



Some critics claim a master's degree in business has little job-market value. But crunching the numbers reveals substantial long-term benefits to graduates with an MBA.

The darling degree of the 1990s was the MBA, which has been described as the ultimate business credential. Yet the debate regarding the value of the MBA has never been more contentious. Some critics argue that the luster of the degree has been tarnished by an oversupply of MBAs, excessive tuition at top-20 schools, an uncertain economy, and corporate misconduct. Others use anecdotal evidence to declare that an MBA has very little effect on a graduate's subsequent salary or career.

However, a macroeconomic analysis of the value of an MBA earned in the U.S. proves these critics wrong. This analysis doesn't compare MBAs to high-powered groups working as consultants, or to CEOs without professional educations. Instead, it simply attempts to show whether or not average, plain-vanilla MBAs can expect to fare better or worse than average college graduates over the entire course of their careers.

by Antony Davies
and Thomas W. Cline

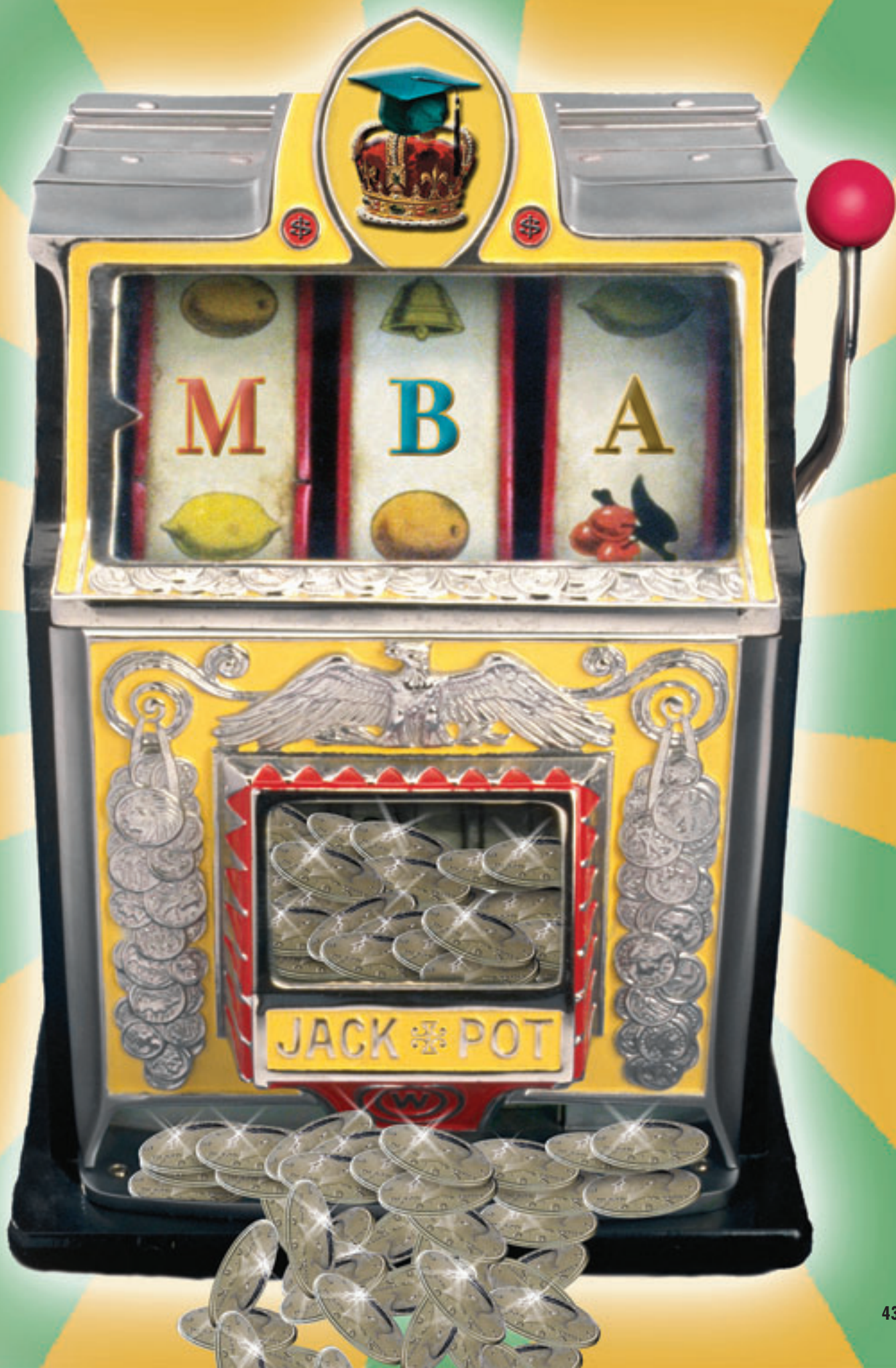
illustration by Lou Beach

Deconstructing the Benefits

Four economic benefits are linked to obtaining an MBA degree: a higher starting salary, greater compensation growth, more stable long-term employment, and a higher likelihood of participating in the workforce.

Starting salaries. In 2002, the median full-time MBA student earned \$50,000 before obtaining an MBA, according to The Graduate Management Admission Council's "The 2003 Global MBA Graduate Study." Immediately after completing the MBA program, that same student expected to earn \$75,000, excluding signing bonus.

Compensation growth. Since 1993, the expected annual wage growth for workers with professional degrees, including MBAs, has exceeded inflation by more than two percent. Those figures are provided by the Statistical Abstracts of the United States for the years between 1995 and 2003, which covers average annual wages for those with BS, BA, and professional degrees.



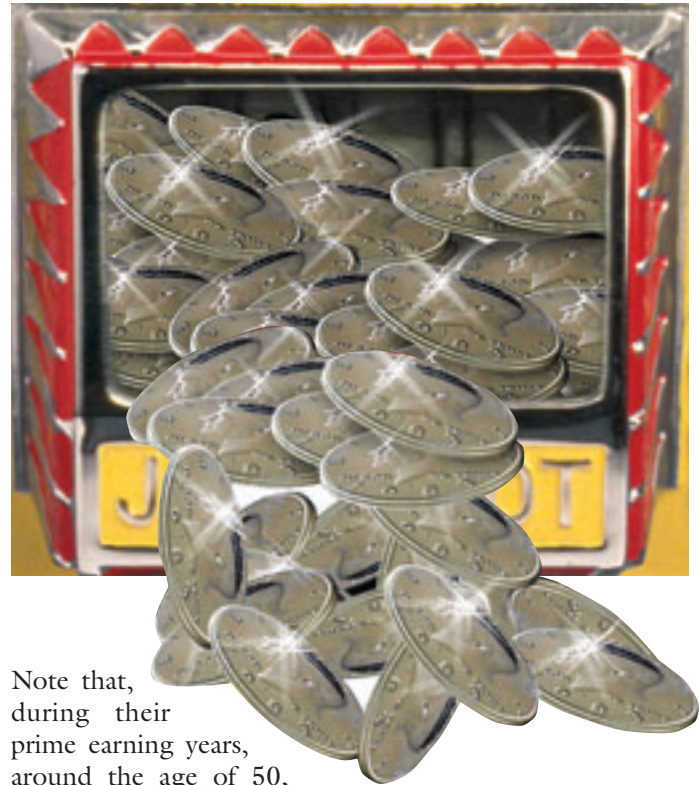
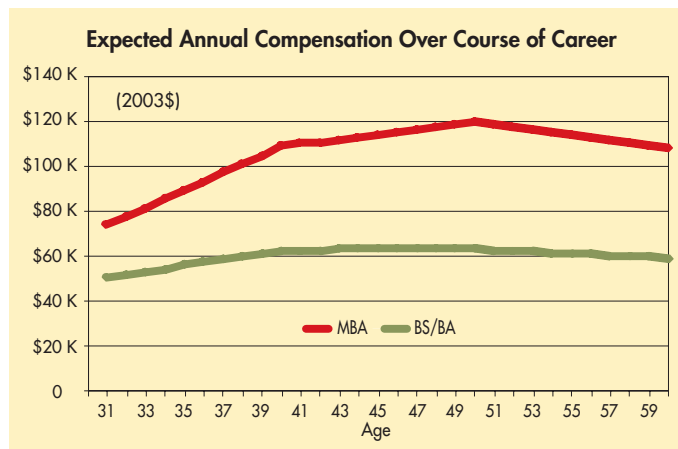
By comparison, the expected annual wage growth for workers with only undergraduate degrees has averaged just one percent more than inflation. Because of this difference in growth rates, the expected annual earnings gap between those with undergraduate degrees and those with MBAs should more than double—in real terms—over the course of their respective careers.

Long-term unemployment. Since 1970, graduates with professional degrees have experienced unemployment rates that are 25 percent less than those with undergraduate degrees, according to the Statistical Abstracts of the United States. Unemployment rates were 1.9 percent and 2.4 percent, respectively.

Likelihood of participating in the workforce. To be considered a workforce participant, an individual either must be employed or actively seeking a job. Between 1970 and 2001, 81 percent of those with professional degrees were workforce participants. By comparison, only 78 percent of those with undergraduate degrees fell into that category. Again, figures are drawn from U.S. Statistical Abstracts.

When all measures of salary and employment are considered, the value of an MBA can be quantified. Graduates with MBA degrees clearly fare better than those who have only earned BS or BA degrees.

Combining these four economic benefits makes it possible to measure the *earnings gap*, or the difference between the lifelong earnings potential of the average college graduate and a graduate with an MBA. Figure 1 shows the typical annual compensations that graduates with MBAs and bachelor’s degrees can expect to earn during their careers. Salaries are calculated from age 31 onward, as the majority of MBA students are between 28 and 34 years of age. Figures have been adjusted for the likelihood of unemployment and labor participation.



Note that, during their prime earning years, around the age of 50, those with MBAs earn about \$120,000 annually. That’s roughly twice the amount earned by their counterparts with bachelor’s degrees.

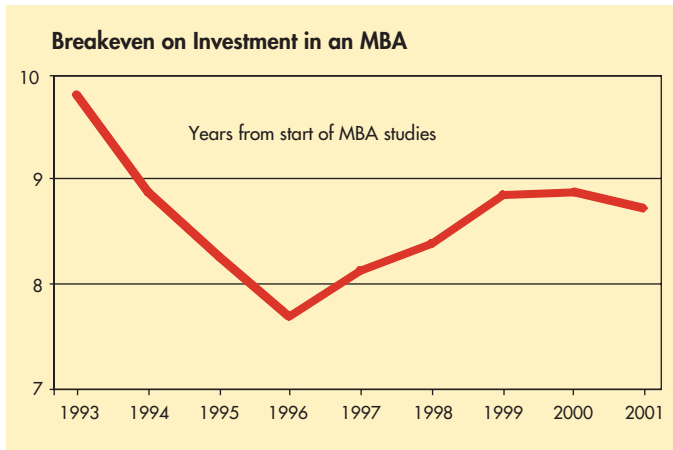
Evaluating the Investment

Any investment can be evaluated by three measures: the breakeven point, the internal rate of return, and the net present value. The *breakeven point* represents the number of years it takes for the income from an investment to pay for the investment. The *internal rate of return* is the effective interest yield that results from the investment. *Net present value* is the amount of cash-in-hand today that, if invested at current interest rates, would yield a stream of payments identical to the income generated by the investment. If we use these three measures to judge an MBA from an AACSB-accredited school, we find that the average MBA degree is an extraordinary investment—even better than it was ten years ago.

Breakeven point. In 1993, a 31-year-old who had earned a full-time MBA had invested an estimated \$124,000 in the degree—\$15,000 in tuition, plus \$109,000 in lost compensation—according to the *Annual Survey of Colleges* produced by The College Board. He could expect to pay that off in 9.8 years.

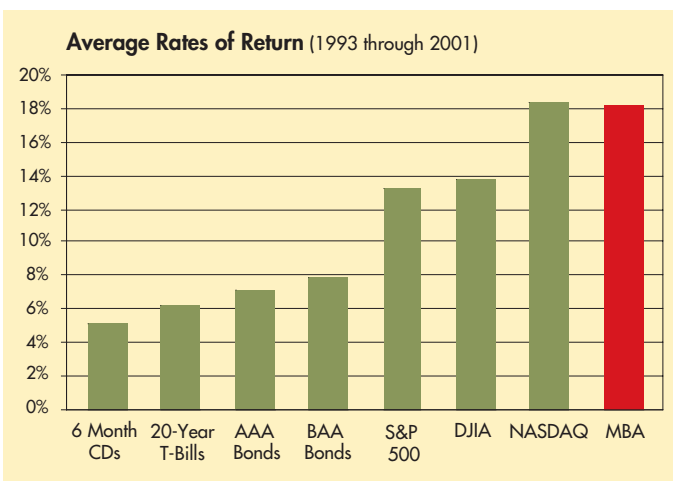
By 2001, however, the cost of the MBA had increased to \$162,000, including \$23,000 in tuition plus \$139,000 in lost wages. Nevertheless, the graduate with an MBA now could expect to earn more money more quickly, enabling him to pay off his higher debt in less time—8.7 years. Figure 2 shows that the breakeven point is getting shorter, not longer, despite rising tuition costs.

Getting a plain-vanilla MBA today is like receiving a tax-free, cash award of more than a half million dollars.

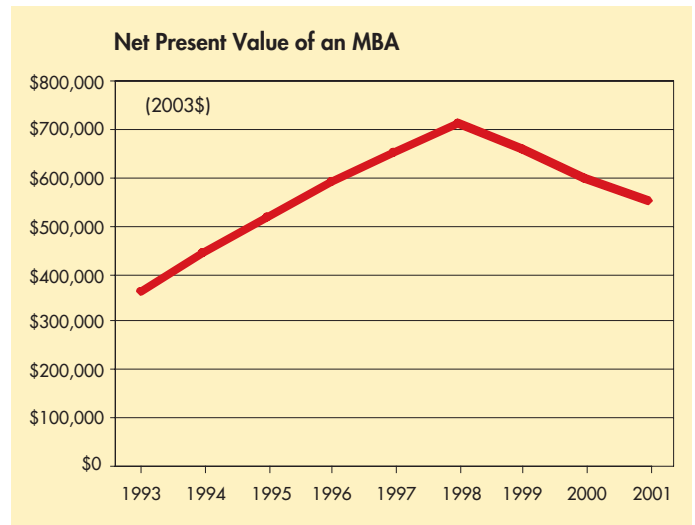


Internal Rate of Return: In 1993, the average full-time MBA student could expect that, over the course of his career, his \$124,000 investment in an MBA would yield total increased compensation of \$745,000 (in 1993 dollars). That's the equivalent of a real rate of return of 15 percent—i.e., 15 percent more than inflation. By 2001, however, the average student investing \$162,000 in an MBA could expect total increased earnings of \$1.4 million (in 2001 dollars) over the course of a career. That works out to a 17.6 percent real rate of return, or 2.6 percent more than in 1993. And this was despite a 50 percent increase in tuition.

In short, over the past decade, an MBA's average ROI has been three times the return on Treasury Bills, ten percent better than triple-A bonds, and four percent greater than the Dow Jones Industrial Average (DJIA). From 1993 through 2001, as Figure 3 shows, only the NASDAQ provided a return on investment equal to that of the plain-vanilla MBA.



Net Present Value: To determine net present value for an MBA, look at how much it will cost a candidate in tuition and lost compensation, and subtract that figure from what the degree holder expects in increased salary over time. In 1993, a 28-year-old could determine that the probable cash-in-hand value of her MBA was \$360,000. Put another way, suppose two identical 28-year-old college graduates were contemplating their futures in 1993. One of them was given \$360,000 and entered the job market; the other started with nothing and had to pay for her own MBA. By the end of their careers, the two would be equally well-off financially. Figure 4 shows that, by 2001, the cash-in-hand value of an MBA had increased significantly, to \$550,000.



Clearly, not all MBAs attain greater compensation and career benefits than their counterparts with bachelor's degrees. Still, it's even clearer that the "average" MBA fares spectacularly better than the "average" college graduate. Getting a plain-vanilla MBA today is like receiving a tax-free, cash award of more than a half million dollars.

No wonder 100,000 students are currently seeking master's degrees in business. Perhaps, unlike the critics, these candidates have done the math to determine what very real rewards they can reap by investing in their MBAs. **Z**

Antony Davies is a Research Fellow at the Mercatus Center, George Mason University, Capitol Hill Campus, and assistant professor of economics at Duquesne University in Pittsburgh, Pennsylvania. Thomas W. Cline is an associate professor at Saint Vincent College in Latrobe, Pennsylvania. This article is adapted from a lecture given to policymakers at the U.S. House of Representatives in March.