HARVARD BUSINESS SCHOOL

2018 FINANCIAL REPORT

DEAN OF THE FACULTY

Nitin Nohria

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Senior Associate Dean for University Affairs

C. Fritz Foley
Senior Associate Dean, Strategic Financial Planning

Janice H. Hammond
Senior Associate Dean, Culture & Community

Kathleen L. McGinn
Senior Associate Dean for Faculty Strategy & Recruiting

Das Narayandas
Senior Associate Dean for External Relations & HBS Publishing

Lynn S. Paine
Senior Associate Dean for International Development

Leslie A. Perlow
Senior Associate Dean for Research

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Senior Associate Dean for Faculty Development

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David Scharfstein
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Gabriel Handel
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Jana Kierstead
Executive Director, MBA & Doctoral Programs

Ellen Mahoney
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Chief Financial Officer

Patrick Mullane
Executive Director, HBX

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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 CHIEF FINANCIAL OFFICER

Harvard Business School delivered strong financial results in fiscal 2018. Revenues exceeded our forecast, driving double-digit growth in cash from operations for the fourth consecutive year. This cash flow enabled HBS to continue providing robust support for mission-driven innovation and campus investment, while maintaining the healthy balance of unrestricted reserves necessary to sustain the School's future relevance and leadership.

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 2018 financial results are reported in detail in the Supplemental Financial Information section that begins on page 8. The balance of this letter discusses the School's fiscal 2018 financial performance at a strategic level, as well as our financial forecast for fiscal 2019.

FISCAL 2018 IN REVIEW

The HBS economic model is unique among the Harvard University schools and in higher education, and 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 pursue the questions that interest them most, and to interact in the field with 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. Completing the self-sustaining cycle, operating surpluses at Executive Education and Harvard Business Publishing (HBP) supplement revenues from MBA tuition and alumni gifts as key sources of funding for faculty research.

The model performed well in fiscal 2018, as revenue grew faster than expenses for the fourth straight year. The resulting income from operations enabled the School to continue strengthening core programs and investing in strategic opportunities.

Total operating revenue increased by $56 million, or 7 percent, from fiscal 2017, compared with our forecast of zero growth. HBP and Executive Education delivered a combined $35 million of incremental revenue, year-over-year, primarily driven by gains in Executive Education enrollment and higher sales across HBP's *Harvard Business Review* group, corporate learning, and education divisions.

The School's recent strategic initiatives—including The Harvard Business School Campaign and Harvard Business School Online (HBS Online, formerly HBX)—also generated strong topline results in fiscal 2018. Philanthropic income from alumni giving and the HBS endowment grew by $9 million, or 4 percent. It was a breakthrough year for HBS Online. Revenue increased by $7 million, or 58 percent, driven by growing enrollment in certificate programs, as well as a strong response to course offerings launched during the year. As a result, the HBS Online operating deficit declined to $5 million, compared with $10 million to $12 million in each of the past four years since the group's inception.

Capital investment for fiscal 2018 increased 18 percent to $92 million, from $78 million a year earlier. This growth largely reflected a step-up in construction activity at Klarman Hall, which was substantially completed during the year. Maintaining its commitment to sustaining the residential campus, the School also increased its investment in facilities renewal and maintenance, highlighted by a major exterior renovation of Aldrich Hall.

Total operating expenses for fiscal 2018 rose 4.8 percent from fiscal 2017, coming in below our forecast of 6.3 percent. Faculty and staff compensation—the School's largest expense—was up 4 percent, versus the 5 percent we anticipated. Other line item expenses, collectively, grew 5.4 percent, compared with a budgeted 7 percent increase, reflecting a strong and ongoing commitment to cost control discipline on the part of managers across the School.

from internally generated funds invested in this endowment is unrestricted.

Building the endowment reserve is a strategic priority for HBS. The strategic initiatives implemented since fiscal 2011 have substantially increased the School's fixed operating costs. At the same time, HBS has become increasingly reliant on revenue from economically sensitive sources to cover those higher expenses. Faced with a prolonged recession, the School's ability to offset revenue shortfalls with unrestricted annuity income from the endowment will be crucial.

The School's unrestricted reserves held outside of the endowment are important to the model, as well. Thanks to consistent operating surpluses, HBS has long been successful in maintaining such

significant difference in key areas across the School. In addition to surpassing its financial goal, the Campaign achieved milestones in all four of its non-fundraising objectives, including alumni engagement, student and young alumni focus, support for One Harvard, and building the narrative about the role of HBS and business in society.

Of the $1.4 billion in endowment and current use gifts raised through the Campaign, $1.1 billion had been received by the School as cash at year-end fiscal 2018. Outstanding pledges totaled $317 million. Endowment giving to the Campaign strengthened the School's core programs by creating an impressive number of new associate professorships and fellowship funds.

Fellowship Spending (in millions)	**MBA**	**Total***
FY18	**$ 37**	**$ 50**
FY17	36	48
FY16	34	47
FY15	32	44
FY14	31	43

** Includes Doctoral Programs and Executive Education*

Investment in Research (in millions)	
FY18	**$ 144**
FY17	136
FY16	131
FY15	123
FY14	117

The School's bottom-line performance for fiscal 2018 reflected these revenue and expense dynamics. Driven primarily by higher margin contributions from Executive Education and HBP, total net margin contribution as a percentage of revenue grew to 10.5 percent, from 8.6 percent last year and 7.7 percent five years ago. Cash from operations—the School's operating surplus—increased 30 percent year over year, from $69 million to $90 million—more than double the average of $42 million over the preceding 10 years.

Concluding the fiscal year in a strong cash position enabled the School to invest $65 million in the HBS endowment reserve, following a similar $50 million investment in fiscal 2017. In contrast with alumni gifts to the endowment, which largely support fellowships, professorships, and other key student and faculty activities, the long-term stream of income

reserves. These funds, which equate to retained earnings, are primarily available for capital activities—investments aimed at sustaining the residential campus for future generations.

HBS concluded fiscal 2018 with an unrestricted reserves balance of $118 million. This balance was down from $145 million a year earlier, but still substantially above the $100 million in unrestricted reserves held outside of the endowment we have established as the School's current liquidity management target.

The School's cash flow and balance sheet dynamics are described in detail, beginning on page 6.

Fiscal 2018 marked the conclusion of The Campaign for Harvard Business School—a successful, seven-year effort that, with 59 percent MBA alumni participation and 26,000+ donors, has made a

Current use giving to the HBS Fund was a key Campaign objective. HBS alumni and friends rose to the challenge with enormous generosity, achieving the School's $40 million target three years after the Campaign's public launch in fiscal 2013. HBS Fund gift income has doubled since then, growing from $22 million in fiscal 2013 to $44 million this year. Restricted current use giving has grown nearly 67 percent during the same five-year period, providing seed funding for HBS Online, the Harvard Innovation Labs ecosystem, MBA innovation including Field Immersion Experiences for Leadership Development, and other strategic initiatives.

As much as we are grateful to the alumni and friends who supported Harvard Business School through gifts to the Campaign, we also are proud of the contributions made by many to Harvard. HBS donors supported schools, programs, and activities across the University by leading campaign committees, giving generously, and working to realize the promise of One Harvard.

HBS is less reliant on endowment distribution income than all but one other Harvard school, because of its ability to support its operations with revenue from Executive Education and HBP. Each fall, Harvard approves the University-wide endowment distribution percentage rate for the following fiscal year. The Harvard endowment experienced a disappointing 2 percent investment loss in fiscal 2016.

As a result, underlying year-over-year growth in the endowment distribution was limited to essentially zero for fiscal 2018. At HBS, however, the endowment distribution increased 2.7 percent from fiscal 2017 to $150 million, representing 17.5 percent of the School's total revenue. This increase was driven entirely by growth in the size of the HBS endowment resulting from gifts during the Campaign.

Harvard Management Company (HMC) and the University endowment portfolio are still in the early stages of a multiyear transition. The Harvard endowment delivered 8.1 percent and 10 percent investment returns in fiscal 2017 and 2018, respectively—above the University's 8 percent long-term target return.

As in recent years, these results are about equal to the average return of larger college and university endowments, but not yet Harvard's immediate peers. We are encouraged by the steps that HMC has taken to reposition the endowment for long-term success, knowing that the positive impact of these changes will take time to unfold.

This year's distribution from the endowment, as well as the endowment's investment performance, are discussed in detail, beginning on page 9.

FISCAL 2019 OUTLOOK

The next fiscal year at HBS will be the 10th since the Great Recession. The School's financial health has improved over the past decade, as has the health of the global economy. Each additional year of recovery, however, makes it increasingly important to prepare for a potential reversal of today's generally favorable economic conditions.

Looking back at the School's financial performance in fiscal 2009—when the economy last hit bottom—there are ample reasons for caution. The HBS revenue sources that were most directly affected by the Great Recession—HBP, Executive Education, and current use giving—have grown substantially.

Raising the stakes further, fixed costs at HBS today are significantly higher than they were in fiscal 2009. Continued investment in core activities and strategic innovation have expanded the School's operating footprint. Our IT infrastructure is larger and more complex. New buildings have added more than 300,000 square feet of learning and residence space to the campus, leading to higher maintenance, repair, and depreciation expenses.

With these realities in mind, we developed our fiscal 2019 financial plan with the goal of strengthening the School's resilience in the event an economic downturn materializes. We will continue to closely monitor the School's actual financial performance versus budget as the year unfolds. Contingency plans for spending are in place should revenues fall short, and, as in recent years, the year's top-line performance may turn out better than we had anticipated.

Starting at the top of the Statement of Activity and Cash Flows (page 6), we expect the School's total revenues for fiscal 2019 to be essentially level with the $856 million reported for fiscal 2018.

Revenue from HBP and Executive Education is forecasted to be essentially flat with fiscal 2018 on a combined basis. Both groups face strong competitive challenges in an increasingly risky global economic environment. Additionally, Executive Education faces uncertainties about international travel to the United States. HBS Online remains in startup mode. Although we expect its revenue to grow nearly 50 percent, the group is not likely to become a surplus-generating activity in the year ahead.

MBA tuition is budgeted to increase a modest 2 percent in fiscal 2019—the smallest amount in many decades—reflecting the School's focus on slowing the pace of growth in the cost of MBA education. Revenue from MBA tuition and fees is projected to rise 1 percent, year over year, reflecting normal fluctuations in actual class size. Financial aid spending—MBA, Doctoral, and Executive Education student fellowships—is expected to increase 6 percent.

Philanthropy will remain essential to the School's financial health in fiscal 2019. Now that early Campaign donors have largely fulfilled their pledges, sustaining the $40 million given yearly to the HBS Fund since fiscal 2016 is one of our most pressing financial challenges. The School's ability to continue investing in innovation while offering generous financial aid depends on the HBS community's success in building on the achievements of the Campaign and sustaining the School's momentum in current use giving.

Publishing Revenue (in millions)	
FY18	**$ 240**
FY17	221
FY16	217
FY15	203
FY14	194

Executive Education Tuition (in millions)	
FY18	**$ 207**
FY17	191
FY16	176
FY15	168
FY14	163

I.T. Investment (in millions; excludes capital expenses)	
FY18	**$ 82**
FY17	85
FY16	85
FY15	72
FY14	66

We expect HBS to benefit from mid single-digit growth in the endowment distribution for fiscal 2019. A portion of this growth relates to the increase in the University's distribution rate. The balance reflects growth in the size of the endowment as a result of endowment gifts and the School's fiscal 2018 investment in its endowment reserve.

Moving down the income statement to operating expenses, our fiscal 2019 financial plan targets a 9 percent year-over-year increase in the School's total spending. This forecast includes approximately 5 percent growth in total compensation cost, reflecting growth in the size of the School's faculty and staff, in addition to higher salaries and benefits expenses.

The balance of the increase in fiscal 2019 budgeted expenses primarily reflects higher costs of goods sold in HBP as that group continues to grow, Klarman Hall space and occupancy expenses, and growth in spending for fellowships. In addition, the School's fiscal 2019 plan includes a larger expense contingency to offset possible margin contribution shortfalls in the event of a revenue slowdown.

With construction of Klarman Hall winding down, the School's total capital budget for fiscal 2019 is $37 million, a decrease of $55 million from fiscal 2018. Completing the Klarman Hall video center, landscaping, and reconfiguration of the parking lot in time for the facility's opening in October 2018 will be the School's largest capital project. Our plan also includes increased investment in security enhancements for buildings across the campus.

In summary, thanks to top-line growth and fiscal discipline, for the past five years we have been able to execute on the School's mission and consistently generate substantial operating surpluses. These surpluses have enabled HBS to strengthen core programs and drive innovation, while strongly positioning the School to sustain its excellence over the long term. We remain committed to delivering sound and consistent financial results in fiscal 2019 and future years.

RICHARD P. MELNICK, MBA 1992
CHIEF FINANCIAL OFFICER
OCTOBER 1, 2018

Capital Investment (in millions)

FY 18	**$ 92**
FY 17	78
FY 16	113
FY 15	81
FY 14	92

Building Debt Outstanding (in millions)

FY 18	**$ 55**
FY 17	64
FY 16	71
FY 15	78
FY 14	85

FISCAL 2018 HIGHLIGHTS

- Operating revenues grew 7 percent to $856 million, while operating expenses increased 4.8 percent to $766 million.
- The largest revenue growth drivers were Harvard Business Publishing, Executive Education, and HBS Online.
- The major areas of expense growth were salaries and benefits, other expense, and professional services.
- In the final year of The Campaign for Harvard Business School, new gifts and pledges totaled $214 million, compared with $233 million in fiscal 2017.
- The return on the School's endowment increased to 10 percent, from 8.1 percent in fiscal 2017.
- The value of the School's endowment (after the net impact of distributions from the endowment and the addition of new gifts) increased to $3.8 billion, from $3.5 billion a year earlier.
- Capital investments in campus facilities and new construction increased to $92 million, from $78 million in fiscal 2017.
- The School generated an operating surplus of $90 million, compared with $69 million for the prior year.
- HBS ended fiscal 2018 with an unrestricted reserves balance of $118 million, compared with $145 million a year earlier.
- The School's total net assets increased to $4.9 billion, from $4.5 billion at the end of fiscal 2017, 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)	2018	2017	2016
MBA Tuition & Fees	**$ 138**	$ 133	$ 127
Executive Education Tuition	**207**	191	176
Publishing	**240**	221	217
Endowment Distribution	**150**	146	138
Unrestricted, Current Use Gifts	**44**	42	40
Restricted, Current Use Gifts	**35**	32	32
HBS Online	**19**	12	10
Housing, Rents, Interest Income, & Other	**23**	23	21
Total Revenues	**$ 856**	$ 800	$ 761

Expenses			
Salaries & Benefits	**$ 340**	$ 327	$ 309
Publishing & Printing	**74**	70	70
Space & Occupancy	**71**	68	62
Supplies & Equipment	**12**	12	14
Professional Services	**68**	63	65
Fellowships	**50**	48	47
University Assessments	**24**	24	22
Debt Service	**3**	4	4
Depreciation	**42**	40	38
Other Expenses	**82**	75	73
Total Expenses	**$ 766**	$ 731	$ 704

Cash from Operations	**$ 90**	$ 69	$ 57
Depreciation	**42**	40	38
Non-Cash Items	**—**	1	—
Cash Available for Capital Activities	**$ 132**	$ 110	$ 95

Capital Expenses	**$ (92)**	$ (78)	$ (113)
Change in Capital Project Pre-Funding	**10**	19	(12)
Use of Gifts for Capital Projects	**3**	51	20
Net Capital Expenses	**$ (79)**	$ (8)	$ (105)

New Borrowings	**$ 0**	$ 0	$ 0
Debt Principal Payments	**(8)**	(8)	(7)
Capitalization of Endowment Income	**(2)**	(4)	(3)
Decapitalization of Endowments	**3**	3	5
Other Non-Reserve Activity	**(73)**	(51)	(7)
Changes in Debt & Other	**$ (80)**	$ (60)	$ (12)

Increase (Decrease) in Reserves	**$ (27)**	$ 42	$ (22)
Beginning Reserves Balance	**$ 145**	$ 103	$ 125
Ending Reserves Balance	**$ 118**	$ 145	$ 103

CONSOLIDATED BALANCE SHEET

FOR THE FISCAL YEAR ENDED JUNE 30,

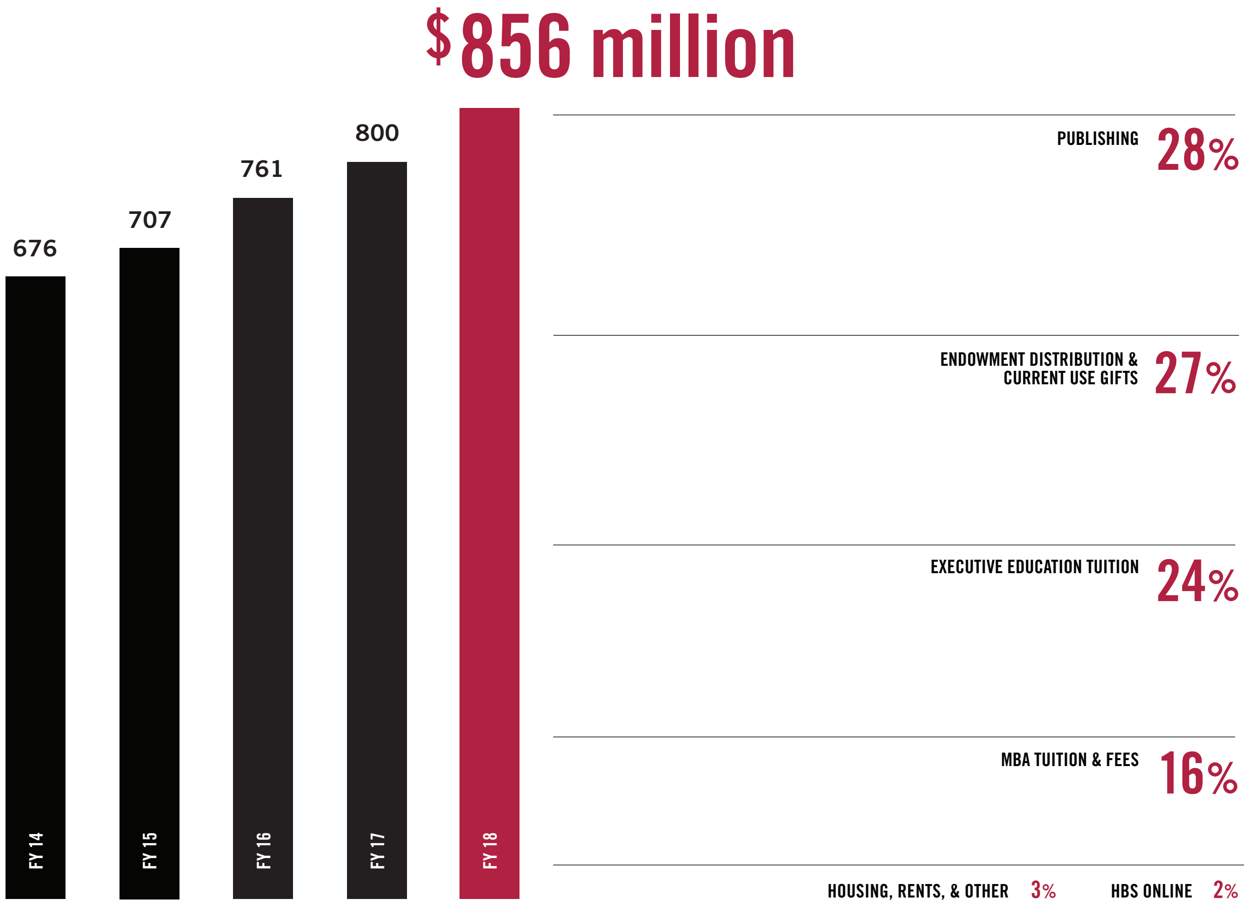
Assets (in millions)	2018	2017	2016
Cash	**$ 89**	$ 80	$ 61
Current Use Reserves	**118**	145	103
Receivables, Loans, & Other Assets	**214**	177	178
Invested Funds:			
Endowment	**3,453**	3,140	2,927
Endowment Interest in Trusts Held by Others	**164**	157	144
Endowment Pledges	**166**	168	127
Undistributed General Investment Income	**4**	7	11
Current Use Investments	**75**	72	107
Current Use Pledges	**151**	151	162
Facilities, Net	**774**	724	688
Total Assets	**$ 5,208**	$ 4,821	$ 4,508

Liabilities			
Deposits, Advances, & Other	**$ 82**	$ 69	$ 76
Deferred Revenue	**181**	150	126
Other Debt Owed to University	**27**	26	24
Building Debt	**55**	64	71
Total Liabilities	**$ 345**	$ 309	$ 297

Net Assets			
Current Use Reserves	**$ 118**	$ 145	$ 103
Endowment Funds	**3,787**	3,472	3,209
Current Use Funds	**226**	223	269
Unexpended Endowment Income	**1**	1	2
Student Loan Funds	**12**	11	11
Investment in Facilities	**719**	660	617
Total Net Assets	**$ 4,863**	$ 4,512	$ 4,211
Total Liabilities + Net Assets	**$ 5,208**	$ 4,821	$ 4,508

* 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 2018, the School's results for fiscal years 2016 and 2017 are presented in ---accordance with GAAP within the Statement of Activity and Cash Flows on page 6.

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).

HBP, Executive Education, and philanthropy are sensitive to trends in the economy and the capital markets, which continued to perform well in fiscal 2018. The School's total revenues increased by $56 million, or 7 percent, to $856 million, from $800 million a year earlier, primarily driven by growth in HBP and Executive Education. Philanthropic and HBS Online revenue grew 4 percent and 58 percent, respectively, from fiscal 2017.

MBA Tuition & Fees

Student tuition and fee revenue from the MBA program grew to $138 million, from $133 million in fiscal 2017. First-year MBA tuition in fiscal 2018 was $72,000, compared with $63,765 last year. This 13 percent increase primarily reflected a reallocation of MBA program costs that were previously recovered through fees. The School's combined tuition and fees for fiscal 2018 were near the midpoint among the seven peer schools tracked by HBS.

Harvard Business Publishing

All three of HBP's market-facing groups delivered stronger-than-anticipated growth in fiscal 2018. Total revenue rose by $19 million, or nearly 9 percent, to $240 million, from $221 million a year earlier, exceeding the School's forecast by $16 million. International sales were up nearly 15 percent, comprising 36 percent of HBP's total annual revenues.

After three consecutive years of zero growth, *Harvard Business Review* (HBR) group sales were up nearly 6 percent from fiscal 2017, when the subscription model for HBR changed from 10 to 6 issues annually. The model continued to gain market traction in fiscal 2018. Paid circulation grew nearly 5 percent to 320,000—the highest since publication began more than a century ago—driven by increased renewals and subscriber engagement.

Corporate Learning sales for fiscal 2018 increased more than 15 percent from a year earlier. Extending its reach as a provider of technology-enabled leadership development solutions for global corporations, the group launched new versions of its flagship product, *Harvard ManageMentor®*, released innovative learning experiences for midlevel leaders, and substantially increased its global services business.

Higher Education sales were up 4 percent from fiscal 2017, driven by balanced performance across all product lines and channels. Leveraging its leadership position in participant-centered learning in business education, the group increased its market share among the world's top 250 MBA programs, launched a redesigned For Educators website, introduced eight simulations, and experimented with new audio cases and experiential learning products.

Executive Education

Executive Education tuition revenue increased by $16 million, or more than 8 percent, from fiscal 2017, to $207 million, exceeding the School's forecast by 10 percent. This growth was made possible by new and newly renovated facilities, including Tata Hall, Esteves Hall, and the Chao Center; together, they enabled HBS to increase total enrollment more than 6 percent to approximately 12,100 by offering an expanded range of higher-priced custom, focused, and global programs.

These included seven new focused programs in fiscal 2018. Additionally, the group continued to diversify its custom portfolio across industries and geographies, as well as program type and size, driving strong enrollment growth.

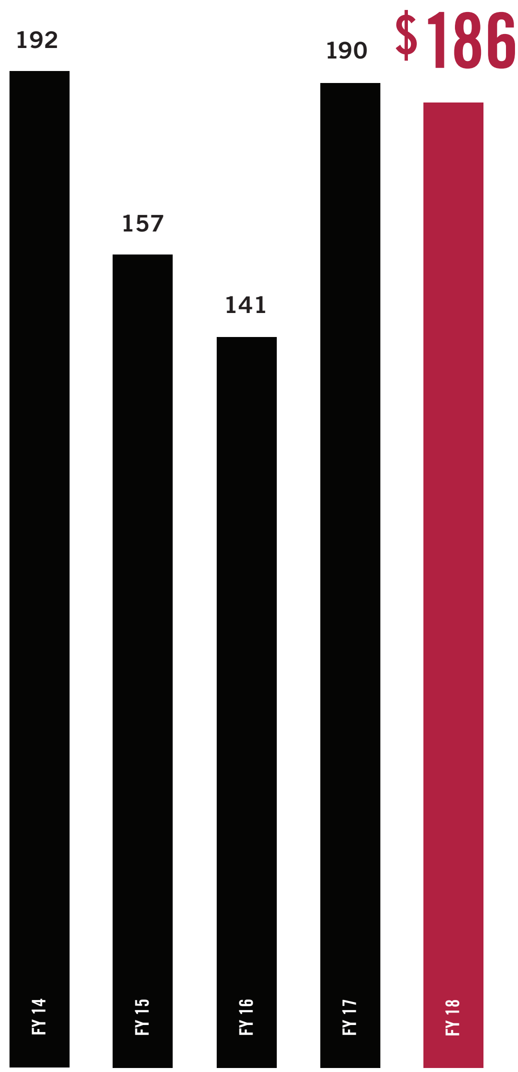
Global program tuition continued to grow as a percentage of total Executive Education revenue in fiscal 2018. This growth was largely driven by increased participation in longer modular programs that include time spent both in region and on the HBS campus. One such offering—the Senior Executive Leadership Program – Middle East—was the largest of the four global programs introduced by the group during the year.

Gifts & Endowment

Philanthropic revenue, including distribution from the endowment and current use gifts, has long been vital to sustaining the School's annual operations.

In fiscal 2018, total revenue from the School's three philanthropic sources—endowment distribution, unrestricted current use gifts, and restricted current use gifts—increased 4 percent to $229 million, from $220 million in fiscal 2017. This revenue amounted to nearly 27 percent of the School's total operating revenues, compared with 28 percent a year earlier. In contrast, for the University as a whole, philanthropic revenue for fiscal 2018 amounted to nearly 44 percent of total operating revenues.

The School's annual endowment distribution for fiscal 2018 increased nearly 3 percent from the prior year to $150 million, amounting to 17.5 percent of the School's



CASH RECEIVED FROM GIFTS (in millions) 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 fair market value withdrawn and distributed annually for operations and for one-time or time-limited strategic purposes. This rate applies to HBS and to all schools at Harvard.

Consistent with the long-term goal of preserving the value of the endowment in real terms and generating a predictable stream of available income, the University's targeted annual payout range is 5.0 to 5.5 percent of market value. The payout rate for fiscal 2018 met that target at 5.2 percent, compared with 5.4 percent for the prior year.

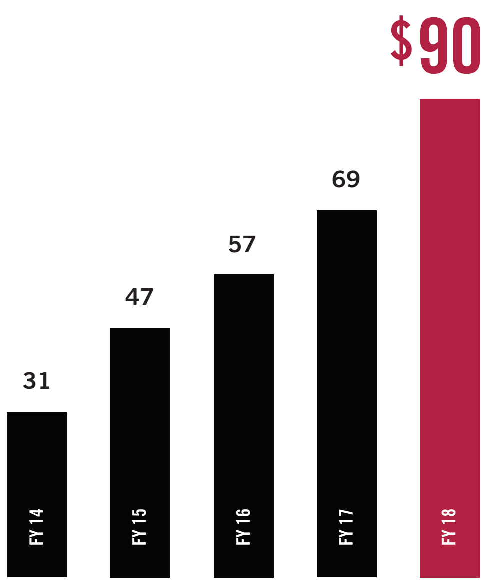
Over the past 10 years, the rate has fluctuated from a low of 4.8 percent in fiscal 2008 to a high of 6.1 percent in fiscal 2010. This variation exists because the dollar amount of the distribution for the next fiscal year is determined well in advance of the start of the fiscal year and prior to knowing the market value at the end of it. This practice is followed to allow the University's schools and units adequate time for financial planning.

The utilization of a payout formula means that the annual payout rate is generally lower following years of relatively high investment returns, and higher following years of lower investment returns. Adjustments can be made in succeeding years, keeping in mind the long-term payout goals of balancing budgetary stability with the preservation of the endowment's purchasing power. Each year the Harvard Corporation approves the final distribution amount.

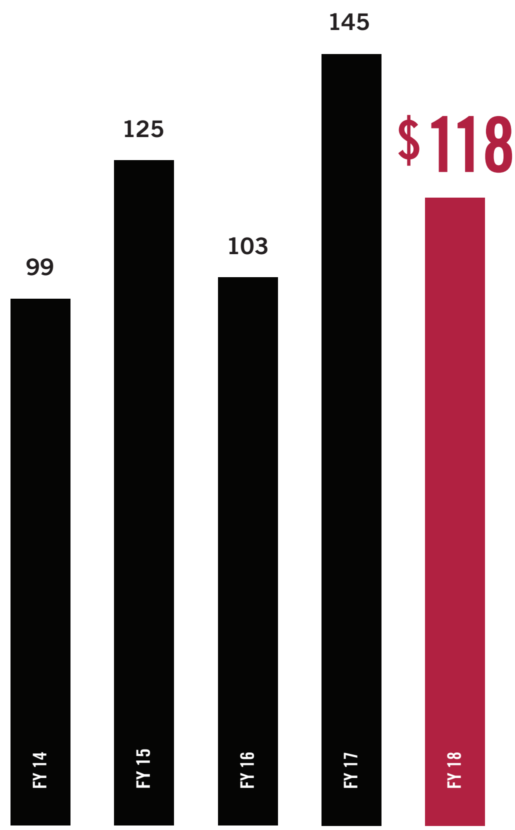
Funds within the HBS endowment, along with those of the other Harvard schools, are managed by Harvard Management Company (HMC), a nonprofit, wholly owned subsidiary of the University. HMC has managed the Harvard endowment portfolio since 1974. Its mission is to produce strong investment results to support the educational and research goals of the University.

HMC, as an organization, and the Harvard endowment portfolio are still in the early stages of a multiyear transition. The return on endowment assets for fiscal 2018, net of investment expenses and fees, was 10 percent—up from the 8.1 percent rate of return for the prior year, and the negative 2.0 percent return in fiscal 2016.

The value of the University endowment grew to $39.2 billion in fiscal 2018—an increase of 5.7 percent from $37.1 billion a year earlier. For the second consecutive year, the total value of the Harvard endowment exceeded the $36.9 billion reported at year-end fiscal 2008, just prior to the start of the financial crisis and recession. These values reflect net investment returns



CASH FROM OPERATIONS (in millions)



UNRESTRICTED RESERVES (in millions)

and cash gifts to the endowment received each year, net of the University's annual distributions and decapitalizations. The HBS endowment has comprised approximately 9 percent to 10 percent of the University endowment's total value over the past 10 years.

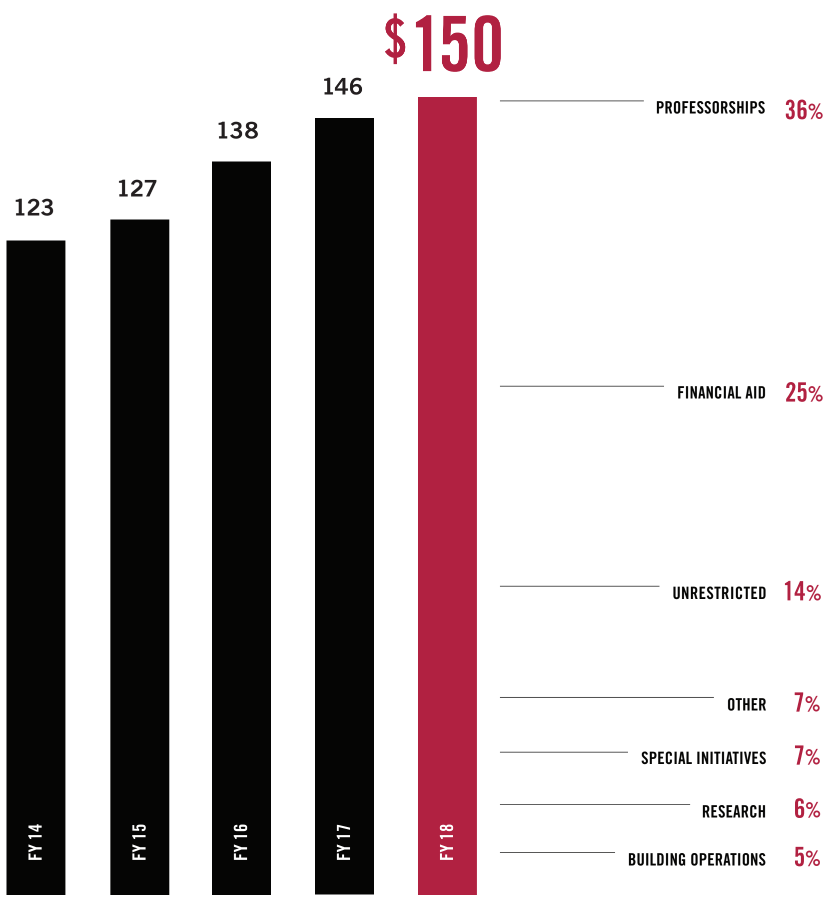
The fiscal 2018 year-end market value of the HBS endowment, plus the School's current use funds, was $3.8 billion at June 30, 2018, compared with $3.5 billion a year earlier. This increase reflected the 10 percent net growth in market value and the subtraction of the School's annual distribution and decapitalizations, offset by the $101 million in endowment gifts received by HBS during the year. The School received $85 million in endowment gifts in fiscal 2017.

Through The Harvard Business School Campaign, the HBS community continued to demonstrate extraordinary involvement and generosity, giving $214 million in new gifts and pledges to the School in fiscal 2018, the Campaign's final year. This compares with $233 million in fiscal 2017.

HBS received gifts from nearly 12,613 donors in fiscal 2018, including MBA, Doctoral, and Executive Education alumni, as well as friends of the School. As in the prior year, approximately 26 percent of the School's MBA alumni gave to HBS in fiscal 2018. Total cash received from gifts, including new endowment gifts and gifts for capital

Harvard Endowment Returns

FY 18	**10.0%**
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



ENDOWMENT DISTRIBUTION (in millions)

ENDOWMENT GROWTH (in billions)

construction projects, payments on prior years' pledges, and restricted and unrestricted current use giving, was $186 million, compared with $190 million in fiscal 2017.

Current use giving—both restricted and unrestricted—has become increasingly crucial in recent years as a source of funding for innovation across the School. Over the past five years, total giving in these categories has increased nearly 84 percent, from $43 million to $79 million, while fundraising expenses have increased at a slower rate. As a result, these gifts, which can be spent immediately, have had a significant impact on cash from operations and, therefore, the School's ability to capitalize on emerging strategic opportunities such as Field Immersion Experiences for Leadership Development (FIELD), the Harvard Innovation Labs ecosystem, and HBS Online. Going forward, sustaining the HBS community's remarkable commitment to current use giving will be instrumental in achieving the mission of the School.

Fiscal 2018 marked both the conclusion of the Campaign and the School's ninth consecutive year of growth in unrestricted current use giving. Revenue from these flexible gifts increased nearly 5 percent to $44 million, from $42 million in fiscal 2017. Restricted current use giving typically varies from year to year, in line with the School's changing fundraising priorities and strategic needs. Reflecting payments on pledges made by HBS alumni and friends in the early years of the Campaign, revenue from these restricted gifts increased more than 9 percent from fiscal 2017 to $35 million.

Cash giving to the endowment grew to $101 million, from $85 million in the prior year. Cash giving for construction projects decreased to $4 million, from $30 million. The results in both categories primarily reflect normal year-to-year variability in the timing of payments on pledges.

HBS Online

The HBS Online group made solid progress in fiscal 2018 on its multiyear path to joining Executive Education and HBP as a contributor to the School's earned revenue and income from operations. Revenue grew 58 percent to $19 million, from $12 million in fiscal 2017. Thanks to a continued focus on disciplined expense management, the group reduced its operating deficit to $5 million, from $11 million a year earlier.

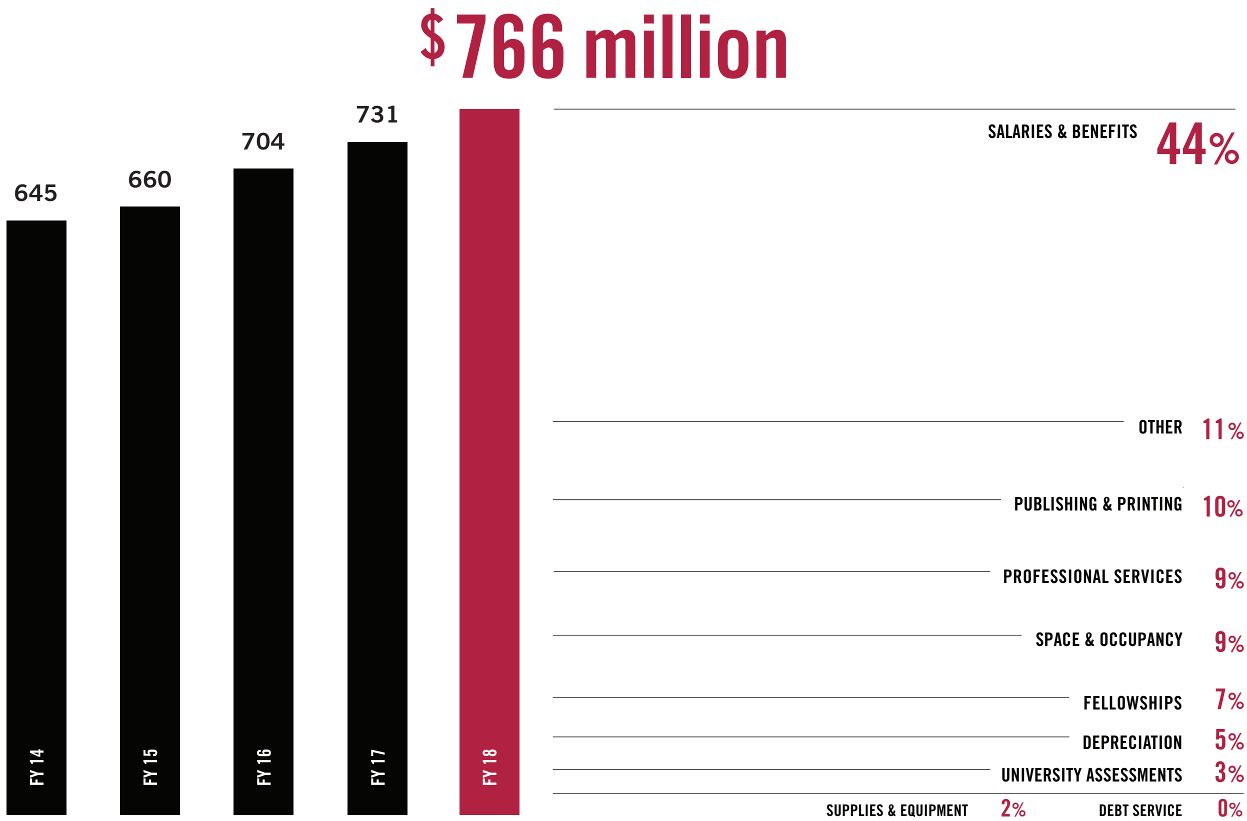
This year's revenue growth was driven by continued portfolio enhancement and expansion. HBS Online unbundled its flagship CORe program, offering each course as a stand-alone option. Additionally, the group added three new course offerings—Entrepreneurship, Becoming a Better Manager, and Sustainable Business Strategy—and leveraged sales resources at HBP and Executive Education to help them reach a wider audience.

To deepen HBS's engagement with the Harvard John A. Paulson School of Engineering and Applied Sciences, HBS Online launched the Harvard Business Analytics Program. Additionally, the group beta tested Leading Change—the first course in the Certificate in School Management and Leadership Program with the Harvard Graduate School of Education.

Finally, the HBX Live Studio, HBS Online's virtual classroom, hosted 101 synchronous sessions in fiscal 2018—a 63 percent increase year over year.

Housing, Rents, Interest Income, & Other

Total revenue of the Housing, Rents, and Other category for fiscal 2018 decreased by $1 million from the prior year to $21 million. Reflecting gradually increasing interest rates, the School reported interest income of $2 million, compared with $1 million in fiscal 2017.



EXPENSES

The School's total operating expenses for fiscal 2018 were $766 million, up by $35 million, or nearly 5 percent, from $731 million for fiscal 2017. The increase was primarily attributable to increased faculty research support, as well as spending aimed at positioning HBP, HBS Online, and Executive Education for future growth.

HBS faculty and staff worked together to offset these investments by continuing to operate in a lean manner, making tradeoffs when necessary to leverage maximum impact from available resources.

Although HBS characterizes its publishing, online 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, HBS Online, and Executive Education include direct costs for staff compensation, specialized outside professional services in information technology (IT) and other functional areas, marketing costs, and residence expenses for executive program participants.

HBP and Executive Education continued to deliver solid operating leverage on sales growth in fiscal 2018. Despite increases in compensation and other variable costs as revenues grew, as well as significant growth-focused investments at HBP, each group contributed more earned income to the School's fiscal 2018 operations than initially anticipated.

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. Research expense also includes direct costs for faculty support staff and travel, and for the School's network of global research centers.

Additionally, HBS allocates a portion of the costs associated with library resources, campus facilities, technology, and administration to this expense category. The School's total spending for faculty research support in fiscal 2018 increased by $8 million, or nearly 6 percent, from the prior year to $144 million.

Salaries & Benefits

Compensation for the faculty and administrative staff is the largest expense at HBS. The School's salaries and benefits expense for fiscal 2018 rose 4 percent to $340 million, from $327 million in fiscal 2017, and represented approximately 44 percent of total operating costs.

Upward pressures on the School's salaries and benefits expenses have intensified in recent years. Growing the faculty in an increasingly competitive marketplace is a priority for the School. Recruiting top talent to fill open staff positions is becoming more challenging as the employment market tightens.

Offsetting these pressures—as well as underlying inflation in employee compensation—is key to the School's cost-control strategy. Carefully managing the growth of the School's administrative staff is central to these efforts, including focusing staff headcount growth in functions that are strategically important. The School also works aggressively to control benefits expense through disciplined vendor selection and management.

As a result of these efforts, the increases in staff FTE positions and total compensation expense for fiscal 2018 both came in below the School's forecast. The total number of faculty, as measured in FTEs, can rise or fall in any given year, reflecting retirements, departures, and fluctuations in recruiting activity. Net of retirements and departures, the size of the HBS faculty decreased to 225 FTEs in fiscal 2018, from 233 FTEs a year earlier.

The School's administrative staff grew to a budgeted 1,721 FTEs in fiscal 2018, from 1,680 in the prior year. In large part, these new staff positions were focused on capitalizing on growth opportunities in HBP and HBS Online. Other positions were added to support the MBA program and assist faculty research efforts, including the Global Initiative and the Kraft Precision Medicine Accelerator.

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 commitment 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-term record of annual increases in financial aid, total fellowship expense for fiscal 2018, including assistance for MBA students, doctoral candidates, and a limited number of Executive Education participants, increased by $2 million, or more than 4 percent, to $50 million from fiscal 2017.

Approximately half of the School's MBA students currently receive fellowships, which cover an average of more than 50 percent of a student's total tuition. Average fellowship support per student increased 4 percent in fiscal 2018 to $38,959, from $37,312 in the prior year. Over the past five fiscal years, the School's average two-year MBA fellowship award has grown from $59,358 for the Class of 2014 to $80,000 for the Class of 2019.

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 $6 million in fiscal 2018.

Publishing & Printing

This expense category includes a portion of HBP's production costs, plus a small amount of spending related to the School's printed materials and publications. The production costs include, for example, *Harvard Business Review* printing expense, which increased in fiscal 2018 as circulation grew. These costs also include strategic investments in digital infrastructure and content, designed to extend the group's record of consistent growth in a dynamic and challenging publishing environment. The School's publishing and printing expenses for fiscal 2018 increased by $4 million, or nearly 6 percent, from the prior year, to $74 million.

Space & Occupancy

The HBS campus includes 35 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 for HBP, HBS Online, and 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 2018 grew by $3 million, or more than 4 percent, from the prior year to $71 million, driven primarily by growth in campus services personnel and associated compensation costs. This increase was partially offset by slower growth in energy-related utilities costs. The School's investments in facilities upgrades, renewal, and modernization over the past 10 years have substantially reduced its energy consumption, as well as its greenhouse gas emissions.

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 HBS Online, and compensation for faculty who teach Executive Education programs. The School's professional services expenses for fiscal 2018 rose by $5 million, or nearly 8 percent, from the prior year to $68 million.

This increase stemmed, in part, from the reclassification of certain costs from the supplies and equipment, and other expense categories. It also reflected higher Executive Education faculty compensation costs as more program weeks were offered. These increases were partially offset by successful expense control efforts at HBS Online.

IT has been a major contributor to higher fixed costs at HBS in recent years. Slowing the rate of growth in this expense category is one of the School's key financial objectives. Fiscal 2017 marked the conclusion of several strategically important IT projects, so technology project spending was down substantially in fiscal 2018. As a result, the School's total IT investment decreased by $3 million, or more than 3 percent, from fiscal 2017 to $82 million.

Nonetheless, fiscal 2018 was an active year for IT investment at HBS. The School rolled out a new post-Campaign alumni website, while also completing networking, audio, and video technology implementations at Klarman Hall. Mobile apps for MBA students were launched, and network security and desktop computing enhancements were implemented across the campus.

Supplies & Equipment and Other Expenses

Supplies and equipment expenses for fiscal 2018 were flat with the prior year at $12 million. Fiscal 2018 spending in the other expenses category, which includes items such as advertising, IT infrastructure maintenance, travel, and catering, increased by $7 million, or 9 percent, from fiscal 2017 to $82 million. These higher expenses were primarily driven by growth-related initiatives in Executive Education and HBS Online, as well as expanded programming at the i-Lab during the year.

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 may also make strategic use of debt financed through the University, as appropriate.

The HBS balance sheet historically has been only modestly leveraged, and debt leverage remained low in fiscal 2018. The School's total capital expenses increased to $92 million, from $78 million in the prior year. As in fiscal 2017, 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 2018.

As a result, the School's year-end fiscal 2018 building debt-to-asset ratio decreased to 1.1 percent, from 1.4 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 and retention incentive—increased by $1 million from fiscal 2017 to $27 million.

The School's debt service expense consists of interest payments to the University and is covered by using cash from operations. Fiscal 2018 debt service expense was $3 million, down by $1 million from the prior year. As in fiscal 2017, 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 2018.

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 2018 for these assessments was flat with the prior year at $24 million.

Depreciation

The School computes depreciation using the straight-line method over the estimated useful lives of the assets. Depreciation expense for fiscal 2018 increased by $2 million, or 5 percent, from the prior year to $42 million. This increase primarily reflected the School's larger asset base following the opening of the Chao Center and Life Lab in fiscal 2016 and 2017, respectively.

CASH BEFORE CAPITAL ACTIVITIES

The School's cash from operations increased in fiscal 2018 by $21 million from the prior year to $90 million. As in fiscal 2017, 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 as the Campaign concluded. In addition, depreciation is a non-cash item that added back $42 million to the School's cash flow in fiscal 2018, compared with $40 million in the prior year.

NET CAPITAL EXPENSES

The School's total capital investment increased to $92 million in fiscal 2018 from $78 million a year earlier. The increase was driven primarily by expanded construction activity at Klarman Hall, which HBS substantially completed during the year. Fiscal 2018 capital activity also included multiple smaller projects designed to preserve the value of the HBS campus for future generations by preventing deferred maintenance, reducing the School's environmental footprint, and enhancing sustainability. In addition to ongoing facilities renewal and maintenance, these projects included IT infrastructure and digital technology upgrades, as well as energy efficiency measures across the campus to meet the University's greenhouse gas reduction goals.

The School's net capital expenses for fiscal 2018 increased to $79 million, from $8 million a year earlier. In addition to higher capital spending, the increase was driven by planned declines in capital project prefunding and the timing of the receipt of cash gifts for capital projects. In contrast to fiscal 2017, when campus investments were primarily supported by capital gifts made early in the Campaign, the School's fiscal 2018 capital projects were largely funded with internally generated cash.

CHANGES IN DEBT & OTHER

The School's debt and other cash activities decreased by $80 million in fiscal 2018, compared with a decrease of $60 million in the prior year. This decrease was primarily driven by a transfer of $65 million in unrestricted cash to the HBS endowment, made possible by the School's strong operating surplus. HBS made a comparable \$50 million cash transfer to the endowment in fiscal 2017.

Because gifts, internally generated cash, and unrestricted reserves have been available and sufficient to finance capital activities, fiscal 2018 marked the School's 10th consecutive year with no new borrowings. Debt principal payments remained level with fiscal 2017 at \$8 million.

Capitalization of endowment income—or cash used to purchase endowment units—was a \$2 million use of cash in fiscal 2018, compared with \$4 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. As in fiscal 2017, decapitalization of endowment income—or cash drawn from endowment appreciation—was a \$3 million source of cash in fiscal 2018.

ENDING BALANCE, UNRESTRICTED RESERVES

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 the endowment is crucial in providing HBS with sufficient liquidity to finance ongoing campus renewal and expansion projects, and to capitalize on unforeseen strategic opportunities through economic cycles over the long term.

Driven by the School's continued healthy cash from operations, fiscal 2018 was a successful year in this regard. After the \$71 million year-over-year increase in net capital expenses, as well as the \$65 million of unrestricted, internally generated cash transferred to the endowment, HBS concluded fiscal 2018 with an unrestricted current use reserves balance of \$118 million, compared with \$145 million in fiscal 2017. This level is substantially above the \$100 million in unrestricted reserves established by HBS as its current liquidity management target.

FIVE-YEAR SUMMARY

FOR THE FISCAL YEAR ENDED JUNE 30,

Financial Data (in millions)	2018	2017	2016	2015	2014
Revenues	**$ 856**	$ 800	$ 761	$ 707	$ 676
Expenses	**766**	731	704	660	645
Cash from Operations	**90**	69	57	47	31
Capital Investments	**92**	78	113	81	92
Building Debt Outstanding	**55**	64	71	78	85
Unrestricted Reserves	**118**	145	103	125	99
Endowment	**3,787**	3,472	3,209	3,309	3,210
Total Assets	**$ 5,208**	$ 4,821	$4,508	$ 4,587	$ 4,409
MBA Program					
Applications	**9,886**	10,351	9,759	9,686	9,543
Percent Admitted	**11%**	11%	11%	11%	12%
Yield	**91%**	91%	90%	91%	89%
Enrollment	**1,870**	1,879	1,883	1,865	1,859
Tuition	**$ 72,000**	$ 63,675	$ 61,225	$ 58,875	$ 56,175
Average Fellowship Aid per Student	**$ 38,959**	$ 37,312	$ 35,571	$ 32,919	$ 31,710
Doctoral Programs					
Applications	**864**	915	843	749	792
Percent Admitted	**4%**	4%	5%	4%	4%
Yield	**64%**	79%	66%	53%	76%
Enrollment	**134**	132	134	147	150
Executive Education					
Enrollment	**12,070**	11,361	10,855	10,614	9,993
HBS Online					
Participants	**11,995**	8,665	6,431	3,899	670
Faculty					
Faculty Positions (full-time equivalents)	**225**	233	233	231	234
Teaching Materials	**642**	573	566	544	617
Research Articles on HBR.org	**199**	182	174	197	195
Books	**11**	14	23	13	18
Staff					
Staff Positions (full-time equivalents)	**1,721**	1,680	1,631	1,541	1,447
Publishing					
Cases Sold	**15,062,000**	14,859,000	13,468,000	13,223,000	11,992,000
Harvard ManageMentor® Active Users	**2,430,000**	3,200,000	3,478,000	2,709,000	2,987,000
HBR.org Average Monthly Visitors	**7,153,000**	7,012,000	5,511,000	4,629,000	3,656,000

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.

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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