Why Evaluate MBA ROI in Terms of Human Capital

The MBA’s return on investment (ROI) is decidedly positive, but human capital is the MBA’s most precious asset. Investing in education is an investment in one’s future. Anyone can tell you that. But aren’t all investments supposed to net a gain in the future? Put away a certain amount of money now and grab a larger sum later. It’s a no-brainer. However, to truly understand how an MBA can impact one’s financial wellbeing, it is crucial to look beyond numbers, and into the non-materialistic realm of soft skills, networking, and most importantly – human capital.

Money talks

Before moving on to the more abstract nuances of the MBA’s value, it is worth taking a look at some numbers. A simple question must be answered. What is the MBA’s return on investment (ROI)? The formula is simple enough. ROI equals the gains minus the costs divided by the costs again, and multiplied by 100 (in order to get the percentage).

According to a report by the Graduate Management Admissions Council (GMAC) from 2016, the median MBA ROI within the first three years after graduation is 37%. It climbs to 132% in five years, and a staggering 445% within a decade. But how do they come up with these numbers?

Let’s take INSEAD, the number one school in the Financial Times’ (FT) Global MBA rankings for 2016. Its full-time MBA programme costs 87,436 EUR. The average salary of INSEAD alumni three years after graduation is 166,168 EUR. Crunching the numbers gives us an ROI of 90%.

However, this does not include a couple of crucial parameters – living expenses and opportunity costs. The former can be rather varied – a man can live very frugally, or like a king. It depends mainly on fiscal prowess, but also on personal preference and lifestyle. The latter refers to the amount of money a full-time MBA student will lose over the course of their studies by virtue of not working and it’s rather easy to calculate.

For the sake of argument, let’s assume that a year at INSEAD’s campus in Fontainebleau, southeast of Paris, will cost an average of 1,500 EUR per month. This is calculated by taking numbers from the crowdsourcing website numbeo.com, so it’s a fair indicator of a moderate to average lifestyle outside the capital. Living expenses for one year total 18,000 EUR.

Moving on to opportunity costs, let’s take the current average salary of an INSEAD alumnus (166,168 EUR) once more and divide it by the salary increase (96%, according to the FT) to find out what the average INSEAD graduate’s salary was prior to joining the programme. It’s 84,779 EUR.

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Now let’s add these numbers to the programme fee to get a more grounded picture of what the cost in the ROI equation will be. The total cost of the investment comes out at 190,242 EUR.

So with a 166,168 EUR annual salary today, which is an 81,389 EUR increase over the pre-MBA salary, an MBA graduate would be able to refund the entire cost in two years and four months. This means that the ROI is 35% in the two years and four months of repaying the investment, and 96% (pre-post salary differential) every year after that.

Of course, this is only one school, and only one set of numbers, and it is imperative that everyone makes this kind of calculation for themselves, depending on their personal choice of school and the statistics, widely available on the Internet. But, just to be sure that the numbers will always be on the side of the MBA graduate, it is also vital to note that the average salary increase following an MBA degree from one of the top 100 b-schools in the world is 97%. This means that once “the debt is repaid”, as any George R. R. Martin’s Lannister family member would say, the net gain of an MBA degree would always be twofold.
Speak softly and carry a calculated smile

While the MBA’s ROI is a simple mathematical computation, the true power of the MBA lies in its many intangible rewards.

One of these benefits is networking. The UK’s Independent newspaper is categorical in its assessment of networking, claiming that “what business schools do so well is to put students in front of powerful contacts”:

“Schools encourage students to invite alumni for ‘coffee chats’, attend industry specific events and capitalise on contacts through projects and internships”.

“It’s about positioning yourself to be at your most interesting and finding people who will be interesting to you,” says Cana Witt, MBA careers advisor at Lancaster University Management School.

The importance of networking is well understood by prospective MBA students. According to GMAC’s 2016 Prospective Students Survey, the enhanced networking possibilities are one of the prime motivations for MBA candidates to enrol in graduate school, along with career change and entrepreneurship.

Check out: MBA’s Hard Power

Crucially, none of this is possible without “soft skills” – another critical advantage of the MBA. In fact, soft skills are the centrepiece of graduate business education, since they incorporate the managerial expertise that has come to be expected of the MBA degree. Deliberate communication, business leadership, processes awareness, strategic vision, a results-focused paradigm and empathetic attitude: all of these skills are invaluable to managers, and together they shape the MBA’s intangible ROI.

“It’s not just experience and technical expertise employers seek. They also look for professionals with outstanding non-technical or soft skills,” says Bill Driscoll, a regional president at Robert Half International, as quoted by BusinessBecause.

“Companies need staff who are leaders, excellent communicators, and [are] able to align their business units’ goals with the firm’s big-picture objectives,” according to Driscoll.

Human capital

There is another term for this collection of abilities – human capital – and along with the new term, come new dimensions of ROI. Few would expect to be able to put something that sounds as abstract as human capital to quantitative scrutiny, but it is possible.

First, let us agree on a definition of human capital. Gary Becker, an economist and founder of the concept, describes it as the sum of knowledge, habits, social and personality attributes, which allows an individual to produce economic value through their labour. Simply put, human capital is the collection of soft and hard skills and attributes, which makes an individual an economic asset, both in and of themselves, and collectively as part of the economic unit that they belong to, whether that is a company, or a nation.

Essentially, human capital is a resource that every individual possesses, and as such, it can be evaluated. Gregg Fisher, an investment adviser and Forbes contributor, refers to a model, which suggests that people exhaust human capital in order to earn financial capital.

Credit: Forbes

“We can define human capital as the present value of your future labour income, or lifetime earning power,” says Fisher, “Over the course of your career, you effectively convert human capital into financial capital […] Thus, the young accumulator is rich in human capital but probably less so in financial capital.”

Professionals of 29-31 years of age contemplating doing an MBA are at the genesis of their lifetime’s earning potential. By investing in graduate business education, they increase their human capital immensely, which allows them to net an exponentially larger profit over a lifetime. Financial investments at this point of life might seem overwhelming, but in truth, they are rather inconsequential, as the lack of overall fiscal capacity means that the basis is too low to be of significant risk. However, a refusal to invest in human capital will mean that the financial capital accumulated over a lifetime will be markedly smaller, because the lack of human capital will not allow for greater earnings.
An MBA degree is unique among its peers in its ability to deliver human capital by incorporating every bit of Becker’s definition. Knowledge, habits, social and personality attributes come together to generate a resource, which can be absorbed, transformed and constantly reinvested to earn more. And while the financial ROI is undoubtedly favourable, it is this lifetime supply of exponentially higher earning potential that makes an MBA a truly intelligent investment.

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