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## Investment Advice: Go for the MBA

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# Investment Advice: **GO** for the **MBA**

**New data based on GMAC surveys suggest that the MBA offers a significant return on investment for nearly all students at nearly all schools.**

**by Brooks C. Holtom and Edward J. Inderrieden**

**B**usiness school deans have been rushing to the defense of their graduate degree programs ever since Jeffrey Pfeffer and Christina Fong published their 2002 article questioning the value of an MBA. Not only did those authors debate the worth of the MBA in general, they suggested that the degree was only valuable if it was earned from a top-ranked school.

A recent U.S.-based study shows this is clearly not the case. Researchers employed by the Graduate Management Admission Council (GMAC) surveyed thousands of graduates over the course of five years, collecting data that compared the costs and rewards of accredited programs across the U.S. Analysis shows that an MBA yields an excellent return on investment (ROI) for nearly everyone, regardless of the type of program, the race of the student—or even the ranking of the school. Pfeffer himself believes management education has undergone significant changes since his original article was published. (See his viewpoint regarding business schools' possible overemphasis on MBA salaries in "What's Right—and Still Wrong—with Business Schools" on page 42.) One thing that hasn't changed is the enduring value of an MBA.

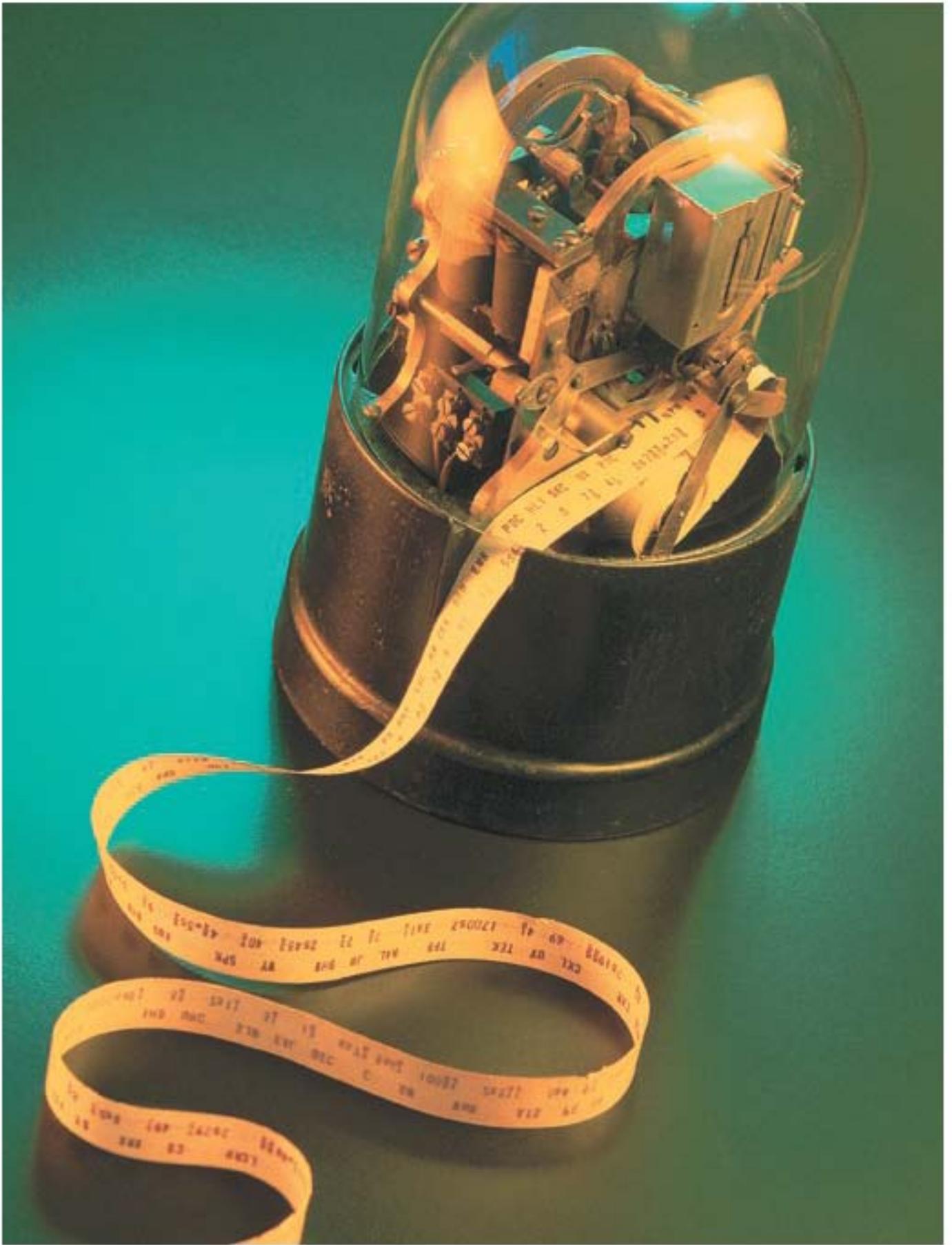
## **Key Findings**

One of the most striking findings from the GMAC data shows that students who attend lower-ranking schools experience a better ROI than those who attend higher-ranking schools. More precisely, the ten-year annualized average ROI for students from a top ten school is 12 percent; for those outside the top ten, it's 18 percent. Students who attend a top 50 school experience a mean return on investment of 17 percent; those who attend a school ranked outside the top 50 have an ROI of 20 percent.

Why the impressive rate of return? It's all about the expense. A highly ranked school costs significantly more than schools with lower rankings. The mean total cost of attending a school in the top ten is just over \$198,300, compared to about \$123,700 for other schools. Yet the MBA confers so many benefits to graduates of schools across the board that they can take better jobs, earn more money, and quickly recoup the costs of their investments in their degrees.

Unquestionably, there are still advantages to attending a top ten school, particularly over the long haul. Students who graduate from those programs are hired at better base salaries—earning a mean of \$96,400, compared to \$79,700 for graduates from schools outside the top ten. In addition, top ten graduates most likely will continue to receive higher pay increases and bonuses as their careers progress, keeping them well ahead of their peers from lower-ranked schools. While they have paid a higher price for their top ten degree, the net value of their investment over time will be higher.

Although the salary bump for students who attend top ten schools is also more—a mean salary increase of about \$34,500, which works out to 56 per-





cent—students at lower-ranked schools do pretty well, too. Their average salary increase is a very respectable \$28,100, which represents a 54 percent increase. When that increase is compared to the substantially lower costs of enrollment, it's no wonder their ROI is so high.

In short, the study is good news for nearly all schools because it means they can honestly proclaim that the MBA provides great value for their graduates. Some schools already are producing their own cost and benefit data to show alumni and other stakeholders that their program compares favorably with other schools across the nation.

### Program by Program

The GMAC study didn't just compare the return on investment for schools grouped by ranking. It also examined the relative value of full-time, part-time, and executive MBAs. The data show that students who receive MBAs through a part-time program experience an annualized ROI of 68 per-

cent, while students in executive MBA programs have an annualized ROI of 35 percent. Full-time students lag behind with a 15 percent ROI.

To some extent, these numbers, while accurate, are misleading. Executives and part-time MBA students don't have to

quit their jobs to pursue their degrees; the cost of forgone salary is the largest driver in the equation for ROI on the full-time MBA. And while full-time students give up that salary for two years, they're rewarded at the end of the program with a generally higher salary—a mean increase of 59 percent.

At the same time, part-time students are faring quite well, too. While their percentage increase is modest, the paycheck they're actually taking home is slightly higher than that of the full-time MBA—\$78,280, compared to \$78,220. This can be largely explained by the fact that part-time students tend to be older than their full-time counterparts; they're already earning good salaries that are enhanced by an MBA. That's also true for those seeking executive MBAs.

No matter what the reason, such strong numbers for part-time programs should be welcomed by deans who are

### The Value of an MBA

	Mean ROI	Increase in salary	Total cost	Percent salary increase	Post MBA base salary
Top Ten	12%	\$34,485	\$198,321	56%	\$96,420
Non Top Ten	18%	\$28,084	\$123,712	54%	\$79,703
Top Fifty	17%	\$30,718	\$141,717	58%	\$83,736
Non Top Fifty	20%	\$22,768	\$ 95,777	45%	\$73,448

**Virtually everyone who earns an MBA degree sees a measurable return on investment, but that ROI is even higher for students who attend programs outside of the top-ranked schools.**

### Program Differences

	ROI	Payback period (in years)	Percent increase in salary	Post-MBA base salary
Full-Time Program	15%	5.1	59%	\$78,221
Part-Time Program	68%	1.6	37%	\$78,287
Executive Program	35%	2.8	17%	\$91,026

**While students who graduate from full-time programs experience a solid return on their investment in their MBAs, students in part-time and executive MBA programs see an even more dramatic ROI. In addition, salaries for those who graduate from part-time programs are on average higher than those for people who graduate from full-time programs.**

## The social network created by an MBA is essential not just for minorities but for individuals who want to switch careers.

seeing their full-time applications fall while their evening and weekend programs grow. Not only is the total pool of MBA applicants expanding, but those in part-time and executive programs are seeing positive results from their investment in education. Schools can continue to promote their part-time programs in good conscience.

### The Ethnic Equation

An MBA offers a satisfactory return on investment for every race, but it's particularly good for Asian Americans. As a whole, they have the highest increase in salary of any group graduating from an MBA program and the largest average post-MBA salary.

While the ROI figures aren't as high for African American MBA students, those students score well on other, less tangible factors, like contacts in new industries. The GMAC survey asked respondents to rate their satisfaction with their degrees according to nine measures, one of them being the opportunity to network and form relationships of long-term value—i.e., improve their social capital. This social capital helps people find jobs and get promoted.

Most MBA programs offer opportunities to develop social capital to all students in their programs, but that capital appears to be particularly beneficial to students of color. Those students rate their satisfaction with opportunities to network and form relationships with long-term value higher than their Caucasian counterparts do. Sociological literature indicates that people of color tend to have close-knit but relatively small social networks composed of people similar to themselves. While these networks might be highly supportive, they are less likely to include a broad range of people who can help group members obtain top jobs.

By contrast, students of color who earn MBA degrees expand their social networks to include professors with con-

sulting connections, friends who work in financial services firms, and alumni at Fortune 500 companies. They also gain access to career services offices that can help them make personal connections with professionals at top firms.

The social network created by an MBA is essential not just for minorities but for individuals who want to switch careers. As these students earn their degrees, they tap into a second network that can help them achieve success in their new fields. There is extensive evidence to show that an MBA degree creates considerable opportunities.

### Taking a Step Back

While an MBA has the potential to benefit most students, the study results show that approximately 10 percent of those who earn the degree do not experience a salary increase. The reasons are varied and apply to a very small number, but it's important to understand why these cases exist.

Some graduates who do not see an uptick in salary are international students who move from well-paying jobs in the U.S. back to their countries of origin. There they take private sector or government positions that are prestigious and comfortable in their countries but might not pay well when compared to U.S. salaries. Since the cost of living varies between countries, these graduates could very well be living better on less money.

Other students who see pay cuts are often individuals who leave high-paying but personally unfulfilling careers in fields such as engineering or medicine. For instance, an engineer who is making \$85,000 a year might decide over time that she really wants a career in marketing; post-graduation, her new MBA nets her \$5,000 less in income, but if she is doing something she loves, then she is likely to be happier overall. In addition, the degree puts her on a trajectory for management positions in the future, so the chances are good she will recover that lost income.

Similarly, an M.D. might want his MBA so he can lead a health-care institution. His first job running a clinic offers him compensation that's less than what he earned as a doctor, but he enjoys the work more and has a broader impact.

The drop in salary comes almost exclusively from people who have earned their MBAs in full-time programs. For the most part, that's because participants in part-time and executive MBA programs tend not to be career switchers. They want better positions within their own companies or their current industries; but to get those jobs, they need to develop better business skills. In addition, many executive MBAs have their tuition paid by their firms, so they have a commitment to remain at those firms, at least for a specified period of time.

### Demographic Differentials

	ROI	Increase in salary post-MBA
Asian Americans	14%	55%
African Americans	15%	38%
Caucasians	16%	46%
Hispanics	12%	47%

**Students of every race benefit from obtaining an MBA, but benefits are particularly strong for Asian Americans.**

## An MBA can nullify the institutional effect of the first salary an individual earns after obtaining a bachelor's degree.

### Satisfaction with MBA Program

Preparation to get a good job in the business world	2.00
An increase in career options	1.70
Desirable credentials	1.74
Opportunity for personal improvement	1.59
Opportunity for quicker advancement	1.86
Development of management knowledge/ technical skills	1.74
An increase in earning power	1.90
Opportunity to network and to form relationships with long-term value	1.96
Increase in work-environment flexibility	2.04

Survey respondents rated their satisfaction with their MBA degrees on nine specific measures, with 1 being extremely satisfied and 5 being not at all satisfied. While students give excellent marks to the practical training they receive in MBA programs, they also give high ratings to areas that revolve around developing social relationships and expanding networks of business contacts.

### Methodology

Student data were collected primarily through two longitudinal surveys conducted by the Graduate Management Admission Council and sent to students of AACSB-accredited schools between 2001 and 2004. Thousands of responses were gathered and used to collect the data. Rankings were obtained from the 2004 *U.S. News & World Report* Business School Report. Tuition and fee data came from Barron's Report 2004.

ROI figures were calculated conservatively: We estimated ROI over a ten-year period, although graduates are highly likely to continue earning value for their MBA degrees over a much longer period of time. In addition, we used only base salary in our calculations, excluding profit-sharing contributions, stock options, and bonuses.

To determine the cost of earning an MBA, we first took the published data for each school's tuition and fees. Then, for full-time students, we added the pre-MBA salaries reported by respondents across two years and added in the average salary increase in the U.S. for the second year. The ten-year gain from an MBA was calculated before taxes and is adjusted for the time value of money. The payback period calculation simply divides total costs by the salary increase and does not adjust for the time value of money.

### Final Thoughts

At first glance, it might seem like all these data paint a rosy picture for every form of graduate business education except the full-time MBA. But there's no cause for alarm for schools that rely heavily on traditional two-year programs. It's still true that graduates from full-time programs dramatically increase their salaries, and those higher salaries serve as the base that defines their earnings power for the rest of their careers.

In fact, a paper published by Stanford University economist Paul Oyer finds that an individual's salary at his first job has a strong impact on lifetime career earnings. Many companies request salary history data before making a job offer, so a candidate's wage at a new firm is often predicated on past salary. This trend is so powerful that when people graduate and take jobs during a recessionary economy, they may never quite catch up. Thus, the amount of money that MBAs make at their first post-graduate position can influence the money they will make the rest of their lives.

That's the argument in favor of both full-time programs and top ten programs. But a stronger argument prevails for the MBA in general, whether it's obtained from an elite program or a merely good one. An MBA can nullify the institutional effect of the first salary an individual earns after obtaining a bachelor's degree, especially in lower-paying social sciences fields. Once people graduate with their MBAs in hand, they jump into a new labor market. The salary game begins all over, but this time they have a new benchmark.

Education provides a wide range of opportunities, and it helps to level the playing field. It doesn't perfectly level the field—there will always be people who are able to obtain excellent undergraduate educations, who can afford GMAT preparation courses, or who are genetically blessed. But no matter where an individual is starting from, an MBA degree confers a distinct advantage. Management educators have long believed this to be true, but now there's data that show an MBA is worth the investment. 

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