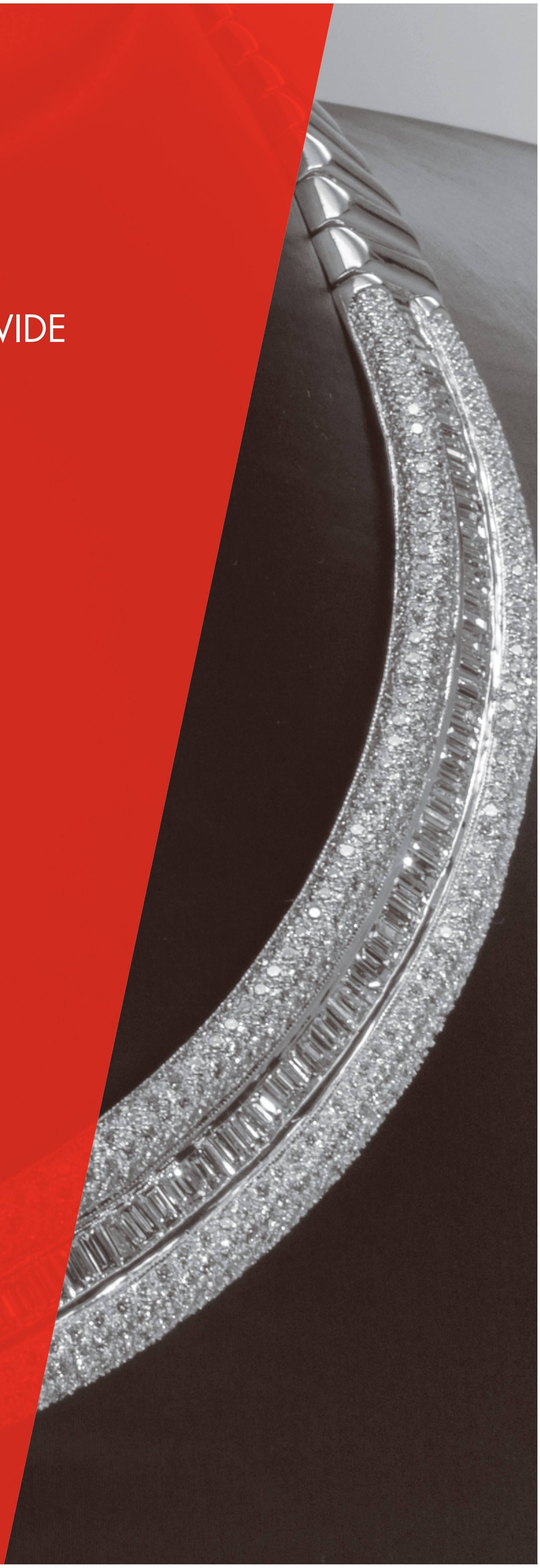
LUXURY GOODS WORLDWIDE MARKET STUDY

Fall–Winter 2015

A time to act: How luxury brands can rebuild to win

By Claudia D'Arpizio, Federica Levato, Daniele Zito and Joëlle de Montgolfier



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Claudia D'Arpizio and Federica Levato are Bain & Company partners, and Daniele Zito is a manager. All three are based out of the firm's Milan office. Joëlle de Montgolfier is the practice area senior director for Retail, Luxury and Consumer Products in EMEA. She is based out of the firm's Paris office. All four are members of Bain's Global Retail and Luxury practices.

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Executive summary

Currency fluctuations and globe-trotters boost the personal luxury goods market, but real growth slows

The 14th edition of the Bain Luxury Study, published by Bain & Company for Fondazione Altagamma, the trade association of Italian luxury-goods manufacturers, analyzed recent developments in the global luxury-goods industry.

The overall luxury industry tracked by Bain & Company comprises 10 segments, led by luxury cars, luxury hospitality and personal luxury goods, which together account for 80% of the total market. The industry surpassed €1 trillion in retail sales value in 2015 and delivered healthy growth of 5% year over year (at constant exchange rates), driven primarily by luxury cars (8%), luxury hospitality (7%) and fine arts (6%).

Aided by global currency fluctuations and continued purchases by "borderless consumers," the personal luxury goods market—the "core of the core" of luxury and the focus of the Bain Luxury Study—ballooned to more than €250 billion in 2015. That represents 13% growth over 2014 at current exchange rates, while real growth (at constant exchange rates) has eased to only 1% to 2%. The slowdown confirms a shift to a "new normal" of lower sales growth in the personal luxury goods market, which we highlighted in previous analyses. The challenge for luxury brands in this environment is to successfully navigate market volatility driven by currency swings and fluctuating tourist flows.

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Currency swings affect regional performance

Boosted by a strong US dollar, the Americas emerged as the biggest global region for personal luxury goods purchases. However, in real terms, the US market did not deliver. The "super-dollar" was too expensive for many global tourists and, although local consumption grew, it was barely sufficient to offset the decline in tourism revenue.

Europe posted sound growth, primarily fueled by Chinese and US tourists attracted by a weak euro. The old continent has become "the world's largest in-season outlet." Our analysis of European tax-free shopping data, conducted in partnership with Global Blue, showed that Chinese tax-free purchases in Europe increased by 64% while tax-free purchases by American tourists in Europe grew by 67%, primarily in the high end of the luxury spectrum. Meanwhile, Russian and Japanese travelers cut their tax-free spending in Europe by 37% and 16%, respectively.

Across Asia, performance varied widely:

- Japan has proven to be a consistent champion in both real and nominal terms, as a sound base of local consumers and the emergence of Chinese tourists looking to capitalize on currency fluctuations are driving sales.
- South Korea shined, with €11 billion in retail sales value, growing at 4% in constant exchange rates despite the negative impact of the Middle East Respiratory Syndrome in the second half of the year.
- Hong Kong and Macau faded, primarily due to government reforms against graft and the gray market (respectively €7 billion and €1 billion in retail sales value, both declining at 25% in constant exchange rates).
- Local spending in Mainland China continued to contract slightly.

Chinese consumers play a primary role in the growth of luxury spending worldwide. They account for the largest portion of global purchases (31%), followed by Americans (24%) and Europeans (18%). Chinese shoppers continue to spend far more abroad than in Mainland China, which accounts for only 20% of their global purchases. However, the depreciation of the euro boosted the country to the global luxury podium; it is now the third-biggest market in the world, after the US and Japan. The most popular travel destinations for Chinese luxury shoppers shift—typically to Europe, South Korea or Japan—in response to currency fluctuations, which create temporary favorable price gaps.

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Wholesale still dominates, but company-owned retail and e-commerce are growing faster

Wholesale is still the dominant selling channel within the personal luxury goods market, capturing 66% of the total market. However, retail continues to gain share, driven by network expansion (600 new directly operated stores opened globally in 2015, a decline from the 750 opened in 2014) and growth in same-store sales (13% at current exchange rates). The wholesale channel's slower performance stems from three factors: the ongoing "retailization" of luxury (converting franchised locations into company-owned stores or joint ventures); the lackluster performance of US department stores across product categories (particularly in leather goods); and the decreasing sales of Asian watch retailers, which are coping with excessive stock and a reduction in the overall store network.

E-commerce grew to a 7% market share in 2015, nearly doubling its penetration since 2012. Specialized e-commerce players are outperforming the market globally, with Chinese e-tailers progressively extending their geographic reach and gaining share on a global basis. The e-commerce sites of European and American retailers (such as department stores) continue to grow, a response to customers' demands for an omnichannel experience. Luxury brands are losing share online overall, with highly variable performance: The largest brands with established direct online and omnichannel platforms are outperforming but the majority of brands still lag, especially European brands.

Luxury globe-trotters have also fueled the performance of airport retail, which posted a 29% growth rate in current exchange rates (18% in constant exchange rates) and now accounts for 6% of the global luxury market.

With the growing middle class in markets such as China seeking good quality and good value, and consumers in mature markets looking for bargains, the off-price channel has more than doubled to nearly €26 billion. Markdowns are also increasing in prevalence across more than 35% of the luxury market.

Accessories remain the leading category

Among specific categories of personal luxury goods, accessories remained the leader, capturing 30% of the market and growing by 3% in 2015 (at constant exchange rates). That was faster than the next two largest categories, apparel (which grew 2% at constant exchange rates) and hard luxury (which contracted by 3%). Within accessories, high-end shoes (4%) continued to grow faster than leather goods overall (2%). Jewelry was the star category within hard luxury, growing at 6% in constant exchange rates, while watches were strongly hit by the channel overstocking in Asia and contracted by 6% in constant exchange rates.

1.

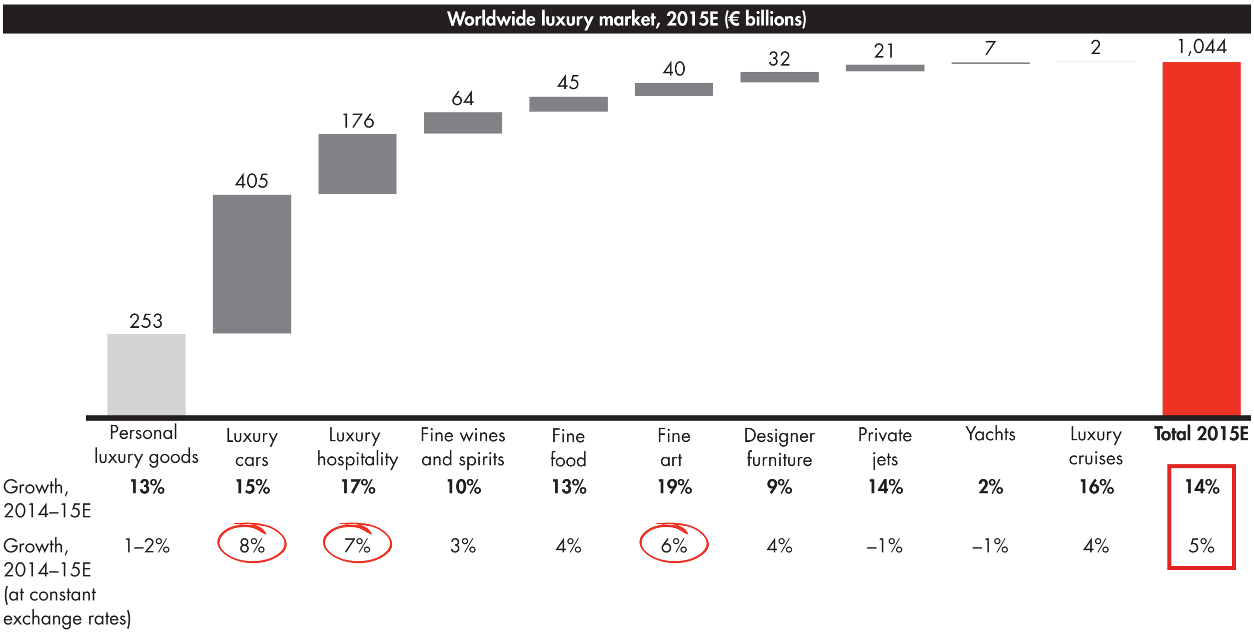
Luxury spending trends in 2015

- The global luxury market tracked by Bain & Company comprises 10 segments, including personal luxury goods, cars, luxury hospitality, luxury cruises, designer furniture, fine food, fine wines and spirits, yachts, private jets and fine art. The overall market exceeded €1 trillion in 2015. Growth in the luxury car market was solid, up 8% from 2014, driven by positive trends in both the US and Europe. Luxury hotel sales, up 7%, benefited from steadily growing demand, particularly in Europe.

- Personal luxury goods—the "core of the core" of luxury and the focus of the Bain Luxury Study—ballooned to more than €250 billion in 2015, more than tripling over the past 20 years. This represents 13% growth over 2014 at current exchange rates, while real growth has slowed to only 1%–2%.

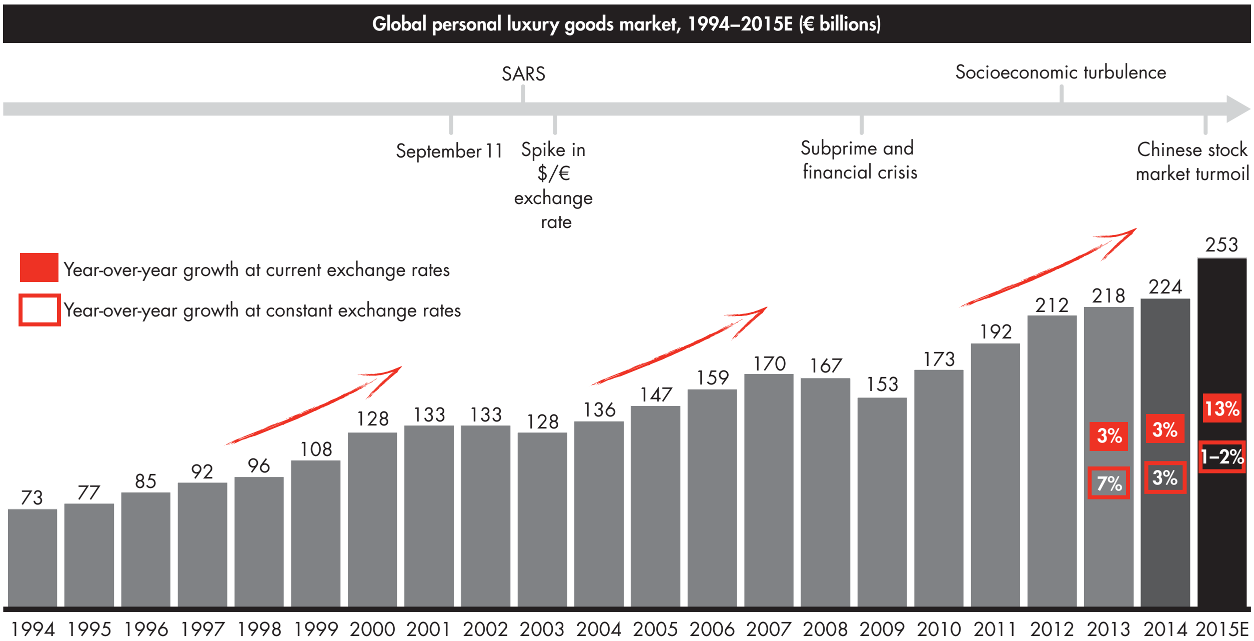
- The year was marked by a strong depreciation of the euro vis-à-vis most global currencies, resulting in a double-digit positive impact on the overall market value.

Figure 1: The global luxury market exceeded €1 trillion in 2015, posting overall growth of 5%, driven by cars, hospitality and fine arts



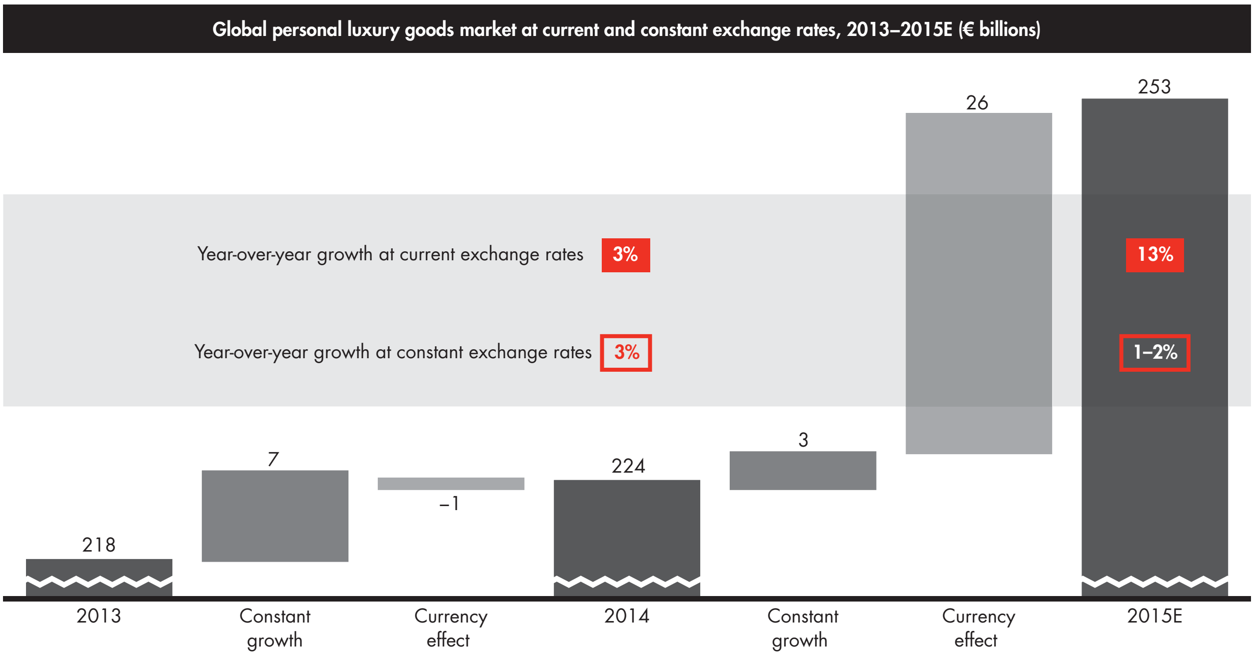
Note: Discrepancy in total is due to rounding
Source: Bain & Company

Figure 2: Currency fluctuations inflated the personal luxury goods market to more than €250 billion, while real growth slowed down



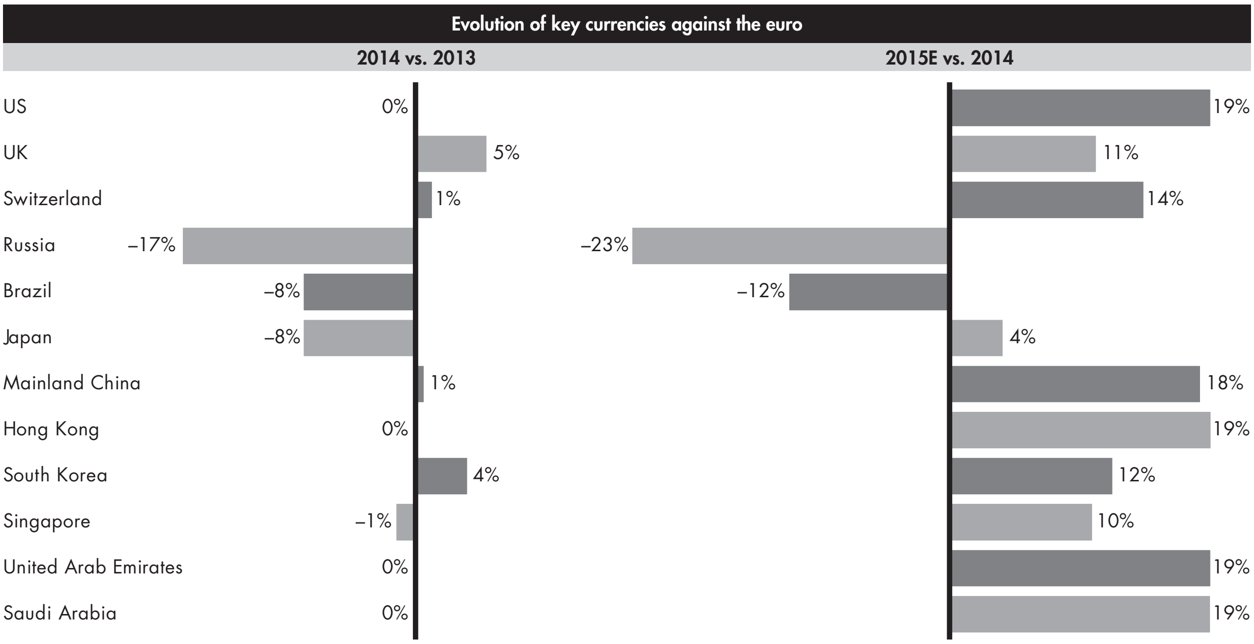
Source: Bain & Company

Figure 3: Exchange rate fluctuations resulted in a double-digit growth rate



Source: Bain & Company

Figure 4: The general trend was a depreciation of the euro vis-à-vis most other global currencies



Source: Bain & Company

2.

Regional highlights

- Boosted by a strong dollar, the Americas emerged as the biggest global region for personal luxury goods purchases. The US alone accounted for €79 billion of the €85 billion regional market (or more than 90%), and remains the largest global market by far, bigger than the next four combined (Japan, China, Italy and France). However, in constant exchange rates, the US market did not deliver.

- The depreciation of the euro also boosted Mainland China to the No. 3 spot in terms of global luxury value, overtaking Italy and France and trailing only the US and Japan. However, local spending in Mainland China (which represents only 20% of global Chinese shoppers' purchases) continued to contract slightly.

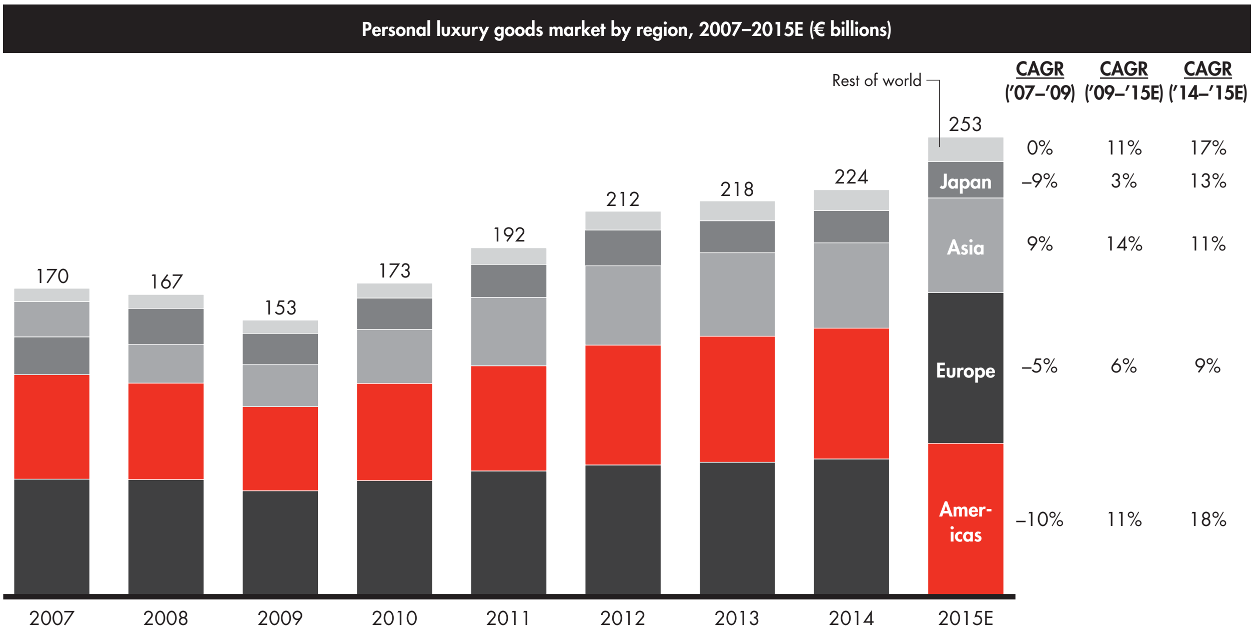
- New York City, Paris and London are the largest luxury cities globally, each representing a market in excess of €10 billion. Luxury goods purchases in New York City alone outweigh those across all of Japan.

- Since 2009, the US market has contributed 1.7 times as much growth in absolute value as the largest growth contributors in Asia. Mature markets in Europe also contributed meaningful growth over the period, equivalent to 80% of the growth Asia contributed. The UK and France contributed 20% more growth in absolute value than China did over the period.

- Chinese consumers played a primary role in the growth of luxury spending worldwide: they made up the largest portion of global luxury purchases (31%), followed by Americans (24%) and Europeans (18%). In 2000, Japanese consumers represented more than one-quarter of global luxury purchases; they now account for only 10%.

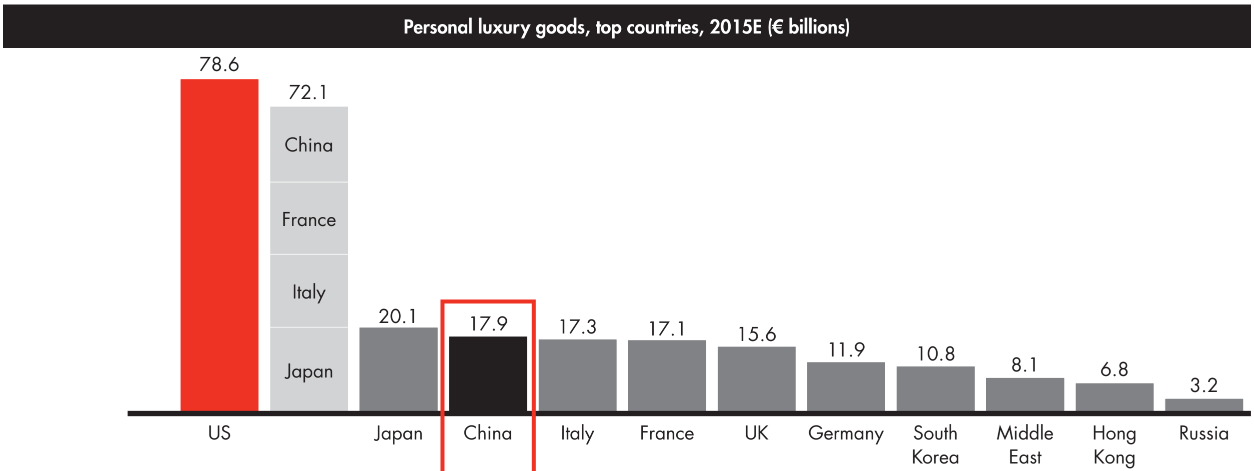
- Luxury consumers in mature markets, such as Europe, the US and Japan, tend to purchase locally. However, growth in these regions increasingly depends on spending by tourists.

Figure 5: The Americas became the biggest global region in 2015, primarily because of the "super dollar"



Note: Growth rates in current exchange rates
Source: Bain & Company

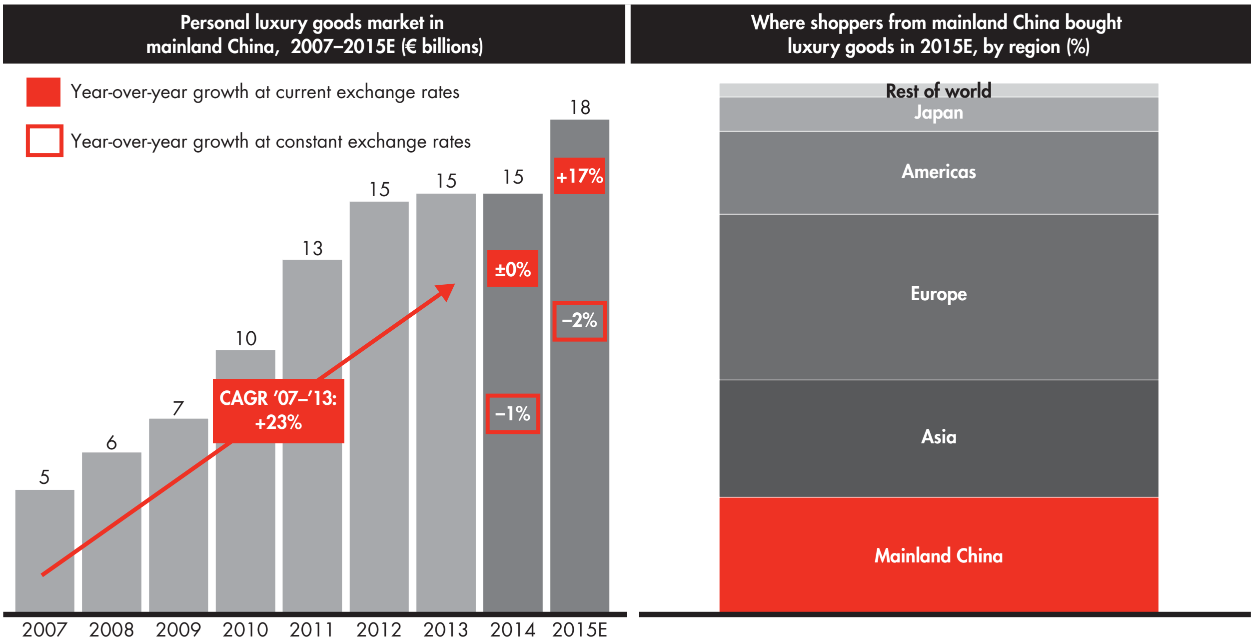
Figure 6: The US remained the largest global market but did not deliver real growth; China joined the global luxury podium



	US	Japan	China	Italy	France	UK	Germany	South Korea	Middle East	Hong Kong	Russia
Global rank in 2014	1	2	5	3	4	6	7	8	10	9	11
Growth in euros 2014–2015E	20%	13%	17%	6%	10%	16%	14%	16%	19%	–11%	–25%
Growth in local currency, 2014–2015E	0%	9%	–1%	6%	10%	5%	14%	4%	0%	–25%	–2%

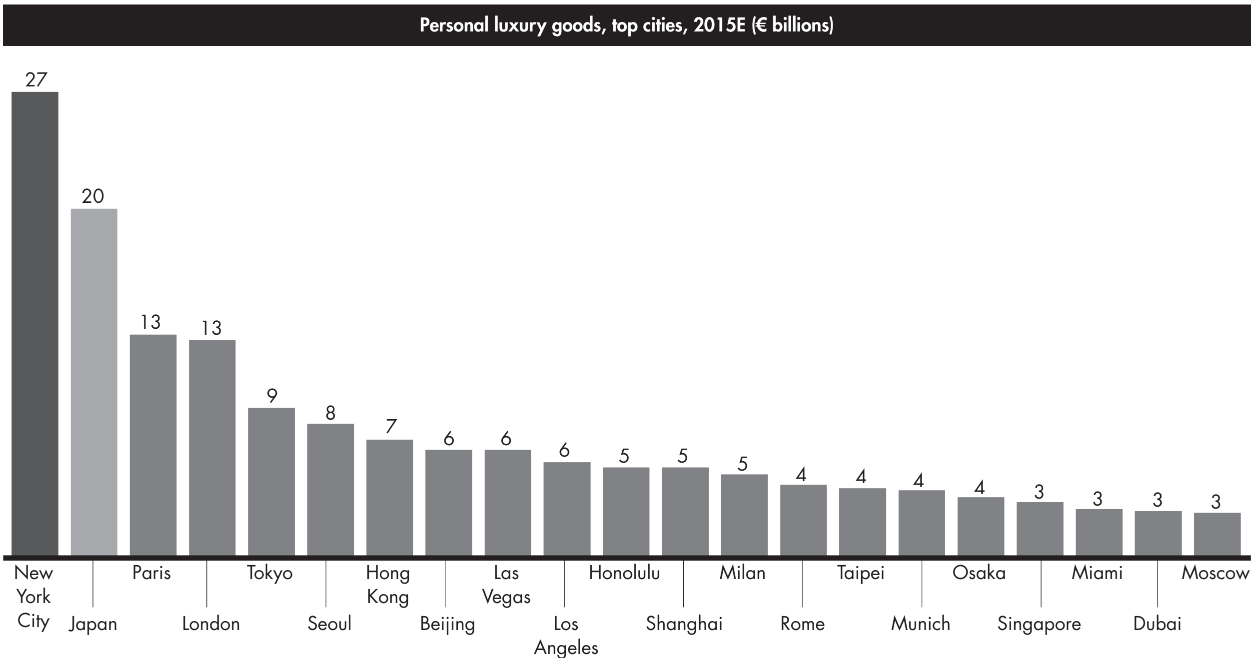
Source: Bain & Company

Figure 7: Local spending in mainland China continued to contract in real terms; mainland China accounts for 20% of global Chinese shoppers' purchases



Source: Bain & Company

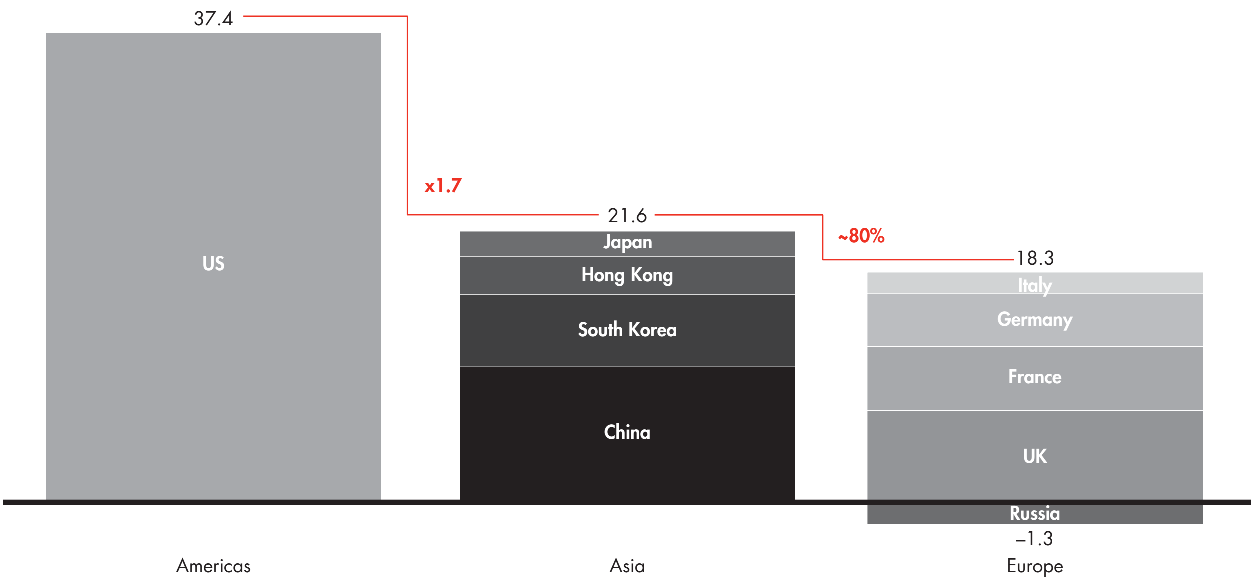
Figure 8: New York City, Paris and London each account for more than €10 billion of luxury sales; luxury goods purchases in New York City outweigh those across all of Japan



Source: Bain & Company

Figure 9: Since 2009, the US market alone contributed 1.7 times as much absolute value growth as Asia; Europe contributed 80% of the growth of Asia

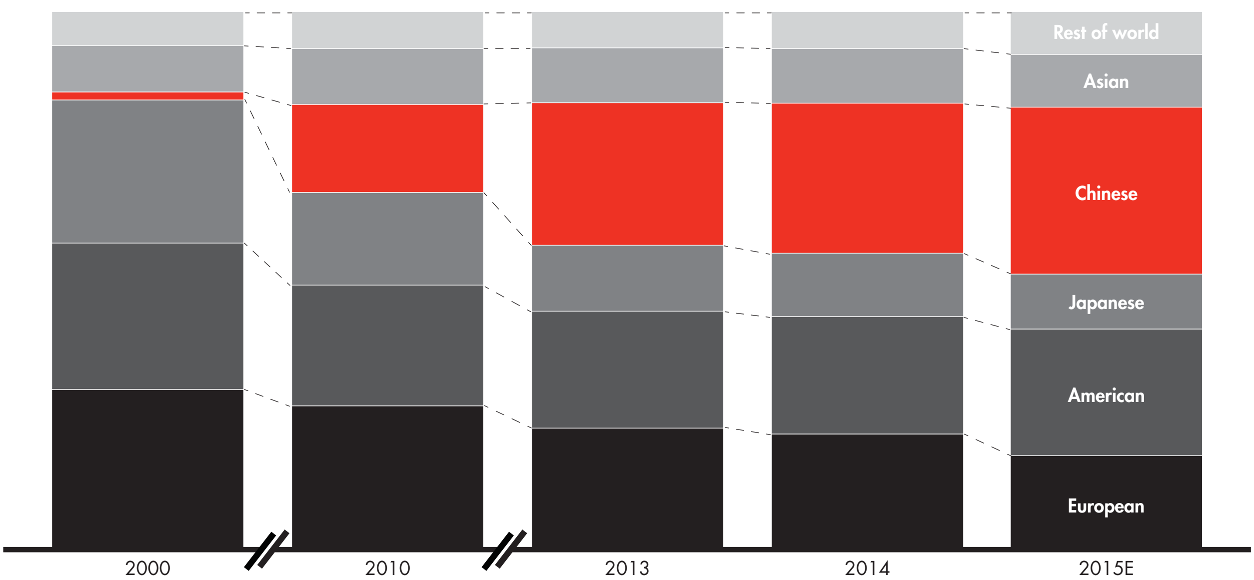
Personal luxury goods: growth contribution in absolute value, by region and top contributing market, 2009–2015E (€ billions)



Source: Bain & Company

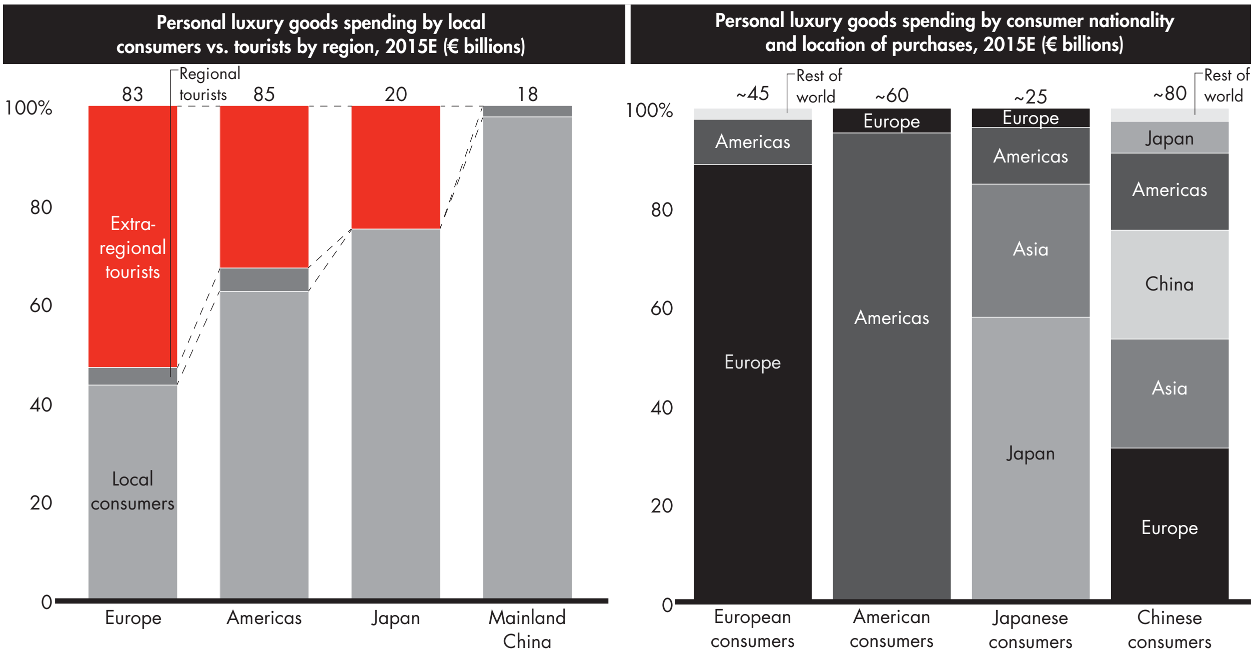
Figure 10: Chinese consumers now represent about one-third of the global market, up from only 1% in 2000; Japanese consumers, who accounted for a quarter of the market in 2000, now make up 10% of global purchases

Global personal luxury goods market by consumer nationality, 2000–2015E (€ billions)



Source: Bain & Company

Figure 11: Europe is largely supported by tourists; consumers from mature markets buy primarily domestically



Source: Bain & Company

3.

Distribution trends

- Wholesale was still the dominant selling channel within the personal luxury goods market, capturing 66% of market share. However, retail continued to gain share. It is up 2 percentage points in 2015 and is growing twice as fast as the wholesale channel at current exchange rates.

- Retail and monobrand distribution continued to be winning formats.

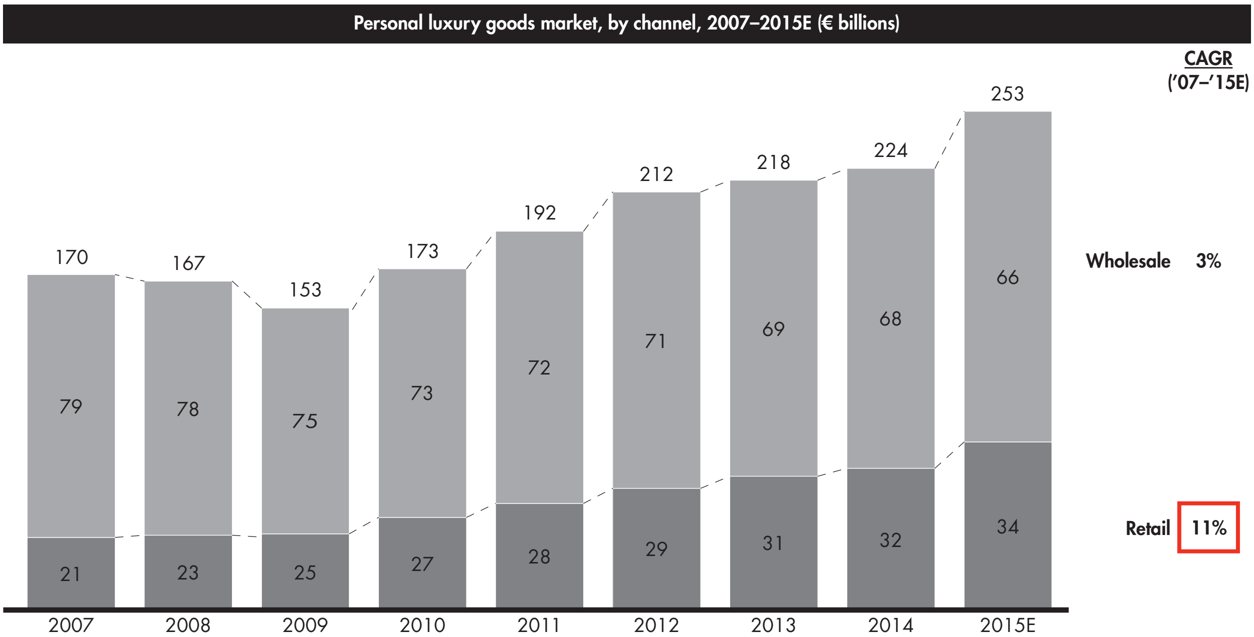
- E-commerce grew to 7% market share in 2015, nearly doubling its penetration since 2012. The channel was particularly strong in the Americas, and is skewed to the accessories and fashion categories.

- Luxury globe-trotters have fueled the performance of airport retail, which posted a 29% growth rate in current exchange rates (18% in constant exchange rates) and now accounts for 6% of the global luxury market.

- With the growing middle class in markets such as China seeking quality and good value and consumers in mature markets looking for bargains, the off-price channel has more than doubled in the past three years, to nearly €26 billion.

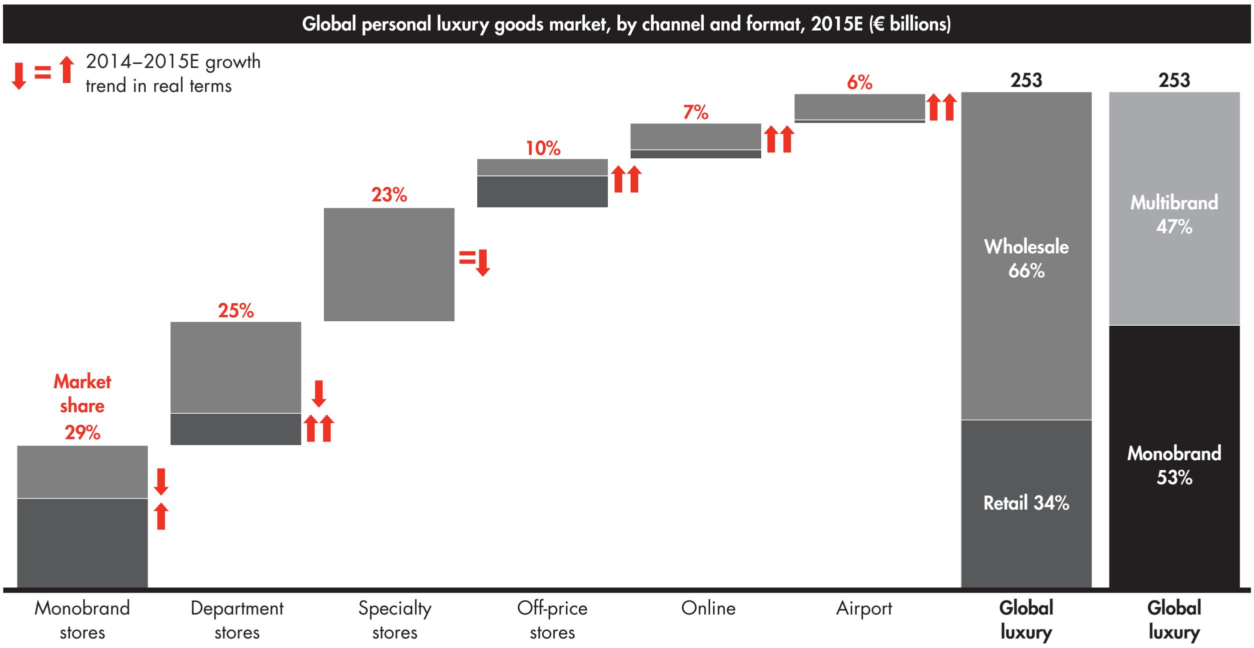
- Markdowns were also increasingly prevalent across more than 35% of the luxury market, particularly in department stores, specialty stores and e-commerce platforms.

Figure 12: Wholesale still dominates among distribution channels, but company-owned retail grows faster



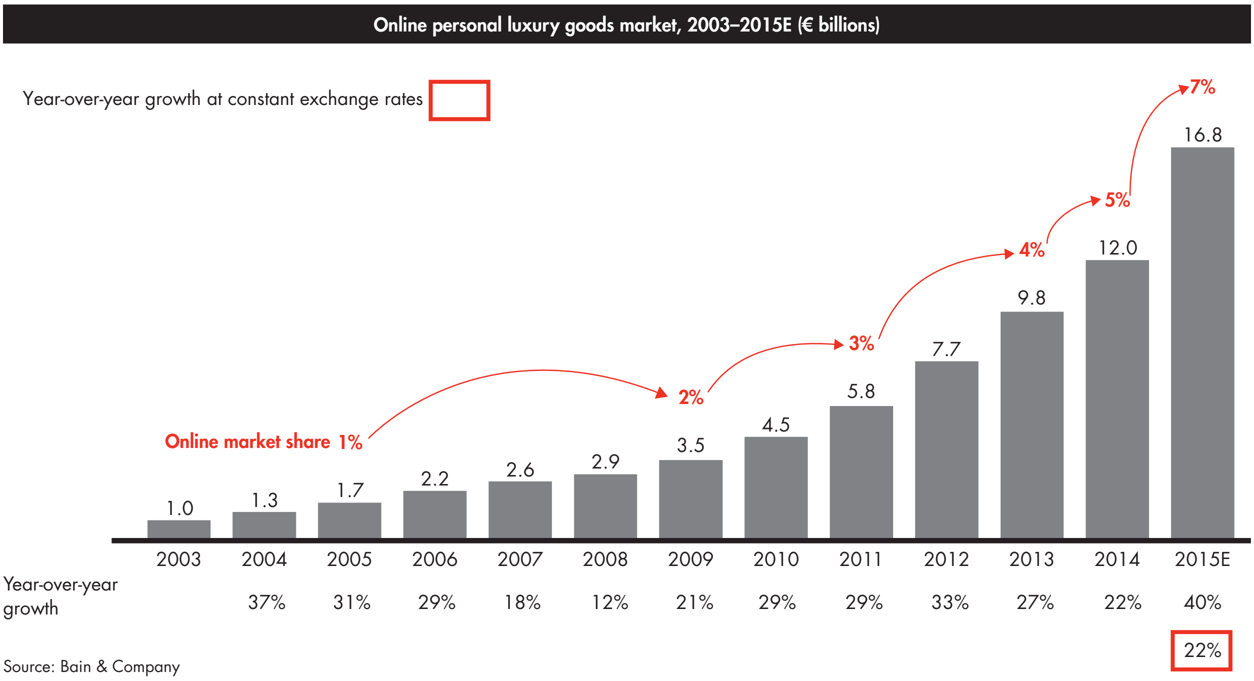
Source: Bain & Company

Figure 13: Retail and monobrand distribution continue to be winning formats



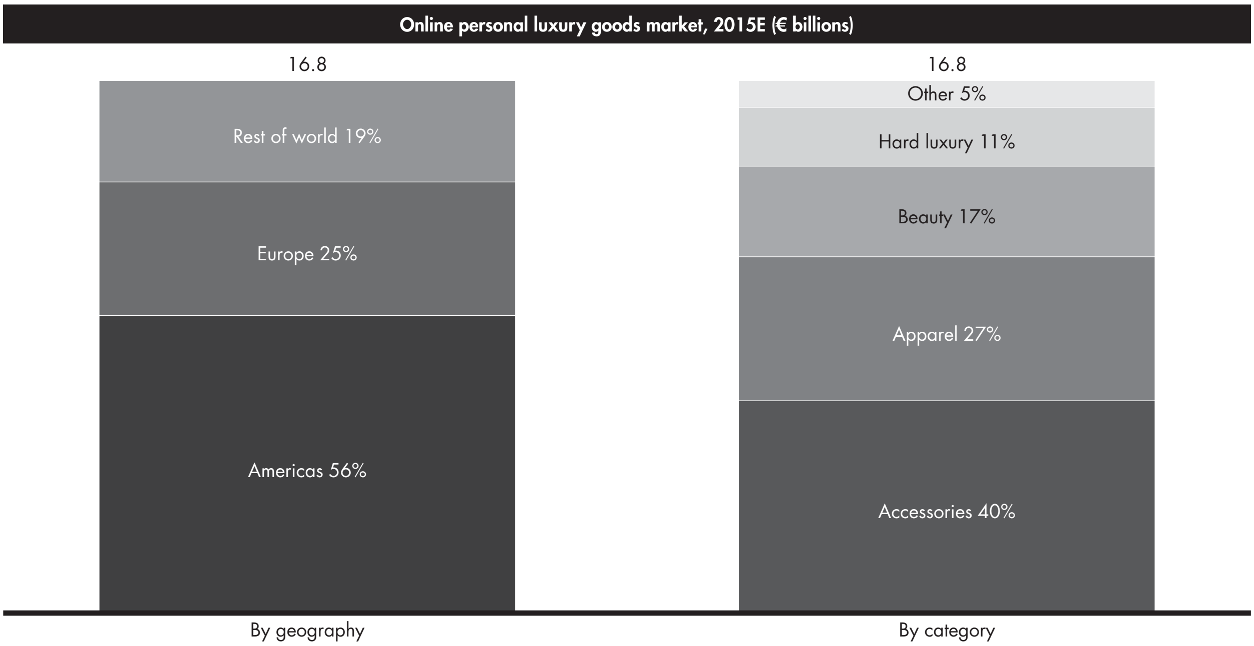
Source: Bain & Company

Figure 14: The online luxury market has grown tenfold since 2005, rising to 7% market share



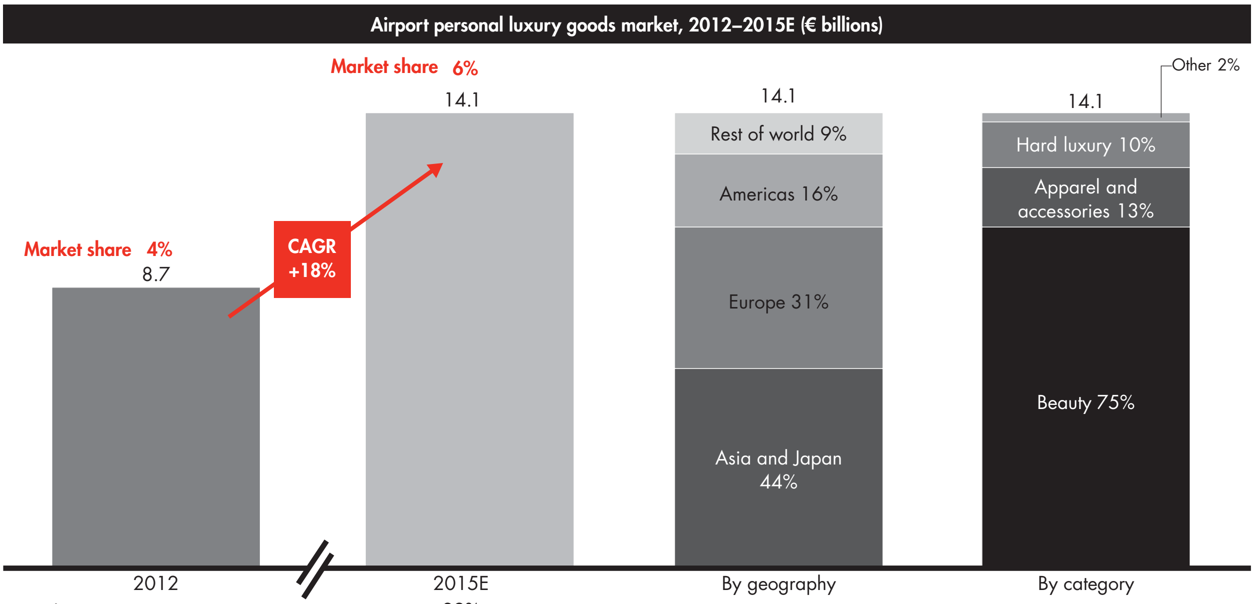
Source: Bain & Company

Figure 15: The online channel is particularly strong in the Americas and is skewed to the accessories and fashion categories



Source: Bain & Company

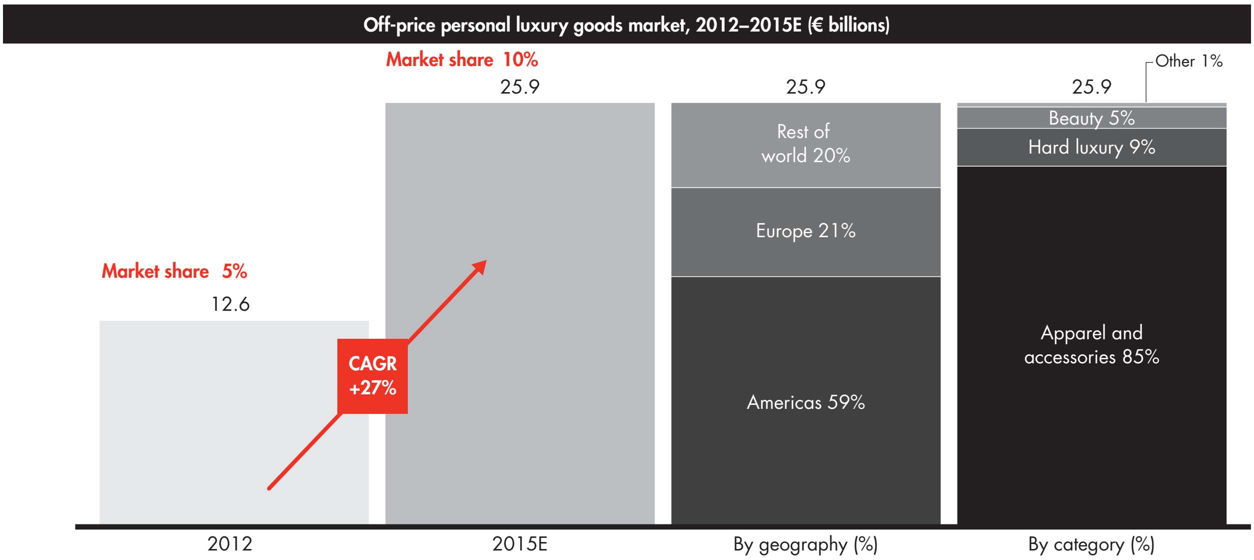
Figure 16: Luxury globe-trotters have fueled the performance of airport retail



	2015E
Growth since 2014	29%
Growth since 2014 (at constant exchange rates)	18%

Source: Bain & Company

Figure 17: The off-price channel has more than doubled over the past three years

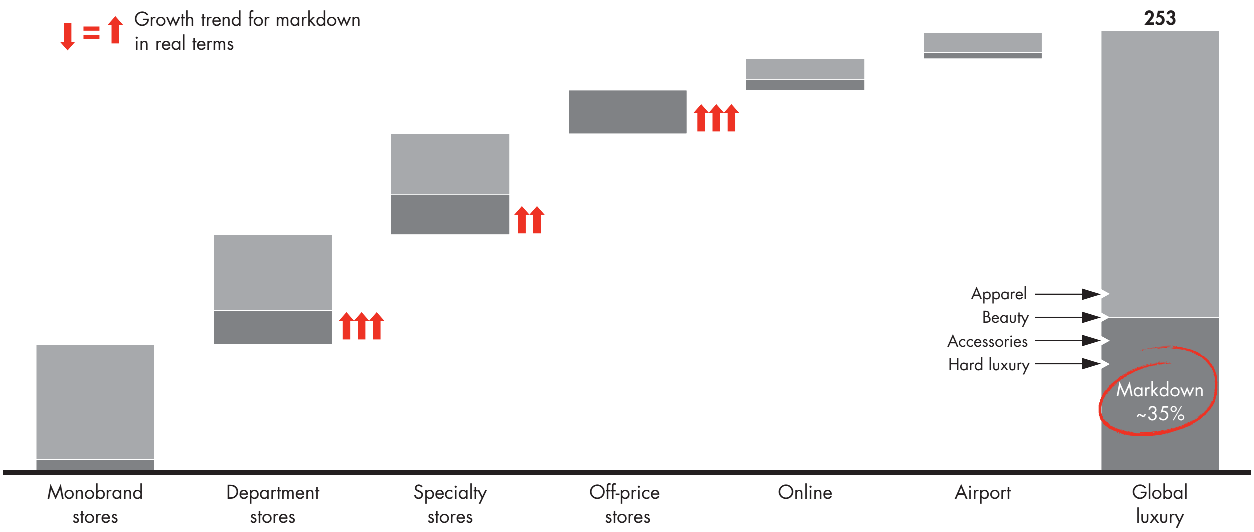


	2015E
Growth since 2014	35%
Growth since 2014 (at constant exchange rates)	23%

Source: Bain & Company

Figure 18: The share of markdown is quickly increasing across formats and reaches over one-third of the total market

Global personal luxury goods market, share of markdown by format, 2015E (€ billions)



Source: Bain & Company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4.

Individual category performance

- Accessories remained the leading personal luxury goods category, capturing 30% of the global market and growing by 3% in 2015 (at constant exchange rates). Apparel was the second-largest category (at 24% of the market, with 2% growth at constant exchange rates), followed by hard luxury (22% of the market, contracting by 3%).

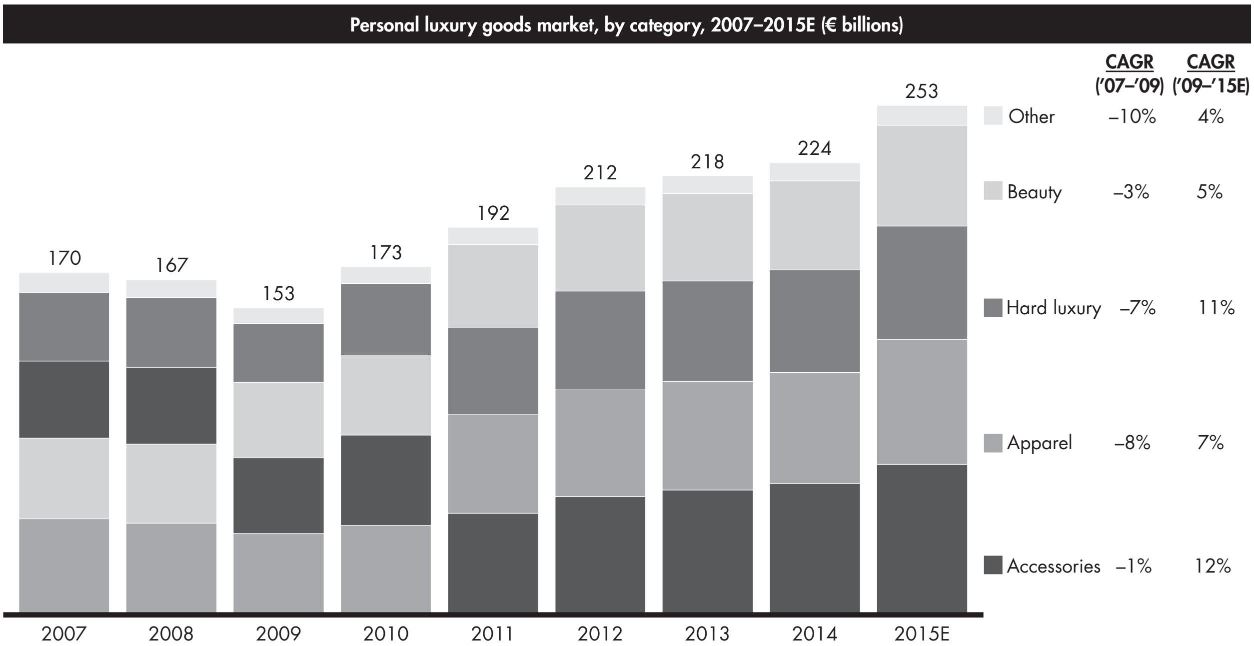
- The performance of the fashion and apparel category was slightly soft, with both women's and men's ready-to-wear segments (accounting for €30 billion and €29 billion in retail sales value, respectively) growing at only 2% in constant exchange rates.

- Within hard luxury, jewelry (with €16 billion in retail sales value) was the star category, growing at 6% in constant exchange rates, while watches (€36 billion in retail sales value) suffered from overstock in Asian channels and contracted by 6% in constant exchange rates.

- Within accessories, the growth of high-end shoes (€16 billion in retail sales value) continued, surpassing that of leather goods (€43 billion in retail sales value) and growing at 4% vs. 2% at constant exchange rates.

- Within the beauty category, fragrances (€23 billion in retail sales value) and cosmetics (€27 billion) grew at moderate rates in constant exchange rates (2% and 1%, respectively, at constant exchange rates).

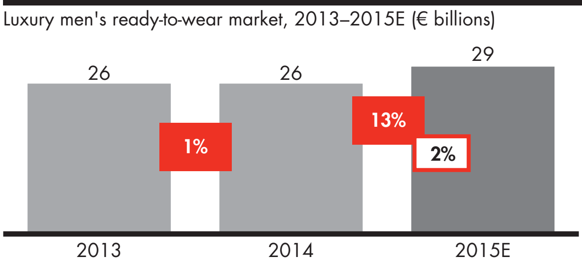
Figure 19: Accessories have been the biggest personal luxury goods category since 2011; they remain the fastest growing



Source: Bain & Company

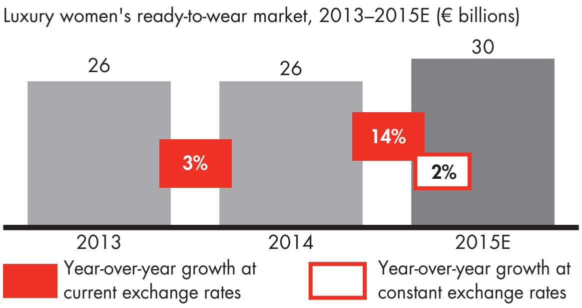
Figure 20: Ready-to-wear posted soft positive growth, with different dynamics across menswear and womenswear

Men's ready-to-wear



- Casual wear posting low single-digit growth, while formal wear continues to suffer
  - Mixed performance within both segments, with *Absolute* brands experiencing a very sound trend, offset by negative *Aspirational* and lackluster *Accessible* brands
- Outerwear, denim and cashmere categories outperforming, in line with 2014
  - Growing success of fur and shearling
  - Denim maintaining momentum also driven by a new fashion twist and the success of customization services

Women's ready-to-wear



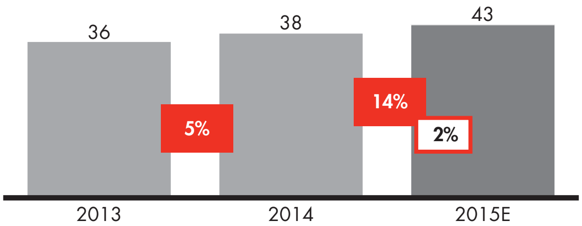
- Overall positive trend for women's ready-to-wear, with high resilience across markets and categories
  - Brisk growth of denim and outerwear across the board
  - At the extremes of the spectrum, activewear and haute couture showing strong dynamism
  - Daywear positive trend driven both by *Absolute* brands and first lines and *Accessible* segment
  - Formal wear lagging behind in terms of growth due to the underperformance of *Aspirational* brands
- Increasing *brandization* of patterns and creative motifs as new icons of the category

Source: Bain & Company

Figure 21: Within accessories, shoe sales continue to outpace leather goods

Leather goods

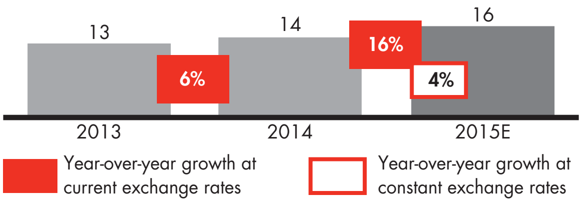
Luxury leather goods market, 2013–2015E (€ billions)



- Overall trend undermined by prices (excluding *Accessible* brands)
  - Brands' attempts at preserving the entry price range by offering a wider selection of lower-priced items were effective from a volume standpoint only, causing the price mix to decline
  - Surging success of the off-price channel and increasing promotional activity by full-price stores
- Ongoing polarization among segments
  - *Absolute* brands outgrowing the overall category, while *Aspirational* brands show mixed performance, with ongoing turnaround of key brands
  - Highly volatile consumers affecting brands in the *Accessible* segment

Shoes

Luxury shoes market, 2013–2015E (€ billions)



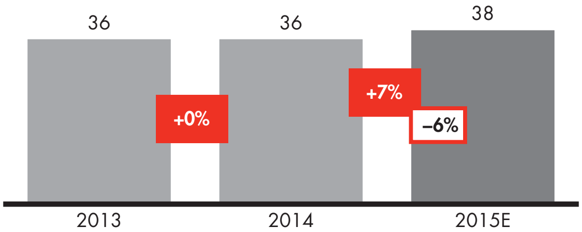
- Consistent positive performance of shoes, the status symbol at the price sweet spot
  - Outperformance of the *Absolute* segment
- Men's segment continuing on its positive trajectory, women's showing increased dynamism
  - Ongoing sneaker phenomenon now influencing other segments (e.g., formal shoes with thick rubber sole)
- Lifestyle brands registering slightly brisker growth than shoe specialists

Source: Bain & Company

Figure 22: Within hard luxury, jewelry continues growing, while watches remain affected by a negative trend in Asia

Watches

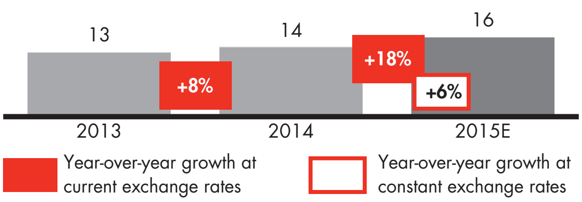
Luxury watches market, 2013–2015E (€ billions)



- Luxury watches still impacted by Asian uncertainty
  - Asian retailers overstocked with declining sales and shrinking store networks
- Exposure to Swiss watchmakers impacted the overall category, with the Swiss franc appreciating over the euro and consequent price adjustments
- The *Absolute* segment performs better; Europe is buoyed due to touristic purchases in brands' own stores
- The impact of smartwatches remains limited to the premium segment (not competing with high-end time pieces playing on different value dimensions)
  - *Luxury* brands launch their own smartwatches and smart accessories for watches, with limited volumes

Jewelry

Luxury jewelry market, 2013–2015E (€ billions)



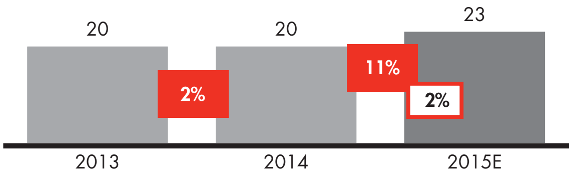
- Luxury branded jewelry continues to outperform the overall category
- Strong performance of *Absolute* and high-ticket items
- Jewels remain among top preferred investments due to intrinsic value of raw materials
- The global demand for diamonds is still growing but at a more modest pace, particularly in Asia as a consequence of the slowdown started last year and the protests in Hong Kong
- For new store openings, Asian retailers rebalance the product offer toward more jewelry than watches

Source: Bain & Company

Figure 23: Within the beauty category, fragrances are on a positive trajectory; skincare's performance is lackluster

Fragrances

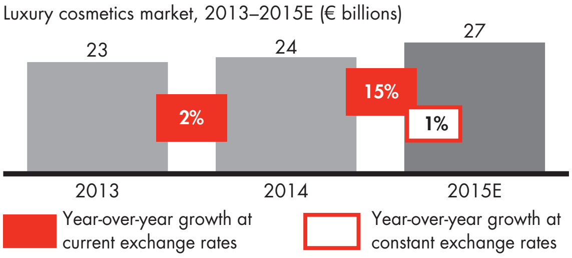
Luxury fragrances market, 2013–2015E (€ billions)



- Mature markets post mixed performances, with Chinese and Middle Eastern demand continuing to rise
  - The growth in mature markets is mainly driven by price increases despite an increasing weight of promotions
- The top end of the market, exclusive lines and essences, and artisanal niche brands are outperforming
  - Growing interest for customized products
  - Brands refocus storytelling on scents, ingredients and nose
- Travel sizes experience a sustained trend

Cosmetics

Luxury cosmetics market, 2013–2015E (€ billions)



- Makeup is the main growth engine in the category, offsetting the overall performance of skin care
  - Sound trend of makeup across subcategories
  - Devices show strong dynamism within skin care, while other subcategories suffer
- Premium Korean brands are increasingly popular among Asian consumers
  - Western players looking for potential acquisitions

Source: Bain & Company

5.

Outlook for the future

- The main challenge facing most luxury brands is establishing the right pricing model. The rise of e-commerce and global tourism growth create greater transparency around international price differentials. In addition, price-conscious luxury shoppers are struggling to reconcile the price of luxury products with their real value. As a result, luxury brands must assess how to mitigate volatility and how best to deliver at local and global levels. This includes managing inventory to accommodate fluctuations in tourist spending and coordinating pricing and markdowns across markets and channels.

- Luxury brands also face a host of tough issues such as rethinking the size of their store footprint and the role of brick-and-mortar shops in a world of growing digitization, as well as figuring out how to delight local customers even as masses of tourists flock to establishments in mature markets.

Figure 24: Strategic international pricing is becoming the main issue to be tackled in the industry

Until recently ...	... then ...	... now
• **Relentless price increases over the past 5–10 years** - To gain more exclusive positioning and sell to emerging consumers with high disposable income • **High price differentials maintained across regions** - To maximize touristic flows and local consumption (Japan)	• **Exogenous effects exacerbating price differentials globally** (currency fluctuations, import tariff cuts) • **Internet allowing full price transparency**	• **Increasingly price-conscious luxury consumers look for international bargains,** resulting in a change in the market equilibrium • **Brands tactically adjust international pricing,** sometimes with shortsighted approaches

Mature consumers are cut off from an industry they can't fully afford anymore and whose real value is strongly questioned, while emerging consumers struggle in truly matching price and value of these products

Source: Bain & Company

Figure 25: The global personal luxury goods market: 10 key takeaways for 2015

A mature market strongly impacted by macroeconomic and sociopolitical events		
Markets and consumers	**Route to market**	**Value proposition**
Still a Western market but boosted by masses of borderless consumers Chinese consumers are the top nationality, increasingly traveling across regions Consumers from mature markets become more demanding and detached	Retail and monobrand are still the favorite formats in which to invest The current retail footprint is under scrutiny in some locations E-commerce is starting to become disruptive, yet brands are still struggling with it Wholesale formats try to hold ground while attempting to modernize Tactical channels such as off-price and airport retail become increasingly strategic	Consumers shop across categories and price points, guided by an informed point of view on players' strategies Growing value awareness and blurred pricing strategies are questioning the overall value proposition of luxury

Source: Bain & Company

Figure 26: Key strategic questions for luxury players going forward

How to reduce brand performance volatility at global and local levels?		
Markets and consumers	**Route to market**	**Value proposition**
How to manage globe-trotting consumers? How to remain strategically focused on local customers? How to reengage disillusioned consumers in mature markets?	How to rethink the size, role and format of the retail network? How to maximize the effectiveness of all distribution channels in an omnichannel world? How to strategically manage full prices and markdowns within and across channels? How to turn digital (besides e-commerce) into a competitive advantage?	How to (re)build aspiration, credibility and trust for luxury products? How to broaden brand territories and platforms to bond with tomorrow's consumers?

Source: Bain & Company

Figure 27: Key strategic themes for luxury CEOs

<table>
<tr><th>Markets and consumers</th><th>Route to market</th><th>Value proposition</th></tr>
<tr><td colspan="3">Design a “locally global” pricing strategy and execution</td></tr>
<tr><td>Personalize customer experiences in store</td><td>Refocus distribution strategy and footprint with a forward-looking perspective</td><td rowspan="2">Master brand content and storytelling</td></tr>
<tr><td rowspan="2">Locally tailor value propositions: assortment, buying, marketing</td><td>Evolve toward a value-driven “fast luxury“ model</td></tr>
<tr><td colspan="2">Foster consumer engagement across all touchpoints</td></tr>
<tr><td colspan="3">Develop, grow and retain best-in-class talents</td></tr>
</table>

Source: Bain & Company

Appendix: Bain's global luxury goods market study methodology

Revenues tracked at retail sales value

- Revenues at retail sales value represent total sales valued at retail price (final price paid by consumers at point of purchase)
- Each player's consolidated sales are brought back to retail sales value through the following methodology

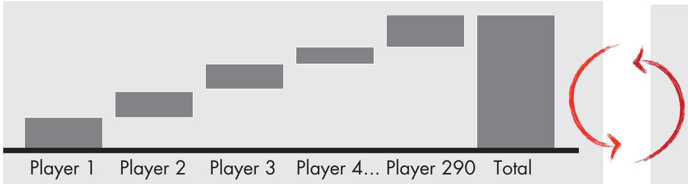
Retail
+
Wholesale
+
Licenses
=
Player consolidated sales

→

Retail
+
Wholesale at retail value — Application of estimated markups by geography and category
+
Licenses at retail value — Application of estimated royalty rates and markups by geography and product category
=
Player sales at retail value

Bottom-up and top-down estimates

Bottom-up



Top-down cross-check

- Category-specific data in the main geographic markets
- Comparison between market breakdown and turnover breakdown of key players
- Expert interviews (top management of brands, distributors, department stores)
- Consistency check and fine-tuning

Source: Bain & Company

Key contacts in Bain's Luxury Goods practice

Europe, Middle East and Africa	**Claudia D'Arpizio** in Milan *(claudia.darpizio@bain.com)* **Federica Levato** in Milan *(federica.levato@bain.com)* **Daniele Zito** in Milan *(daniele.zito@bain.com)*
	Marc-André Kamel in Paris *(marc-andre.kamel@bain.com)* **Joëlle de Montgolfier** in Paris *(joelle.demontgolfier@bain.com)*
	Serge Hoffmann in Munich *(serge.hoffmann@bain.com)*
	Oliver Merkel in Johannesburg *(oliver.merkel@bain.com)*
Americas	**Darrell Rigby** in Boston *(darrell.rigby@bain.com)*
Asia-Pacific	**Bruno Lannes** in Shanghai *(bruno.lannes@bain.com)*

About the Bain Luxury Goods Worldwide Market Study

Bain & Company analyzes for Fondazione Altagamma the market and financial performance of more than 290 leading luxury-goods companies and brands. This database, known as the Luxury Goods Worldwide Market Observatory, has become a leading and much-studied source in the international luxury-goods industry. Bain has published its annual findings in the Luxury Goods Worldwide Market Study since 2000. The study's lead author is Claudia D'Arpizio, a Bain partner in Milan. Fondazione Altagamma is led by Andrea Illy, who was named chairman in 2013.

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