Market Research at Merrill Lynch & Co., 1940-1945: New Directions For Stockbrokers

Edwin J. Perkins
University of Southern California

Let me explain at the outset that this paper is drawn in large part from information gathered in the course of researching and writing a career biography of stockbroker Charles E. Merrill. With several lengthy interruptions, which were necessary to complete other scholarly projects that focused on earlier historical periods, this project has been ongoing for the last six years.

Born in Florida in 1885 and educated at Amherst College and the University of Michigan, Merrill was the most dynamic entrepreneur in the American financial services sector during the middle decades of the twentieth century. He founded Merrill Lynch & Co. in 1915 and served as the directing partner for the next four decades [16, 18]. When he died in 1956, the firm, with over 100 branch offices nationwide, was the acknowledged market leader in the brokerage field – the retail end of the securities business. On Wall Street, Merrill Lynch ranked among the top five houses in underwriting and investment banking – the wholesale end of the securities business. In researching the man and his career, I have benefited from the full cooperation of Merrill Lynch & Co. and the Merrill family; and just in case anyone is wondering, I have received to date no direct financial assistance of any sort from the firm, except free access to the high-speed copy machine. Thus I have retained the liberty to interpret events and personalities without fear of interference or censorship.

My presentation is pertinent to the general theme of this panel because Merrill Lynch was one of the first firms in the securities business to make effective use of opinion polls and customer surveys both in formulating marketing strategies and in reorganizing the administrative system of its numerous branch offices. Before proceeding with the presentation of information drawn from archival sources, I want to comment briefly on the fact that my search for a useful historiographical context proved surprisingly elusive. Quite honestly, I had no idea that so little had been published on the history of market research. I was fairly sure that there was not much in print on the origins of market research in the financial services sector, but the paucity of similar material on basic consumer products prior to World War II came as somewhat as a shock. Therefore, I want to thank Sally Clarke, Jonathan Silva, and Mansel Blackford, in particular, for drawing me into this panel, since I now realize that I was on to something much bigger than I had ever imagined in terms of the broader significance of this material to the emerging history of marketing, advertising, and distribution.

Most of the books and articles that comprise my abbreviated bibliography focus primarily on the history of advertising and public relations [13, 14, 15, 20, 24,

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25]. Ad agencies and their clients were among the first enterprises to conduct surveys and opinion polls in an effort to determine consumer preferences in the early twentieth century [28]. Several scholars pointed toward Susan Strasser's *Satisfaction Guaranteed: The Making of the American Mass Market* (1989) as the authoritative secondary source on the birth of market research, but I found her ten-page discussion of the topic frustratingly thin [22, pp. 153-62]. Considered in a wider context, much of the recent literature on advertising focuses on the negative impact of these ubiquitous messages on American culture and values – namely the undue emphasis on instant gratification and the promotion of excessive materialism. On that score, I have in mind two recent books – *Fables of Abundance* by Jackson Lears and *Land of Desire* by William Leach [10,11].

For my purposes, however, the existing literature sheds little light on the evolution of strategies designed to convince upper-middle class American households to divert a healthy portion of their current income into investment securities. In this niche of the marketplace, delayed gratification through savings, not instant gratification from acquiring goods and services, was the message of advertisers and marketing departments. Over the course of this century, the superior success rate of advertisers in promoting instant gratification explains, perhaps, why Americans today are reportedly spending too much of their incomes on consumption and, as a consequence, are allegedly salting away insufficient savings to build a nest egg that would maintain their current living standards in their retirement years. Prior to World War II, the only enterprises that as a group were consistently successful in convincing Americans to defer consumption were life insurance companies, and they put the emphasis on prudence and safety [21, 29]. Most of the policies sold were the so-called "whole" life policies, with a portion of the premium covering the actual risk of death plus additional monies that created a pool of savings over time. During the first three decades of the century, many insurance companies were phenomenally successful in selling whole life policies to American households.

Given the fact that brokerage firms were driven from their origins in the early nineteenth century to encourage trading volume and thereby generate commissions on transactions in stocks, bonds, or commodities, it's again surprising to discover how few partners in the leading firms within this broad financial sector had thought systematically about effective sales and marketing techniques prior to World War II. Brokerage was, by its very nature, a sales driven occupation, yet attempts to implement proven selling techniques and organize comprehensive marketing campaigns were slow to develop. Perhaps the main impediment was the prevailing attitude of the New York Stock Exchange itself.

In an effort to achieve a status comparable to recognized professionals such as lawyers, doctors, and accountants, the leadership of the NYSE discouraged member firms from virtually all forms of promotional advertising. "Tombstone" announcements, which listed the participants in a recent underwriting, was about all the rules would allow. Some firms on the periphery made use of direct mail advertising to solicit prospective investors, including Merrill Lynch in the early years, but the largest and most prestigious brokerage and investment houses avoided anything that seemed even mildly aggressive. I wish there was more space to discuss Merrill Lynch's initial experiences with advertising agents, but we have to move on. Suffice it to say that Charlie Merrill produced some highly positive results with direct mail solicitations, and he was among those financiers who frequently questioned other members the Wall Street community about why they took such a dim view of

activities that he thought were perfectly legitimate with regard to informing the public about the services of brokerage firms and investment banks.

In order to provide more context for the later discussion, I want to take a couple of paragraphs to survey Merrill's career up to the eve of World War II [7, 18]. From 1915 to 1930, he was directing partner and CEO of Merrill Lynch & Co. He made a small fortune through what today we call "merchant banking." He invested heavily in the common stocks of the companies for which he had performed various investment banking functions, and capital gains made him wealthy. His specialty was chain stores of all varieties – shoes, clothing, auto parts, and, particularly, groceries. For several years, he and his partner Edmund Lynch owned and managed Pathe Studios – the movie producer and film distributor with French origins. After the crash in 1929, Merrill put his financial services career on the back burner and largely abandoned Wall Street. Using the money from the sale of Pathe to Joseph Kennedy, a founder of the RKO movie studio and the father of a future president, Merrill acquired a controlling interest in Safeway Stores, a grocery chain based in Oakland, California, in the mid-1920s. He was very active in overseeing the operations of Safeway throughout the 1930s. By the way, his grandson, Peter Magowan, is the current CEO of Safeway Stores – and also one of the key owners of the San Francisco Giants baseball team.

In fighting a proposal by the California legislature to place a prohibitive tax on the outlets of chain stores in 1935, Merrill met Ted Braun, who headed a Los Angeles management consulting firm that routinely used consumer surveys and public opinion polls in advising corporate clients [26]. Braun provided valuable assistance to Safeway in the fight against the chain store tax. The tax proposal finally turned up as a proposition on a state-wide ballot and was defeated handily by voters; citizens decided that they valued the low prices of the chain stores more highly than protecting locally-owned, independent retailers from the rigors of price competition [12].

In late 1939 and early 1940, Winthrop Smith, a former business associate, persuaded Merrill to return to the financial services sector as the directing partner of a new firm created through the merger of Merrill Lynch & Co., which had been essentially dormant during the depression, with E. A. Pierce & Co., which ranked as one of the nation's leading brokerage houses, with approximately 40 branch offices and 300 brokers. Pierce & Co. had been losing money for several years, and Merrill acted as the white knight who rescued it from probable dissolution. In 1941, Fenner & Beane, another brokerage house with a chain of branch offices, and also on the brink of dissolution, came on board to create Merrill Lynch, Pierce, Fenner & Beane. (Fenner & Beane had experimented with customer surveys in the mid-1930s, and I had originally intended to use some of that data in this paper, but, unfortunately, time and space proved a roadblock [4].)

After the stock market crash in 1929, brokerage houses remained profitable for the next half decade or so because trading volume on the exchanges held up reasonably well. When stock prices started to recover from their extreme lows in 1934, most brokers thought they were out of the woods, but their optimism was dashed two years later. For reasons inexplicable at the time and still a mystery today, trading volume on the exchanges started to fall precipitously in 1937, and it failed to rebound for six long years (Table 1). Hundreds of stockbrokers were forced out of the business, and those that remained saw their commission earnings steadily decline; it was especially frustrating because so many other Americans were enjoying the benefits of the economic recovery.

Table 1
Trading Volume on the New York Stock Exchange, 1897-1956
(in millions of shares)

Year	Vol.	Year	Vol.	Year	Vol.	Year	Vol.
1897	77	1930	812	1940	207	1950	524
		1931	576	1941	170	1951	444
1900	139	1932	425	1942	126	1952	337
1905	232	1933	655	1943	278	1953	377
1910	164	1934	324	1944	263	1954	573
		1935	382	1945	340	1955	649
1920	231	1936	496	1946	363	1956	556
		1925	466	1937	409	1947	253
		1938	297	1948	302		
1929	1,125	1939	262	1949	272		

Mean volume in 1930s = 463 million shares; in 1940s = 257 million shares

Source: Maurice Farrell, ed., *The Dow Jones Averages, 1885-1970.* (New York: Dow Jones & Co., 1972).

One of Merrill's first acts as CEO in early 1940 was to commission Ted Braun's management consulting firm to conduct a thorough analysis of the operations of the Los Angeles branch of E. A. Pierce & Co. Braun studied the branch office from two perspectives. First, he engaged accountants to conduct an internal review of the revenues and costs associated with servicing different types of brokerage accounts. Second, Braun hired a group of interviewers who, discreetly, without revealing the name of the client, surveyed the attitudes and opinions of a broad sample drawn from the nearly 3,000 customers who maintained accounts at the Los Angeles office. The questions ranged from broad and sweeping inquiries to other questions narrow and concise; interviewers sought customer views about the capital markets in general and about the performance of the Pierce branch and its personnel in particular. What Braun discovered mirrored the conclusions of the Elmo Roper poll that had been conducted earlier on behalf of the NYSE [27]. Most customers expressed doubts about the fairness of the system to outsiders like themselves, and, not surprisingly, they were suspicious of the veracity and ethics of stockbrokers as an occupational class. On the other hand, most customers gave generally high marks to Pierce brokers in the Los Angeles office, which indicated that criticisms of the capital markets were generic in origin and did not reflect negatively on the quality and reputation of the firm's current employees.

Based on his review of the operations of the Los Angeles branch, his discussions with top management at the expanded Merrill Lynch, and his experiences with other firms in the goods and services sectors, Braun proposed one of the most unconventional ideas in the history of the American financial services sector. To long-time participants in the brokerage field, his proposal was thoroughly revolutionary in its implications. Braun recommended that individual brokers no longer be compensated by paying them a percentage of the commissions linked to specific transactions – at Pierce the split to brokers was 28 percent of the gross commission. Instead, brokers would receive fixed annual salaries that reflected their overall contributions to the profitability of the firm.

If Merrill Lynch genuinely wanted to differentiate itself from other brokerage houses, Braun argued strenuously, the firm needed to inaugurate a dramatic new policy that addressed the lingering concerns not only of existing customers, but more importantly in the long run, the fears of millions of potential future customers. Merely proclaiming that its brokers were more honest than rivals and were more dedicated to meeting the financial goals of investors was unlikely to translate into anything much more than a marginal competitive advantage. Braun's polling data suggested that almost everyone who had ever dealt with a brokerage house had wondered at times about whose interest was paramount whenever the broker recommended either the purchase or sale of securities. Was the broker merely seeking to earn the commission linked to a proposed trade or did the broker genuinely believe the transaction was in the customer's financial welfare? These suspicions about a broker's motivation were inherent and unavoidable, Braun stressed, so long as sales personnel received compensation based on commissions linked to specific trades. The only effective means of altering the fundamental relationship between brokers and their customers was to eliminate completely any incentive to churn individual accounts.

Merrill, whose experience was primarily in the investment banking field rather than in the secondary markets, was initially dubious about the new compensation proposal, but Braun wore him down. In correspondence years later with Lou Engel, who headed Merrill Lynch's advertising department, Merrill recalled the circumstances: "Of all the policies suggested by Ted Braun, this was the toughest one of all for me to adopt...I remember distinctly telling Ted Braun that I would not work for a firm that did not pay a commission." After a pause, "Ted leaned back in his chair, relaxed and said: 'This point is the keystone of all my suggestions. If you do not adopt it, it's no use talking about any of the rest.'" After Merrill had accepted the idea, he "too had a difficult time in selling this policy to my partners." Looking back on his long career in 1954, just two years prior to his death, Merrill confessed: "I think that of all our policies, this is the most important one" [17, Dec. 8, 1954].

To inform the branch managers of the upcoming changes, the partners planned a three-day conference in New York City in April 1940 [2]. Pierce opened the proceedings and quickly introduced the new directing partner – Charles E. Merrill. He began by discussing the rationale for the meeting and the strategic planning that had preceded it. After his introductory remarks, Merrill, in turn, introduced Braun as the man who had produced the facts that had become the cornerstone for a series of innovative managerial decisions. Braun reported in detail on his consulting firm's review of the operations of the Pierce branch in Los Angeles. The office employed nine brokers who handled a total of 2,828 customer accounts, an average of over 300 customers per broker. Approximately 90 percent of all customers traded primarily stocks and bonds; six percent dealt strictly in commodities; and four percent were involved in both commodities and securities. Women maintained 25 percent of the branch's accounts. The volume of trading activity varied greatly: over 15 percent of all customers had initiated no trades at all over the last year; 55 percent had recorded from one to five transactions; and 30 percent had generated six or more transactions. The slowest 70 percent of accounts produced a mere 15 percent of commissions, while the more active accounts were responsible for 85 percent of commission revenues.

Braun's analysis highlighted the importance of customers who maintained accounts either with debit balances or with credit balances to the firm's profitability

and, in turn, to the commission income of its individual brokers. The most active trading accounts were margin accounts. Customers who bought securities in part with borrowed funds generated average annual commissions of $165 versus only $50 for customers who paid for securities fully in cash. Moreover, the average margin customer produced over $70 annually in interest revenue. The largest revenue sources were a handful of margin accounts with debit balances of over $5,000; these customers had generated more than $500 in commissions and $440 in interest revenue in 1939. On the other side of the ledger, customers who regularly left large cash balances with the firm to finance future transactions were also among the most profitable accounts; they averaged $175 annually in commissions – more than three times greater than cash customers without credit balances.

The second day of the branch managers' meeting was devoted to discussions of organizational, structural, and procedural matters. To members of the audience, the most crucial presentations addressed the new policies related to broker compensation, customer service, and public relations. The big news was that annual fixed salaries would replace fluctuating commissions in compensating brokers. No longer would there be any incentive, or, equally important, the public suspicion of an incentive, for brokers to churn customer accounts. The minimum salary for brokers was set at $2,400 (about $30,000 in 1995 prices), and for about 15 percent of the sales force that figure represented a boost over their earnings in 1939. All brokers that had earned higher than the minimum were automatically granted a $25 monthly increase over their current earnings for the remainder of 1940. No broker was asked to take a cut in take-home pay. The salary program placed limits on how much a given broker could earn during the upcoming year, but that negative feature was offset by the security of a steady income and the prospect of salary increases in future years – if and when trading volume on the exchanges improved.

Along with changes in the compensation package, the firm instituted a significant reorganization of work assignments and responsibilities at the branch level. Based on Braun's in-depth analysis of the Los Angeles office, Merrill and his key advisors decided to make dramatic changes in the traditional system of servicing accounts. These changes had dual purposes that were viewed as complementary – to provide better service for a varied clientele, while simultaneously boosting volume and improving the firm's overall profitability. The standard method of assigning accounts at every brokerage house in the nation had always been based on individualistic and competitive principles. Managers usually granted the originating broker – the employee who had initially recruited or opened a new account – the option of retaining that customer's future business on a more or less exclusive basis. The net result of this traditional mechanism was that almost every broker at Merrill Lynch (and elsewhere) laid claim to a mixed bag of customers. In most instances the majority of names on a broker's client list were small, relatively inactive, and unprofitable accounts. From one-fourth to one-third of the typical broker's accounts were moderately active, but only marginally profitable. Just a few names on the client list, typically persons with large portfolios financed in part by margin loans, regularly placed orders for securities on a monthly or weekly basis.

In addition to differences in trading volume, almost every broker also handled a wide range of customers with varying objectives: bond investors were primarily interested in capital preservation; common stock investors bought and held securities for long-term growth; and speculators trading puts and calls (options to buy and sell securities at a fixed price) sought to maximize capital gains in the short to intermediate run. Every broker, in short, was expected to be a jack-of-all-

trades with respect to their knowledge about providing a range of services. In an effort to improve efficiency, Merrill Lynch reassessed the effectiveness of the all-purpose, all-knowing broker and the haphazard system of account allocation.

The new rationale for improved customer service was based on specialization and employee expertise. The task of reassigning accounts fell to the branch manager, who, except in the smaller offices, was no longer expected to act as a part-time broker. To assist in the realignment of customers and brokers – an evolutionary process that was expected to take several years before full implementation – the branch manager was given a new tool for decision making. At Braun's urging, Merrill Lynch executives decided to circulate a customer questionnaire designed to pinpoint the aims and goals of every client. The partners introduced to the brokerage field the personalized financial profile sheet – a universal form that, when completed, identified every client's financial objectives and the jointly agreed-upon strategy for achieving his or her stated goals. The customer filled out the questionnaire, preferably during a face-to-face meeting with a Merrill Lynch broker, and then signed on the dotted line. The central idea was to give each customer the opportunity to tell the firm precisely what level of service he or she wanted from Merrill Lynch; and the firm, in turn, pledged to provide nothing more and nothing less than the customer desired. For example, customers were asked whether they routinely wanted brokers to offer opinion and advice about the purchase and sale of specific securities? Some customers indicated on the survey sheet that all they desired was reliable information on business trends and the finances of certain corporations – and that unsolicited trading advice was unwelcome.

Drawing on the information in the completed questionnaires, the branch manager divided customers into several categories. All the small and inactive accounts in a given branch office were, over time, scheduled for transfer to just a few brokers, usually the most inexperienced men in the office, who now specialized in maintaining and nurturing the accounts of low-activity customers. These brokers handled mostly odd lot orders and performed what was viewed, at least from one standpoint, as essentially a public service to the local community. At the same time these brokers were instructed to remain alert to the fact that some previously inactive clients were on the verge of increasing their trading volume and were therefore eligible to graduate into the ranks of profitable accounts. After the transfer of small accounts took effect, the client list of brokers with the responsibility for handling the genuinely profitable accounts was expected to drop significantly – in the Los Angeles branch most client lists declined from around 300 names to only 150 names or thereabouts. The mainstream brokers now had more time to concentrate on providing superior services to accounts that were already generating a profitable volume of trades.

In a further effort to match clients with the one broker most qualified to meet their specific needs, branch managers used the information on the individual survey sheets to divide customers into three broad groups: investors, speculators, and persons who periodically alternated between prudent investing and speculation depending on current market trends. In the Los Angeles office about one-third of active accounts seemed to fall roughly into each category. Based on this data, those brokers who were more oriented toward capital preservation and long-term growth in their selection of securities were matched with clients who emphasized safety and income. Brokers who were comfortable with high risks and volatile price movements served customers who indicated a speculative bent; these same brokers usually handled the 5 percent or so of active accounts that traded commodities on

a regular basis. Customers who fit most logically in the alternating investor-speculator group were assigned to brokers who were reasonably at home in both camps. There was, in other words, still a place in the organization for all-purpose brokers, but they now became a minority within the office rather than the overwhelming majority.

Under the new compensation and account allocation plans, the personnel in each branch office were encouraged to act as a team in meeting the needs of local customers and in developing new business. Brokers in the same office no longer had a strong incentive to compete internally with each other for new accounts – at least, not for small or modest accounts; now they could concentrate on explaining to business prospects why Merrill Lynch's broad services were superior to those of all competitors. Executives in New York planned to judge the performance of each branch as a comprehensive unit. Local branch managers were granted the power to adjust salaries to reflect each employee's contribution to the overall success of the branch.

To support their brokers in the field, Merrill and his new partners planned to break with the old taboos on Wall Street and launch an aggressive advertising and public relations campaign. In a light-hearted comment to the assembled managers, he remarked: "If R. H. Macy had the same approach toward...business-getting expenses that all members of the New York Stock Exchange have, I assure you R. H. Macy & Co. would be out of business by next April – and it wouldn't be April Fool's Day either" [2]. The new emphasis was on educating the public about the functioning of the exchanges and the benefits arising from long-term investments in selected securities of profitable and growing corporations. The NYSE itself had parted with tradition and started running a series of generic advertisements in the late 1930s but the impact on trading volume had been minimal. At Merrill's insistence, his partners allocated $100,000 to the advertising budget over the next year. An analysis of income and wealth patterns indicated that there were approximately 5 million households nationwide – mostly upper middle class households in mid-sized cities – which owned few, if any, securities, and they were considered likely prospects for solicitation. Braun announced that the firm had contracted to place advertisements covering two-thirds of a page in *Time Magazine*, with a circulation of over 750,000, for 28 weeks. According to Braun, *Time* was "the best single medium in the United States to reach the maximum number of potential customers for this business" [2]. The firm also scheduled ads to run in newspapers with a combined circulation of 14 million in cities with branch offices.

The new organizational and marketing strategies adopted at Merrill Lynch in 1940 proved remarkably successful, and amazingly they required little modification over the next quarter century. From the start, Merrill had assured everyone in the organization that the partners' radical departure from long-standing precedents on Wall Street was experimental and that major adjustments were possible if serious problems unexpectedly arose. As it happened, few actually emerged. Indeed, the firm maintained the salary compensation program until deregulation and the elimination of fixed commission schedules led Merrill Lynch to abandon the practice and revert to industry norms in the 1970s.

Meanwhile, implementing the new policies and holding the organization together in the early 1940s proved difficult because trading volume on the exchanges continued to fall in 1941 and 1942 (Table 1). The 126 million shares traded on the NYSE in 1942 was so low it actually dropped below the level reached four decades earlier in 1900. (Today, the same number of shares is frequently traded in a mere two or three hours.) Despite the unfavorable investment climate, the

campaign to attract new customers was enormously successful. From April through December 1940, the number of new accounts exceeded 50,000 – an increase of about one-third in the customer base. In an appearance before members of the Financial Advertisers Association in September 1941, senior partner Edward Pierce told the audience that the firm's advertising had produced some very positive results. "Even those who have ridiculed our efforts," Pierce added, might one day realize the benefits accruing from "the right kind of public relations campaign" [*NY Herald Tribune*, Sept. 11, 1941]. That year the firm added 30,000 new customers; in 1942 another 27,000 signed on; in 1943 another 49,000; and in 1944 another 46,000. By the end of WW II, Merrill Lynch served approximately 250,000 customers. During this period, the brokerage firm generated 8 to 12 percent of all trading on the NYSE.

Despite sharp cost reductions in rents and communications services, the firm lost over $300,000 in 1940. The next year was marginally profitable, with earnings of $459,000. In 1943 pre-tax earnings jumped to $4.8 million, which translated into a 70 percent return on the partner's invested capital; the imposition of extremely high wartime taxes reduced the after-tax figure to $1.1 million and a 16 percent return on capital [17]. In the postwar era, the partners continued to earn handsome returns on their capital. From a big-picture perspective, Merrill Lynch truly brought Wall Street to Main Street; the firm's brokers helped hundreds of thousands of upper middle class households accumulate substantial portfolios of blue chip stocks through sustained programs of regular life-cycle investing. Many professors will likely obtain the same results by investing regularly in the stock funds offered by TIAA-CREF over a 25- to 30-year period.

The partners' decision in 1940 to shift the firm's broker compensation system from commission splitting to fixed salaries was a bold move, with many potential dangers. Previously the firm's annual expenses were roughly fifty percent variable (the brokers' split of the gross commissions), and fifty percent fixed (for office leases, equipment depreciation, phone lines, bookkeeping, and the like). Under the new compensation system fixed costs rose to about 85 percent of total expenses. Merrill and his partners were assuming tremendous risk in very uncertain times.

To summarize and conclude, when Charles Merrill decided to return to the financial services sector in 1940, he relied heavily on the data and the recommendations generated by Ted Braun's management consulting and public relations firm. Based on the information in other published public opinion polls and from a confidential survey of the customers of a single branch office, Braun presented a sweeping reorganization plan that was to be coordinated with an aggressive marketing and advertising program. Initially skeptical, Merrill soon accepted the logic of Braun's grand design to reinvigorate the firm; the new focus was on the solicitation of millions of upper middle class households that typically owned life insurance policies but few, if any, common stocks.

The decision to move forward with such a truly revolutionary program would not have been possible without the data gathered from a group of outside consultants who analyzed the financial environment from several angles. The fruits of market research made a huge impact on Merrill Lynch; and the brokerage firm, in turn, made a tremendous impact on the development and maturation of the American financial services sector in the post-WW II era. The SEC reforms in the public realm and Merrill Lynch's new strategies in the private realm were highly complementary; together they revived the securities markets in the mid-1940s, and in time led directly to the expanded Wall Street that we know today.

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