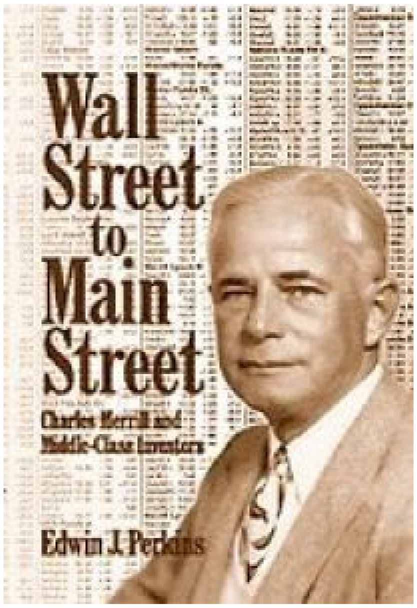

Book Wall Street to Main Street

Charles Merrill and Middle-Class Investors

Edwin J. Perkins
Cambridge UP, 1999

Recommendation

Charles Merrill is an authentic American genius and today's capital markets bear his distinctive stamp in many ways, as Edwin J. Perkins' book proves in fascinating detail. While the book works as a business history and as a professional portrait, it is less successful as a biography because Perkins deliberately chose to focus on Merrill's professional life. By keeping Merrill's personal life very much in the background, Perkins declines to bring Merrill's personality to life. We learn about his career, but we do not seem to get to know the man himself. Happily, Merrill's achievements and business innovations are well worth examining. His commitment to service, integrity and the good of the common customer - even when that angered the elite customer - made him richer than most of the aristocrats who fought against him. *BooksInShort* recommends this worthy portrayal of a riveting role model to entrepreneurs, finance professionals and any business history buff.

Take-Aways

- Charles Merrill was America's greatest financial entrepreneur and innovator.
- Merrill's principles of honesty, integrity, service and putting the customer first revolutionized the brokerage industry.
- Merrill succeeded in brokerage in part because of his mass-marketing experience from running the Safeway grocery chain.
- Merrill secured his reputation by predicting the 1929 market crash.
- Merrill correctly foresaw the post-war economic boom when many forecasters predicted a slump.
- Merrill Lynch's innovative compensation and fee system helped restore post-war investor confidence.
- Merrill was one of the few on Wall Street to recognize that market reforms would help restore trust in the securities industry.
- Merrill forbade his firm to offer mutual funds-a great miscalculation.
- The entire brokerage industry today reflects Merrill's vision and innovations.

Summary

In October 1939, just after the outbreak of World War II, semi-retired entrepreneur Charles Merrill agreed to rejoin his sleepy brokerage firm, Merrill Lynch & Company, on a full time basis. Charlie Merrill had once been one of Wall Street's leading lights. He'd predicted the 1929 stock market crash and saved his clients millions of dollars in the process. He had then accumulated a vast personal fortune through the Safeway grocery chain. At 54, newly married for the third time to a beautiful young woman, seemingly content in his leisure, Merrill chose to take on the greatest challenge of his career. By the time of his death 17 years later, he had emerged as the most influential and innovative financial entrepreneur America has ever produced.

> "Perhaps as much as the establishment of the SEC, the new ways of doing business at Merrill Lynch transformed public opinion and restored public confidence in the integrity of the securities markets."

Charles Merrill was born in Florida in 1885, the eldest child and only son of a professional family. His father was a doctor and owned a drugstore. Charlie helped out in the store and showed a flair for figures and store management. He also learned how storeowners typically ran their businesses. He attended Amherst College for two years, where he found that his middle-class background and southern roots set him apart from the old-money aristocracy in the northern United States. He never lost his sense of identification with the middle class.

> "Charles Merrill had been prescient about an economic downturn in the late 1920s, and he was prescient again about the continuation of the economic expansion after 1945."

At Amherst, he was an adequate but undistinguished student with a flair for writing. After his family suffered a financial setback, he returned to Florida in 1906 and worked as a journalist for a summer. When he returned to school, he selected the University of Michigan, where he intended to study law and make enough money to help support his family. But he did poorly during his year at Michigan and never did finish his college degree.

> "The willingness to adopt unorthodox and untraditional promotional techniques was one of the hallmarks of Charles Merrill's career on Wall Street."

In 1907, Merrill became engaged to his Amherst sweetheart and went to work for her father in New York City. Robert Sjostram, a textile manufacturer, owned six mills in the area. Charlie began as an office boy and quickly worked his way up. During his early days in New York, he met his future partner, Edward Lynch. They had very different personalities; Merrill was gracious and gregarious; Lynch was more blunt and aggressive. Still, they became fast friends and Merrill moved in with Lynch. Soon he was making $100 a week - the equivalent of around $100,000 annually in contemporary terms - and was able to pay off his parents' mortgage.

> "The democratization of the stock market, originally fostered by Charles Merrill, has been inexorably expanding to new locales, drawing in new investors ranging in economic status from the middle class to the super rich."

In 1909, his fiancŽe broke their engagement and Charlie went back to Michigan for the summer session. At the end of the summer, he returned to New York and soon accepted a job with George Burr, a stockbroker who had decided to diversify his company by offering corporate bonds. Merrill was put to work selling bonds. He decided to go against Wall Street tradition and advertise the bonds.

> "Because of his many contributions, Charlie Merrill deserves recognition as the nation's premier entrepreneur in the thriving financial services sector."

He was already committed to the principles that would mark his later career. In 1911, he wrote a magazine article about the importance of knowing a customer's financial circumstances before starting an investment program for him and the merit of tailoring the investment to the client.

In 1912, Charlie learned that the bonds he had been selling for Burr were worthless. The company was insolvent, and Burr had essentially bailed out his own company at his customers' expense. Furious, he soon left Burr and privately vowed to create a company with colleagues he could trust. While he worked for Burr, Charlie had his first encounter with chain stores and their suppliers. He quickly recognized their vast potential.

> "Merrill's influence equaled the impact of all previous American financiers, including his only legitimate rival, J. P. Morgan."

He married Elizabeth Church, who would be the mother of his first two children. As a newlywed in 1912, he took a job at the firm of Eastman Dillon. However, his innovative approaches were unwelcome and he clashed with the firm's owner. In 1913, he proposed a kind of housekeeping deal; he would operate independently on the premises of Eastman Dillon, with his own company, office and staff, but would trade securities through Eastman Dillon, thereby generating commissions for them.

The Birth of Merrill, Lynch

Charles E. Merrill & Company was launched on January 6, 1914. The new firm made steady progress. Edward Lynch came in as a partner early on and the firm thrived by doing what would now be called merchant banking - buying blocks of stock that were also sold to retail customers. Merrill, Lynch earned large profits and the partners worked hard to overcome the unsavory reputation stockbrokers had in those days. At a time when most reputable firms focused on helping wealthy people maintain their fortunes, Merrill, Lynch was dedicated to helping middle and upper-middle class customers increase their wealth over time. They aimed to serve every type of investor with every degree of risk tolerance.

> "Charlie kept learning about successful business practices throughout his life, and the lessons kept paying off."

Merrill volunteered to serve in World War I, eventually becoming a trainer in the Army Air Corps. After the war, he invested heavily in three key growth sectors: automobiles, motion pictures and chain grocers. His automobile and motion picture choices were not terrifically successful, but he acquired vast wealth in chain groceries. In the '20s, Merrill, Lynch became the leading financier for chain stores. Merrill was divorced in 1924, when divorces were considered somewhat scandalous among the Wall Street crowd. He was soon remarried to Hellen Ingram, a former journalist.

> "Merrill had a vision of the future that his contemporaries on Wall Street generally lacked."

By 1928, Merrill foresaw a major economic downturn and began to order his associates, including Ed Lynch, to retrench positions accordingly. He warned his clients to retire their debts. He pursued this defensive policy into 1929, even as the market soared to new heights. His associates and partners, including Lynch, infuriated him by dragging their feet in executing his orders. When the crash came, Merrill, Lynch clients saved millions because of Merrill's advice and the firm survived intact. Even when the market seemed to rally, Merrill stayed bearish. Just as he predicted, the Dow sagged again, losing 85% of its value by 1932.

Chains and Change

Merrill's reputation was secure but he was so disgusted by his partners' foot-dragging that in the 1930's he all but left the brokerage business to focus on running the Safeway grocery chain. At the time some states, including California, were trying to tax chain stores out of existence to protect local independent stores. Charlie led the fight to defeat the chain-store tax. His success in helping keep food prices down was one of his proudest accomplishments.

> "Prior to Merrill Lynch's ascendancy in the 1940s, the provision of routine brokerage services had never been a pathway to leadership in the elitist world of high finance."

His Safeway experience taught him many new business techniques that he would later apply to brokerage. Traditionally, grocery stores had been run like his father's drugstore, extending credit, writing off many bad loans and keeping rigidly high margins to maintain profits. Chain stores worked on a cash-only basis, kept low margin and made money on volume. They even attracted customers by selling some products at or below cost as 'loss leaders.'

> "Charlie envisioned the sales staff as a group of trusted advisors to valued clients."

In the mid 1930's, Charles took up with Kinta Des Mare, a beautiful young woman from New Orleans who would become his third wife. By the time he married her a few years later, he was living a life of leisure. Ed Lynch died suddenly in 1938. Intensely loyal to Lynch, Charlie insisted his name remain on the firm's shingle, though New York state law said no dead man could have his name on a partnership. The solution was to rename the firm "Merrill Lynch," without a comma.

Wall Street Innovator

Merrill was one of the few Wall Streeters to support Franklin Roosevelt's New Deal reforms of the financial markets. Traditionally, those who ran brokerages structured the rules to protect their interests, not the customers' interests. Merrill saw that by putting customers first, the industry could create a vast pool of investors and all firms would benefit. He even sought an end to guaranteed minimum commissions on stock trades, but the New York Stock Exchange leadership fought him. While many brokers howled that reforms were socialist or Marxist, or proclaimed that the old system was perfect, Charlie saw that transparency - the flow of good information to the public - and reforms leading to honest business practices could only help the securities industry recapture public confidence.

> "For Charlie, business and pleasure overlapped and often were indistinguishable."

When he returned to the helm of Merrill Lynch in 1954, Charlie brought his Safeway mass-marketing experiences to bear on the brokerage business. Merging with two other chains, Merrill Lynch put offices in many cities. The firm dropped the commission system and put their brokers on salary. That removed any incentive - and just as important, the appearance of any incentive - for brokers to "churn" accounts or prompt trades just to generate commissions. Merrill Lynch became the first brokerage to publish financial reports, even when they were not required. The firm eliminated fees for accounts, and established a research department that offered information free to people who would agree to answer a questionnaire about their finances and goals. One now-legendary newspaper ad consisted of a beginner's guide to investing printed in small type. Some in the firm questioned the ad, but it was a hit with potential clients.

> "Charlie's entrepreneurial creation ranked number one in more of the leading money centers around the world in the 1990s than any other competitive enterprise."

These efforts generated goodwill and leads that more than repaid their expense. Merrill correctly predicted a post-war economic boom and positioned his firm to take advantage of it, though other analysts expected a recession like the one that had followed World War I. As trust in the brokerage industry grew, so did trading volume. When the 20-year depression in the brokerage business ended in the early 1950s. Merrill Lynch was the greatest beneficiary.

Professional Success, Personal Decline

Merrill, a longtime smoker and social drinker, suffered two heart attacks in the mid-1940s. For almost a decade thereafter, he was unable to come to his office. He was plagued by angina and his activities were sorely limited, including sexual activity. In 1952, he was divorced for the third time. A colleague named Winthrop Smith served as his surrogate in the main office, and Merrill became mostly a strategic thinker for Merrill Lynch. The firm started a training program for new brokers and became the first brokerage to stick with it, even in bad times.

In 1953, Charlie took an experimental radioactive-iodine treatment that cured his angina attacks, and he was able to return to the office. By then, the firm had 108 retail offices across the country and accounted for almost 12% of the trading volume on the NYSE. The firm continued to expand into other areas, including commodities, always with the goal of offering investors the greatest range of services. In 1954, the firm created the Monthly Investment Plan. This compromise between Merrill Lynch and other firms allowed investors to sign up for small, regular monthly transactions. These odd-lot trades could lose money for the firm, but Charlie recognized that they would serve as loss leaders, and bring in clients who would become profitable over time.

Merrill Lynch also became the first firm to pay interest on cash balances. This lured in extra cash, which made the firm even more profitable. The one area where Merrill miscalculated was mutual funds. He refused to get involved with them, in part because of bad experiences with old-fashioned 'closed-end' mutual funds in the 1920s. He also felt that mutual funds would ruin the brokerage business, since mutual fund investors tend to buy and hold for long periods of time.

Merrill died of kidney failure in 1956. Since his death, Merrill Lynch has continued to innovate. Though brokers now receive commissions and some fees have been re-established, Merrill's philosophy of service and putting the customer first still reigns. Now the firm is well established overseas. As a result of his achievements in his three careers, and the transforming power of his vision of the brokerage industry, Merrill stands as the most important and influential financial entrepreneur the United States has ever produced.

About the Author

Edwin J. Perkins is professor emeritus of history at the University of Southern California. He is an expert on the history of American financial services and has written five books, including a history of the New York banking firm, Brown Brothers Harriman. He has testified before the U.S. Congress about proposed reforms of outdated banking laws.