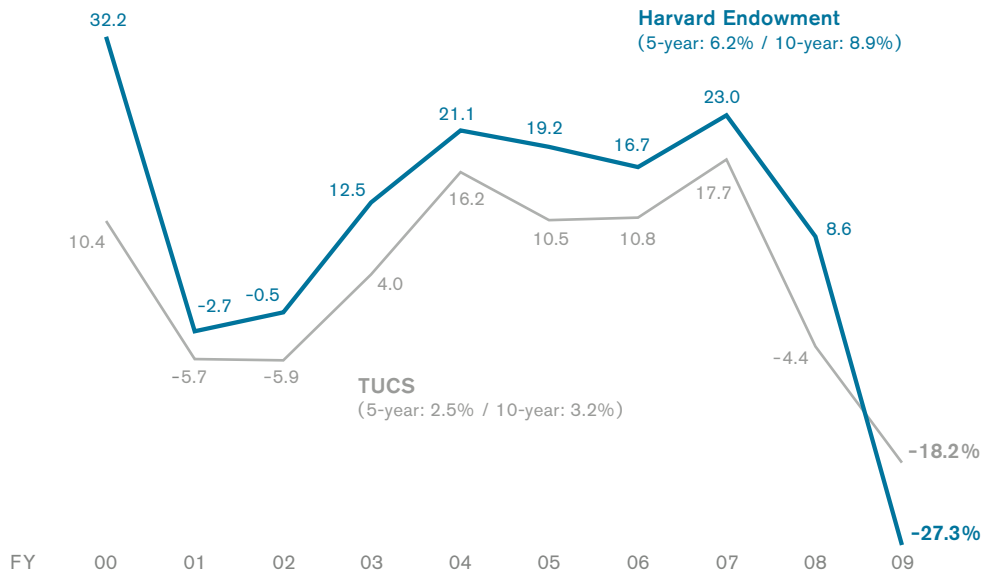
endowment, the School's endowment distribution revenue continued to increase in fiscal 2009, rising by \$19 million, or 20.2 percent, to \$113 million from \$94 million a year earlier.

This growth will be reversed in fiscal 2010. The absolute return on the University's pooled investments (including the endowment) was -27.3 percent for fiscal 2009, net of all fees and expenses. After including all gifts received and subtracting annual distributions and decapitalizations, at June 30, 2009, the University endowment was valued at \$26 billion—down by \$10.9 billion, or 29.5 percent, from \$36.9 billion a year earlier. The market value of the HBS endowment, together with current use funds, decreased by approximately \$900 million, or nearly 30 percent, from \$3 billion at June 30, 2008, to \$2.1 billion.

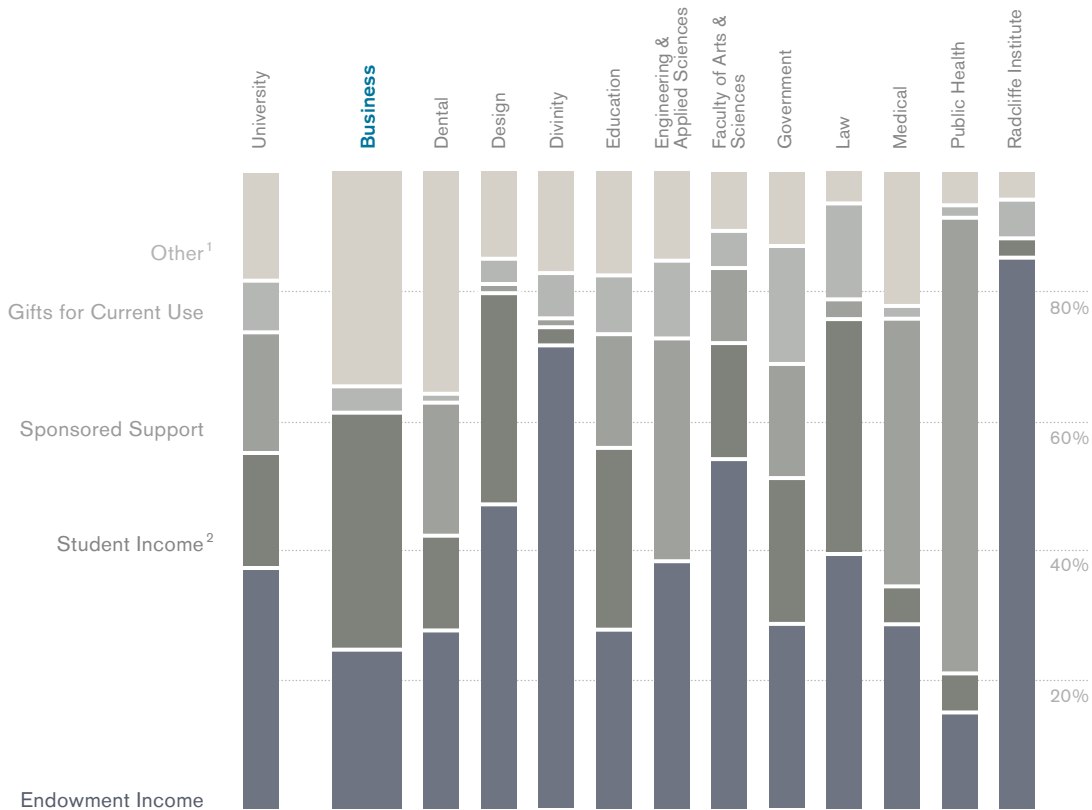
Consistent with its endowment goal of providing the Harvard schools with a reliable stream of operating income over the long term, the University has advised the Harvard community to prepare for smaller endowment distributions over the next few years. For fiscal 2010, endowment distribution income is budgeted to decline by \$15 million, or 13.3 percent, from fiscal 2009.



**GIFTS RECEIVED**  
(dollars in millions)

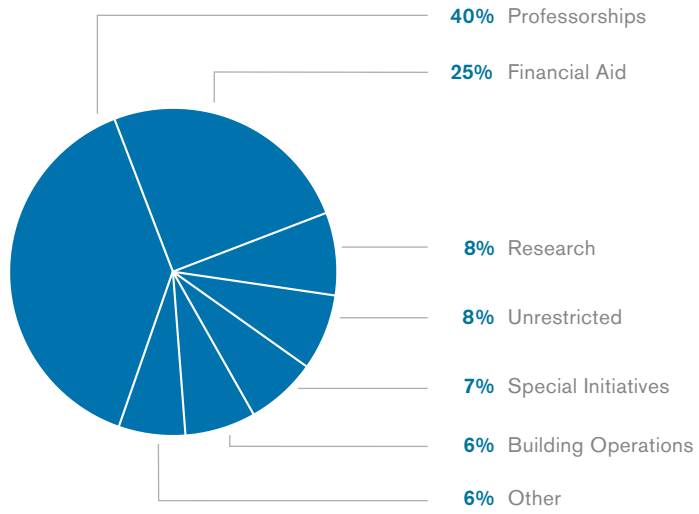


ENDOWMENT RETURNS

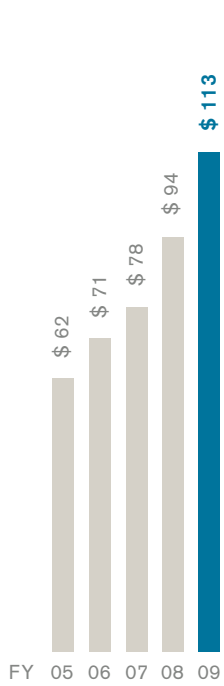


REVENUE SOURCES BY HARVARD UNIVERSITY SCHOOL, FY 2009  
(percent of total revenue)

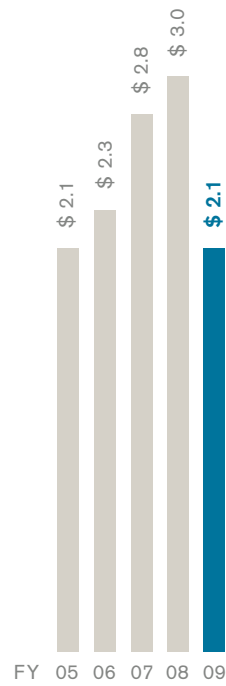
<sup>1</sup> Other for HBS includes Harvard Business Publishing.  
<sup>2</sup> Student Income for HBS includes MBA and Executive Education.



ENDOWMENT COMPONENTS, FY 2009



ENDOWMENT DISTRIBUTION  
(dollars in millions)



ENDOWMENT GROWTH  
(dollars in billions)

**FISCAL 2009 REVENUES**

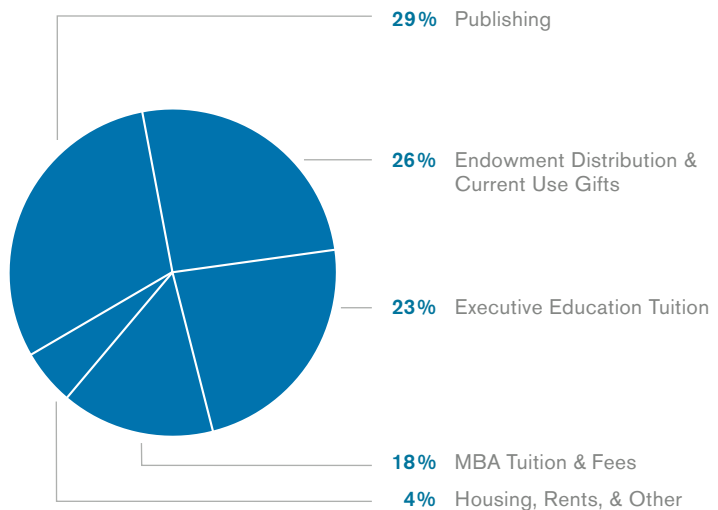
The School’s top-line growth slowed to 4.7 percent in fiscal 2009, from a compound annual rate of 8.9 percent for the previous five years, as total revenues increased by \$21 million from fiscal 2008 to \$472 million. In contrast to fiscal 2008 when Executive Education and HBP together represented more than \$26 million of year-over-year growth, revenue from these combined sources was down by \$1 million in fiscal 2009. This decline reflected weaker demand in both the corporate and academic markets as the economy deteriorated in the second half of the fiscal year.

The School’s alumni and friends continued to be generous in fiscal 2009, but the market collapse and recession clearly had an impact on giving to HBS. Income from unrestricted current use gifts totaled \$12 million, or 2.5 percent of the School’s total revenue, compared with \$14 million, or 3 percent of revenue a year earlier. Total cash received from all types of gifts for fiscal 2009 was \$37 million, compared with \$51 million in fiscal 2008. Approximately 24 percent of the School’s MBA alumni made a gift to the School in fiscal 2009, compared with nearly 30 percent in fiscal 2008.

The flat revenues in Executive Education and HBP and decline in current use giving were offset by the larger endowment distribution, as well as an increase in the Housing, Rents, and Other category. Revenue in this category was up by \$4 million from fiscal 2008, the result of Global Business Summit registration fees and an expansion of the MBA immersion programs. As in prior years, MBA tuition and fees increased as well, generating an incremental \$2 million in revenue for the fiscal year.



**REVENUES**  
(dollars in millions)



**REVENUE COMPONENTS, FY 2009**

**FISCAL 2009 EXPENSES**

**BACKGROUND**

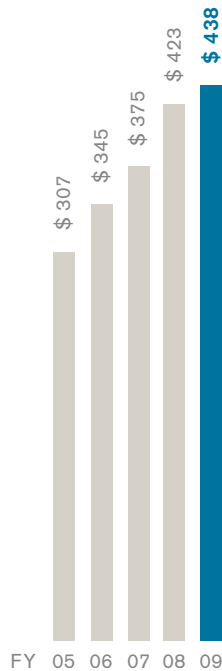
Total operating expenses increased by \$15 million, or 3.5 percent, in fiscal 2009 to \$438 million, from \$423 million last year—roughly half the increase initially projected. Early in the fiscal year, HBS anticipated slowing revenue growth and implemented a multitude of budget cuts that affected nearly every area of spending. Aggressive expense management at HBP alone resulted in \$11 million in savings, compared with the initial fiscal 2009 budget. In total, the School’s fiscal 2009 operating expenses came in \$22 million lower than the \$460 million initially planned.

The expense reductions implemented in fiscal 2009 were designed with two goals in mind. The first goal was to ensure that the School’s operating budget reflects an environment of slower revenue growth. The second goal was to protect key priorities—academic programs, faculty research, and strategic initiatives—while minimizing costs to the extent possible. From an expense management perspective, these goals relate to various functional areas that transect a number of items in the School’s Statement of Activity and Cash Flows.

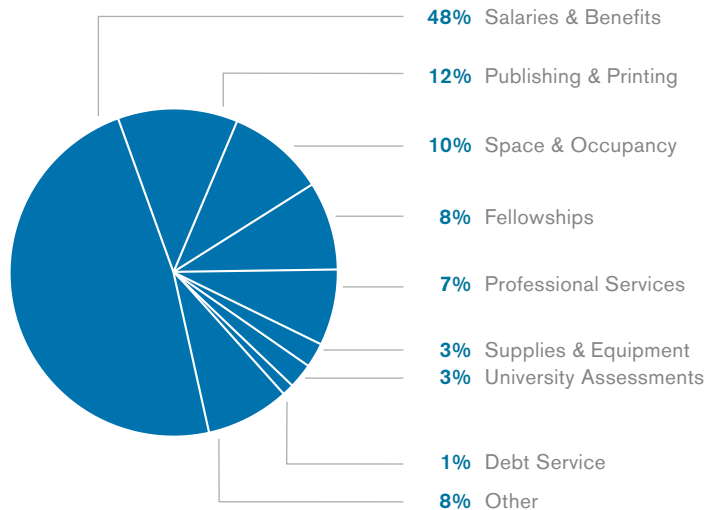
In HBP and Executive Education, for example, expenses include direct costs for staff compensation, specialized outside professional services in areas such as IT and marketing, and residence expenses for executive program participants. As another example, faculty research expense includes a significant portion of faculty salaries and benefits, as well as direct costs for research support staff, travel, and IT services. Also included in the cost of faculty research are allocated expenses for the School’s network of global research centers, as well as library resources, campus facilities, technology, and administration. When viewed in this way, the School’s total investment in faculty research for fiscal 2009 was \$97 million, compared with \$102 million last year.

**SALARIES & BENEFITS**

Compensation for faculty and staff is the School’s largest expense. For fiscal 2009, salaries and benefits expenses rose by \$6 million, or 2.9 percent, from a year earlier. The fiscal 2008 figure was unusually high due to a one-time expensing of both historic vacation liability and faculty early retirement incentives.



**EXPENSES**  
(dollars in millions)



**EXPENSE COMPONENTS, FY 2009**

Amid increasing global competition for academic talent, HBS recruits aggressively and seeks creative ways to attract outstanding faculty. The ability to offer competitive salary and benefits packages is crucial in this effort. The total number of faculty, as measured in full-time equivalents (FTEs), can rise or fall in any given year as a result of retirements, departures, and normal fluctuations in recruiting activity. In fiscal 2009, the size of the faculty grew by nine FTEs to 228, which contributed to the increase in faculty compensation expense.

HBS tightly controls administrative staff levels, adding staff positions only when they are critical to achieving the School's teaching and research mission. Although the operational footprint of the School has expanded significantly in the past five years, the number of administrative FTEs has grown at a compound annual rate of only 3.1 percent.

In fiscal 2009, the administrative FTE budget increased by 41 to a total of 1,187, from 1,146 at the end of fiscal 2008, reflecting plans completed prior to the economic downturn. Looking forward, the staffing reductions implemented for fiscal 2010 will result in a significant year-over-year decline in total administrative FTEs.

#### FELLOWSHIPS

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

Generous giving by the School's alumni and friends, coupled with strong investment returns on the HBS endowment, have significantly increased the size of the School's endowed financial aid funds in the past five years. Total financial aid spending, including fellowships for doctoral as well as MBA students, has risen at a compound annual rate of 17.1 percent during this period. In fiscal 2009, the School's total financial aid expense grew by \$7 million, or 26.9 percent, from the prior year, to \$33 million.

Since fiscal 2004, the average two-year MBA fellowship award has grown from \$24,500 for the Class of 2005 to \$49,500 for the Class of 2010. HBS will continue seeking ways to assist MBA students in reducing their debt

at graduation, thus broadening their career opportunities in both the private and public sectors. The School is also increasing its investment in doctoral education. The number of doctoral students rose to 120 in fiscal 2009 from 105 in the prior year, driving commensurate growth in spending for doctoral fellowships, stipends, and research support.

#### PUBLISHING & PRINTING

Publishing and printing expenses includes HBP production costs as well as a small amount of spending to produce the School's other printed materials and publications. Primarily reflecting lower costs for printing and paper and marketing at HBP as business activity contracted, publishing and printing expenses were down by \$1 million in fiscal 2009 to \$52 million, from \$53 million a year earlier.

#### SPACE & OCCUPANCY

The HBS campus includes 33 buildings encompassing more than 1.5 million square feet of occupied space. Space and occupancy expenses includes costs related to maintaining and operating the School's buildings and associated campus infrastructure. In addition, facilities improvement and renovation costs that do not qualify as capital expenses are generally categorized as space and occupancy.

Also included in space and occupancy are expenses related to dining facilities and other campus services, as well as costs associated with leased space that houses HBP's operations. In addition, residence expenses for executive program participants—equivalent to cost of goods sold in Executive Education—are reported under this category.

In the past five years, space and occupancy expenses have risen at a compound annual rate of 6.2 percent. Despite incremental spending related to the School's centennial activities, these expenses were flat with the prior year in fiscal 2009 as a result of midyear budget reduction initiatives, which included cuts in campus-wide dining costs and the postponement of numerous facilities projects.

#### SUPPLIES & EQUIPMENT

Spending in this area increased by \$1 million, or 9.1 percent, in fiscal 2009, primarily reflecting projects related to enhanced IT security and business continuity measures.

#### PROFESSIONAL SERVICES

Professional services expenses increased by 7.6 percent in fiscal 2009 to \$31 million, from \$29 million in fiscal 2008. Over the past five years, the School's spending on professional services has risen at a compound annual rate of 17.2 percent. This increase largely reflected spending for outside contractors who assisted with HBP's IT infrastructure upgrade and migration to a digital product platform, as well as other IT projects across the campus. The slower growth in professional services expenses in fiscal 2009 was mainly due to a decrease in Executive Education spending in this area.

#### UNIVERSITY ASSESSMENTS

Expenses for University assessments are primarily calculated as a percent of the School's total expenses on a two-year lagged basis. These assessments cover essential services provided to HBS by the University, including payroll and benefits administration, processing of accounts receivable and payable, and legal services. University assessments increased in fiscal 2009 by \$1 million, or 8.3 percent, to \$13 million, reflecting growth in the School's expenses. University assessments may rise at a faster rate in future years, as the negative endowment returns of fiscal 2009 are likely to reduce the amount of endowment income available to support the University's central administrative functions.

#### DEBT SERVICE

The School's debt service expenses, which consists of interest payments to the University on building and other University debt, declined in fiscal 2009 by \$1 million, or 14.3 percent, to \$6 million. As in the prior year, debt service expenses were mainly associated with borrowings to finance campus expansion earlier in the decade.

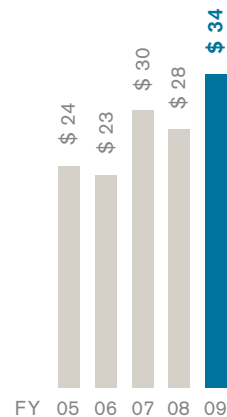
#### OTHER EXPENSES

Other expenses were flat with the prior year in fiscal 2009 at \$37 million. Incremental expenses related to MBA Program innovation, career services initiatives, and the School's centennial were offset by budget cuts in numerous areas, as well as the postponement of special projects.

#### CASH BEFORE CAPITAL ACTIVITIES

HBS invests in capital projects and covers the related debt service using cash from operations, as well as prior years' endowment gifts or appreciation. The health of the global economy significantly affects the School's cash flow from operations, because margins from HBP and Executive Education, income from investment returns on the endowment, and levels of unrestricted giving are all economically sensitive.

The economy also drives the School's decisions regarding the use of prior years' gifts or appreciation, available to be spent in accordance with a donor's wishes. These funds vary from year to year depending on the type of gifts available, the purposes for which they were given, the status of the School's initiatives related to these purposes, and the available appreciation.



**CASH FROM OPERATIONS**  
(dollars in millions)

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

In fiscal 2009, the School's cash from operations increased by \$6 million, or 21 percent, to \$34 million, reflecting a mix of factors. Growth in the endowment distribution, and to a lesser extent an increase in student housing and tuition income, were offset by a slight decline in combined revenue from HBP and Executive Education, a slowdown in unrestricted current use giving, and a modest rise in operating expenses.

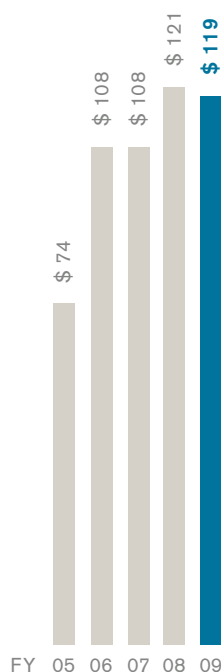
At the same time, there was a decline in use of cash from prior years' endowment gifts or appreciation. Income from this source contributed \$11 million to the School's cash flow in fiscal 2009, compared with \$41 million last year. The fiscal 2008 figure included the School's \$26 million share of a University-wide strategic decapitalization of principal and appreciation from the endowment, drawn from the Harvard endowment's strong investment returns in the decade prior to fiscal 2009.

Reflecting the \$6 million increase in cash from operations, netted against the \$30 million drop in cash from endowment gifts or appreciation, cash before capital activities declined in fiscal 2009 by \$24 million, or 34.7 percent, to \$45 million, from \$69 million a year earlier.

#### NET CAPITAL EXPENSES

The School's capital investments in the campus peaked at \$79 million in fiscal 2005 with the construction and improvement of classroom space, the addition of new core facilities, and major residential space renovations. Since then, as these large projects reached and neared completion, the School has focused on protecting the long-term value of the physical plant through the renewal and maintenance of buildings, campus infrastructure, and IT systems. Capital spending has declined, as a result.

The exception was fiscal 2008, when capital expenses doubled year-over-year to \$40 million, largely due to renovations of MBA residence space and classroom facilities for executive programs. The only large capital projects in fiscal 2009 were the completion of renovations and systems upgrades in two residence halls, which represented a combined \$7 million in capital expense. Unlike prior years, there were no gifts specified for the capital projects that were under way this past year. As a result, net capital expenses for fiscal 2009 were \$19 million.



#### BUILDING DEBT OUTSTANDING (dollars in millions)



## NET DEBT & OTHER

In addition to gifts and internally generated cash, as well as unrestricted reserves, the School finances major capital projects with debt financed through the University, using leverage strategically as a means of optimizing its capital structure. HBS borrows only on qualified capital projects, carefully considering the interest rate environment, expectations for the performance of the Harvard endowment, and the availability of University debt.

New borrowings have generally declined since mid-decade in line with the lower capital spending and in fiscal 2009 roughly equaled debt principal payments, decreasing to \$3 million from \$22 million a year earlier. Debt principal payments decreased to \$5 million, from \$9 million in fiscal 2008, reflecting the winding down of scheduled gift pledge payments during the year.

Other non-reserve activity in fiscal 2009, primarily consisting of digital platform investments by HBP, was \$7 million, compared with \$33 million in fiscal 2008. Prior-year non-reserve activity was unusually high because it included the transfer of \$25 million of current use reserves to the unrestricted endowment reserve established several years ago. Reflecting the negative investment returns on the University endowment in fiscal 2009, the market value of this reserve was \$85 million at June 30, 2009, compared with \$126 million a year earlier.

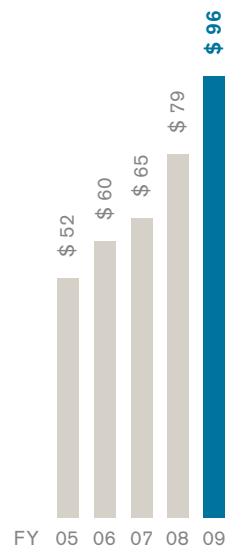
The School's balance sheet remains modestly leveraged. The University functions as a banker for Harvard schools, allowing them to borrow on a triple-A-rated tax-exempt basis. In fiscal 2009, the School's building debt decreased by \$2 million to \$119 million, as the \$3 million of new borrowings were offset by \$5 million of principal repayments. Other University debt—mainly consisting of repayment obligations to the University for mortgage loans made by the School as a faculty recruiting incentive—decreased by \$3 million, to \$26 million.

Total debt has averaged only 4.3 percent of total assets for the past five years. The interest portion of the School's debt service amounted to 1.4 percent of total operating expenses in fiscal 2009, compared with 1.6 percent in fiscal 2008. At June 30, 2009, the School's building debt as a percentage of net assets was 4.6.

## UNRESTRICTED RESERVES BALANCE

As part of the mix with gifts, internally generated cash, and debt, HBS relies on unrestricted reserves to finance capital projects. The School also uses unrestricted reserves as a resource for capitalizing on unforeseen strategic opportunities. In fiscal 2009, the decrease in cash before capital activities was more than offset by declines in net capital expenses and net debt and other activity.

As a result, the School's year-end reserves balance grew by \$17 million to \$96 million. Given the uncertain outlook for revenue from Executive Education, HBP, and the endowment, and potential constraints on the availability of debt financing through the University, maintaining a strong unrestricted reserves balance will continue to be one of the School's most important financial goals.



UNRESTRICTED RESERVES  
(dollars in millions)

**Harvard Business School**  
**Soldiers Field**  
**Boston, MA 02163**

This document is intended to provide insight into the way Harvard Business School manages its resources and plans strategically for its future. Further information about the School can be found at [www.hbs.edu](http://www.hbs.edu).

This report can be viewed and downloaded online at [www.hbs.edu/annualreport](http://www.hbs.edu/annualreport).

Harvard Business School is led by the Dean of the Faculty in conjunction with various advisory and oversight groups comprising faculty, staff, alumni, academics, and business practitioners. Harvard University appoints a Visiting Committee to review Harvard Business School's strategic goals and objectives and to provide advice and input to the Dean. The group meets annually and reports to Harvard University's Board of Overseers.

We welcome questions and comments from our readers. Please direct correspondence to Richard Melnick, Chief Financial Officer: [rmelnick@hbs.edu](mailto:rmelnick@hbs.edu) or to the Office of the Dean: [officedean@hbs.edu](mailto:officedean@hbs.edu).



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