The Changing Banking Environment from the Past Decade to the Next: A Study of Farmers and Merchants Bank

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James Madison University

Team: Collin Blanchard, Sara Kate Garman, Nicolas Gonzalez, Emelia Potteiger, Noah Vanhoy

Advisor: Dr. Carl Larsson

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Executive Summary

The COVID-19 pandemic catalyzed changes in operations and technology for banks of all sizes. These trends are likely to continue to permeate the industry over the next decade. In this case study, we examine these retrospective and forward-looking trends in the context of Farmers and Merchants Bank Corporation of Timberville, Virginia (henceforth F&M Bank or F&M).

Located in the agricultural Shenandoah Valley region of Virginia, F&M Bank is a community bank with total assets of over $1.2 billion. Founded in 1908, F&M has served its community for over 100 years. Over the last ten years, F&M has grown rapidly and experienced many changes in its technology and operations. The bank's founding values, however have remained the same. F&M strives to keep deposits within the area it serves, to seek organic growth, and to provide exceptional service by developing and maintaining long-lasting relationships.

In order to examine the greatest retrospective and forward-looking changes to F&M Bank, we use the following methods. In *Section 1: Financial Analysis*, we analyze F&M's financial performance. To gain a unique insight, we interview the bank's top executives, and analyze data from 10-K filings and F&M's Uniform Bank Performance Report (UBPR). To conduct a comparative analysis, we construct a custom peer group of banks that are highly comparable to F&M Bank. We first identify seven banks of similar asset size that are also located in the Shenandoah Valley. We then gather all relevant UBPR financial data for analysis from each bank. We finally average each data point across the seven banks to compute our custom peer group values. Our approach allows for a more accurate comparison relative to using the UBPR peer group values which are subject to a larger range in asset size and are not geographically focused. In *Section 2: Looking Back,* we discuss F&M's banking environment and operations over the last ten years by deriving information from F&M's Annual Report and give context using interviews with

F&M executives. In addition, we also interview a Chief Investment Officer of a bank equity focused hedge fund. In *Section 3: Looking Forward,* we investigate F&M's future expectations conducting in-person interviews with F&M executives. We then compare their predictions to national expectations.

Our results are as follows. In *Section 1: Financial Analysis*, we determine that F&M has slightly lower return on equity (ROE) than its local peers, driven by a lower return on assets. Time series analysis, however, shows upward trends in ROE. Additionally, management seeks to expand its commercial loan base post-pandemic. In *Section 2*: *Looking Back*, we find that F&M used to have a more real-estate focused loan portfolio and less advanced technology ten years ago. More recently, the pandemic provided an opportunity to expand customer relationships following its participation in the Paycheck Protection Program (PPP). In order to remain competitive with larger banks during the pandemic, F&M increased investment in client-facing and back-end technology and redefined the traditional model of bank operations. In *Section 3: Looking Forward,* we describe how F&M foresees FinTech partnerships as key to remaining competitive with larger institutions that can make substantially larger investments to develop technology internally. Furthermore, we expect that community banks that do not keep up with technological changes are more likely to fail.

It will be crucial for the continued success of F&M and community banks around the country to become market leaders in adopting innovative technologies and more flexible operational models. In addition to being important to community banks, our analysis is also relevant to regulators monitoring evolving cybersecurity and compliance risks, as well as investors seeking highly performing bank equities.

Section I: Financial Analysis

Section I.1: Overview

We conduct a financial analysis of F&M Bank over the past 5 years using the 2021 Form 10-K filing and data from the Uniform Bank Performance Report. We also present details from discussions with the executive management team[1]. We compare F&M's financials to a peer group of community banks located in the Shenandoah Valley based on an index of zip codes, asset size, and geographic scope. We create our own peer group of Shenandoah Valley community banks to allow for more comparable averages, as the UBPR is not geographically limited to this regional area and the asset size has a larger range. Our findings suggest that F&M must facilitate loans to increase the loan-to-deposit ratio as well as take advantage of the higher rate environment to improve earned interest income. F&M must monitor profitability in the coming years when moving from post-pandemic tailwinds.

Section I.2: Earnings Performance

It is important we analyze F&M's profitability as the COVID-19 pandemic brought uncertainty into every industry in the past few years, F&M's 2019 return on equity was 5.02%, and ROE has been recovering and reached a recent high of 11.15% in 2021: however, F&M is still trailing the peer group return of 13.37% in 2021. During the pandemic, interest rates were extremely low which caused compression in interest income. The compression is associated with strategic risks because banks must make efforts to elevate earnings including cost-cutting or leveraging loans which many entail increasing credit risk (*OCC, 2021*). Paycheck Protection

[1] We are grateful to have interviewed the following executives when compiling all sections of our case study: Mark Hanna (Chief Executive Officer), Carrie Comer (Chief Financial Officer), Katherine Preston (Senior Vice President (SVP) and Valley Market Executive), Garth Knight (Chief Banking Officer), Stephanie Shillingburg (Executive Vice President and Chief Experience Officer), and Karen Rose (SVP, Deposit Operations).

Program (PPP) lending to small businesses gave community banks an avenue to generate fee income and increase loan production throughout the pandemic. Additionally, provisions for losses declined due to the improving economy. The combination of reduced provisions and lingering beneficial effects of the PPP enabled higher profitability in 2021. Therefore, banks may struggle to maintain high profitability as they transition from the post-pandemic environment with historically low net interest margins (OCC, 2021).

Moving forward, the Basel III implementation may pose a concern to recent high profitability due to higher capital requirements. Banks will phase in this accord over five years, beginning Jan. 1, 2023. Another potential concern is the reduction or elimination of overdraft charges. That is something the Consumer Financial Protection Bureau is examining, which could hurt profitability because it is a large contributor to a bank's income (Comer, 2022).

Finally, we note rising interest rates. If rates increase, it could increase the net interest margin (NIM). Although rising interest rates could improve profitability, we must monitor earnings performance as the Basel III Accord is implemented.

Section I.3: Loan Portfolio Composition

F&M has diversified and grown its loan portfolio through organic loan growth and expansion in the Valley. [2,3] Due to the history of F&M, we would expect agricultural loans to comprise a larger majority of the loan portfolio, especially because F&M is strategically placed beside two of the largest agricultural counties in Virginia: Augusta County and Rockingham

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[2] Defined, organic loan growth is growth from internal operations as opposed to growth through mergers and acquisitions.

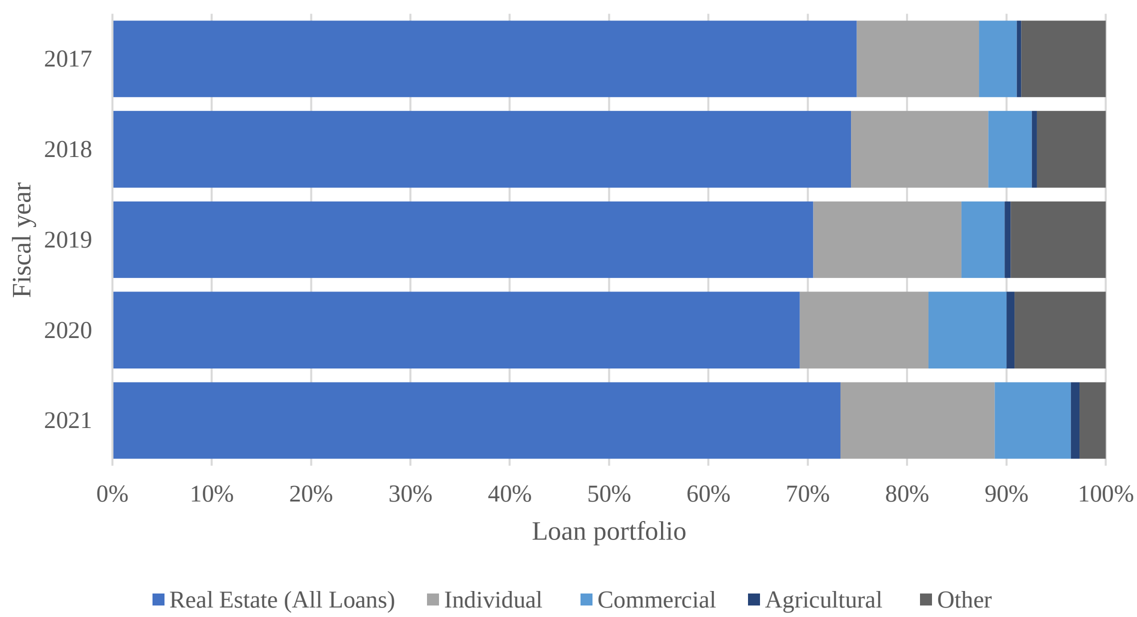
[3] Expansion is occurring currently in the Winchester/Frederick County and Augusta County markets.

County. However, F&M has focused efforts to rebrand itself as "F&M," rather than "Farmers & Merchants" to attract non-agricultural customers to the bank (Knight, 2022).

Recently, there has been more focus on commercial and small business lending (Hanna, 2022). This was prevalent during the pandemic when the US government made PPP loans available to commercial and small businesses. The community bank model exists to understand business and tailor products to their needs (Hanna, 2022). Whereas mortgage lending has more regulation and is increasingly becoming "boxed-in," small business lending is the opposite because it allows F&M to blend required metrics with relationships. See figure 1 for loan portfolio composition.

Figure 1: Loan Portfolio Composition of F&M Bank from 2017-2021

This figure depicts F&M Bank's loan portfolio composition as a percentage of its total portfolio value. Data Source: UBPR



Section I.4: Asset Growth

As reflected in Figure 2, loans held for investment comprise most net loans and leases. Figure 2 depicts that net loans and leases had a -7.05% growth year-over-year in 2021. This decline is largely due to the decrease in loans held for sale in 2021. In addition, there has recently been a larger allowance for loan losses, likely attributable to uncertainties from the pandemic. An increasing loan loss allowance has a direct and negative impact on profitability.

Figure 2: F&M Bank's Total Asset Growth from 2017-2021

This table depicts the balance sheet line items in $1,000s. Data Source: F&M Bank's 2021 Form 10-K filing.

	2017	*2018*	*2019*	*2020*	*2021*
Loans Held for Investment	$616,974	$638,799	$603,425	$661,329	$662,421
Less Allowance for Loan Losses	-$6,044	-$5,240	-$8,390	-$9,433	-$9,000
Net Loans Held for Investment	$610,930	$633,559	$595,035	$651,896	$653,421
Loans Held for Sale	$39,775	$55,910	$66,798	$58,679	$4,887
Net Loans and Leases	$650,705	$689,469	$661,833	$710,575	$658,308

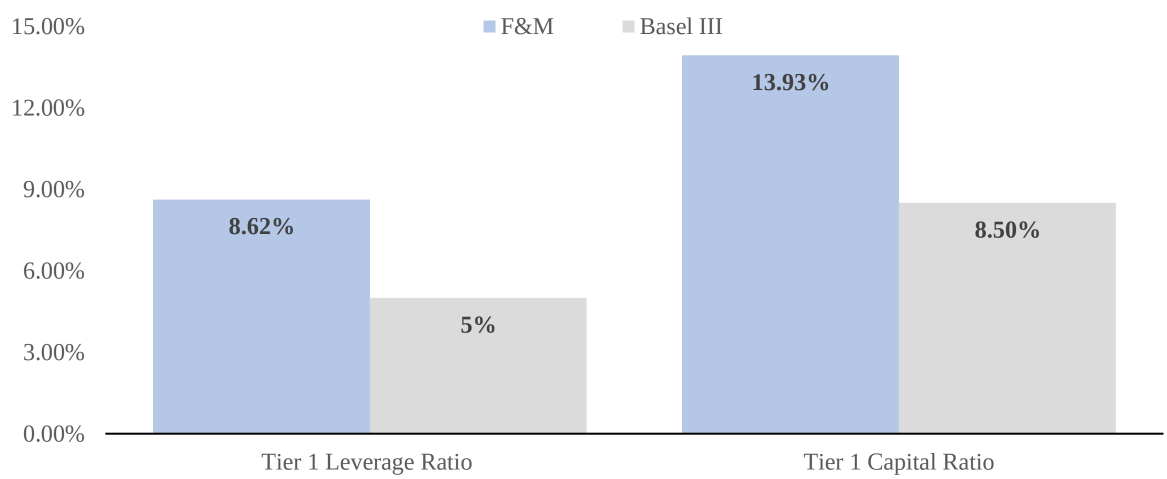
Section I.5: Capital Levels

The Basel III Accord, with planned implementation on Jan. 1, 2023, and a phase-in over five years, raises capital requirements. This will create a change from 2% to 4.5% of common equity, as a percentage of the bank's risk-weighted assets. In addition, Tier 1 capital must be at least 6% and total capital must be at least 8% of risk-weighted assets (RBC20 - Calculation of Minimum Risk-Based Capital Requirements). The FDIC Community Bank Study of 2020 notes, "The most important change to capital adequacy regulation during the 2008-2019 period was U.S. implementation of a version of the Basel III capital framework."

"Well-capitalized banks" have a Total Capital Ratio greater than 10.5% and a Tier One Capital Ratio greater than 8.5%. F&M's tier one leverage and tier one capital ratio is 8.62% and 13.93%, respectively. After analysis of F&M's capital levels, we find that it meets and exceeds the requirements to be classified as "well-capitalized" (Figure 3).

Figure 3: F&M Bank's Capital Ratios Compared to Basel III

This figure depicts Tier One Leverage and Tier One Capital Ratio in percentage terms. Minimum requirements for a well-capitalized bank are represented in Basel III percentages. Source: UBPR, FFIEC



Section I.6: Liquidity

In 2018-19, a strategy at the forefront of F&M operations was bringing in core deposits. Due to the pandemic, liquidity increased for community banks. Analysts have correlated trends in deposit growth to government stimulus, lower consumer spending, and companies drawing down credit lines (White, 2021). Banks within the Shenandoah Valley experienced larger deposit growth, on average, compared to national trends. Data suggests that banks within the Shenandoah Valley experienced an increase of 30.4% year-over-year in 2020 and 37.1% in 2021 (UBPR, 2022). Increasing liquidity does pose a challenge to F&M as they must deploy the glut of deposits. F&M chose to handle the deployment challenge by putting deposits into an investment portfolio. Moving forward, F&M would like to find a balance between the investment portfolio and lending to enable its loan-to-deposit ratio to be around 80-95% (Comer, 2022). Before the pandemic, its loan-to-deposit ratio was over 100%. This signifies that F&M was loaning out over a dollar for every dollar that they were receiving in deposits. Currently, this ratio is approximately 60%. The loan-to-deposit ratio also impacts NIM, and therefore profitability. The lesser the loan production, the lesser the interest received. Although the increase in deposits dramatically reduced banks' funding costs due to near-zero interest rates, F&M must work to balance lending and investment to achieve its desired loan-to-deposit ratio.

Section I.7: Section Summary

After thorough financial analysis utilizing UBPR and10-k data, we conclude that F&M must monitor profitability in the future with lingering pandemic uncertainties as well as high liquidity, compressing net interest margin and reducing the loan-to-deposit ratio. F&M is currently more high-performing than national averages when considering the net interest margin and loan-to-deposit ratio[4]. Moving forward, F&M must work to increase loan facilitation and take advantage of the high-rate environment at present to continue high earning trends.

[4] The loan-to-deposit ratio has fallen to 74% for community banks at mid-year 2021 (White, 2021), while the industry average was 58.6% (Duren C. & Sikander A., 2021).)

Figure 4: Key Financial Ratios

This figure depicts key financial ratios in percentage terms. Source: UBPR

	2021		2020		2019		2018		2017	
	F&M	Valley Avg	F&M	Valley Avg	F&M	Valley Avg	F&M	Valley Avg	F&M	Valley Avg
Loan-to-Deposit	60.40%	74.99%	85.20%	92.71%	102.88%	94.71%	116.45%	100.34%	114.15%	98.52%
Net Interest Margin	3.09%	3.49%	3.62%	3.71%	4.28%	3.61%	4.60%	4.08%	4.47%	4.07%
Return on Assets	1.01%	1.29%	0.93%	1.14%	0.56%	1.00%	1.21%	1.24%	1.20%	0.96%
Return on Equity	11.15%	13.37%	9.64%	11.99%	5.02%	9.40%	10.11%	11.40%	9.89%	8.60%
Loan to Asset	54.12%	65.76%	73.41%	75.66%	81.41%	77.91%	88.55%	81.15%	86.55%	80.13%
Equity Multiplier	11.04%	10.64%	10.37%	10.59%	8.96%	9.54%	8.36%	9.34%	8.24%	9.29%
PLL/Avg. Total Assets	-0.26%	0.00%	0.35%	0.40%	0.93%	0.24%	0.39%	0.18%	0.00%	0.11%
OI/Avg Assets	0.90%	1.17%	1.11%	1.45%	1.06%	0.97%	0.93%	1.00%	0.95%	0.95%
OE/Avg Assets	2.89%	2.79%	3.07%	3.11%	3.54%	2.89%	3.44%	3.11%	3.31%	3.06%
Leverage Ratio	8.62%	9.09%	9.93%	9.16%	10.89%	9.86%	11.79%	10.58%	15.41%	11.30%
Asset Growth	26.08%	29.33%	18.90%	26.27%	4.41%	250.14%	3.57%	8.98%	0.90%	7.67%
Tier 1 Capital Growth	9.04%	39.65%	7.62%	13.27%	-2.26%	19.00%	0.94%	6.24%	4.12%	7.76%
Net Loans & Leases Growth	-7.05%	16.05%	7.22%	27.01%	-4.01%	21.52%	5.96%	10.85%	0.60%	6.86%

Section II: Looking Back

Section II.1: Section Overview

In this section, we examine the profile of Farmers and Merchants Bank Corp in 2012. We use financial analysis and conduct interviews with executives to learn about the bank's profile. Supplementally, we interview a hedge fund investor who specializes in the banking industry, to provide insight at a national level. In addition, we learn about challenges the bank faced during the last ten years. Finally, we recount a story that encompasses what it means to be a community bank.

Section II.2: Bank Profile

Section II.2a: Institutional Size

F&M was a different institution ten years ago than it is today. In 2012, the bank celebrated its 104th anniversary. The bank had grown outside of Timberville, where it was founded, but remained within the Valley.[5]

In 2012 the bank offered mortgages through VBS Mortgage. The bank opened two new loan production offices, one in Fishersville known as the Fishersville Loan Production Office, and an automotive dealer finance division in Harrisonburg known as the Dealer Finance Department. The bank also operated cash-only ATMs in five Food Lions. It employed 142 full-time and part-time employees (F&M Bank Annual Report, 2022).

In 2012, F&M had $572,529,000 in assets, and held $453,796,000 in deposits. Of the bank's assets, 93.66% were earning assets. Its return on assets for the year was 0.86%, which had been increasing ever since the financial crisis of 2008. Its return on equity for the year was 10.26%, which had been increasing since 2009. The bank had a net-interest margin of 3.95% which had

[5] It had bank branches in Bridgewater, Broadway, Edinburg, Elkton, Harrisonburg, Timberville, and Woodstock.

held steady since 2008. The bank's efficiency ratio was 54.03% and decreasing since 2008. [6] Finally, the dividend payout ratio was 32.65%, which had been decreasing since 2009 (F&M Bank Corp 10-K, 2013).

Section II.2b: Institutional Business Model and Strategic Focus

In 2012, the bank's business model centered around offering different loan types, with a focus on construction and development loans, commercial real estate loans, and mortgages. The bank's construction and development loans averaged 12 months in length, with the loan amount being between 75% to 90% of the property's appraised value. Commercial real estate loans were for multi-family residential buildings, commercial buildings and offices, shopping centers, and churches. The bank offered some business loans which were much riskier than other loans but higher yielding. The bank makes these loans on the projected cash flows the business will generate. These loans are secured by business assets.

Figure 5: F&M Bank Loan Composition

This exhibit details the loan composition of F&M from 2008 to 2012 in thousands. Source: F&M Bank Corp. 10-K

(Dollars in thousands)	2012	2011	2010	2009	2008
Real Estate-Mortgage	$204,812	$193,280	$190,162	$180,990	$161,224
Real Estate-Construction	$71,251	$72,224	$79,337	$86,320	$71,259
Consumer Installment	$15,753	$13,015	$19,043	$19,247	$22,792
Commercial	$147,089	$141,014	$121,490	$115,638	$115,297
Agricultural	$14,099	$15,985	$19,761	$19,355	$18,711
Multi-Family Residential	$ 9,357	$13,157	$12,259	$10,391	$7,898
Credit Cards	$2,788	$ 2,812	$ 2,771	$ 2,356	$1,940
Other	$670	$83	$324	$106	$112
Total Loans	$465,819	$451,570	$445,147	$434,403	$399,233

[6] Noninterest expenses divided by the sum of tax equivalent interest income and noninterest income

The bank had a policy to make conservative loans, which it would hold for future interest income. In 2012, the company issued 5.7% more loans than the year before, but 1.35% fewer construction loans. The decrease in construction loans was due to a slowing economy in the Shenandoah Valley, therefore reducing construction in the bank's primary market area. F&M was aware that most of the loans they issued were centered around a particular geographical market. To diversify, F&M entered into loan participation agreements with other banks in the region. Its goal with these agreements was to diversify geographically and by borrower and collateral type (F&M Bank Corp 10-K, 2013).

F&M faced strong competition in 2012 from traditional financial institutions like large national and regional banks, community banks, and credit unions. In addition, they faced competition from consumer finance companies, mortgage companies, loan production companies, mutual funds, and life insurance companies. To address competition, the management of the company had decided to implement a growth strategy. The growth would come from opening new loan production offices and bank branches in existing and new markets (F&M Bank 10-K, 2013). The bank's growth has helped it to realize economies of scale and better compete with larger banks, helping to prevent the bank from being acquired by a larger competitor (Katherine Preston, 2022). Management was aware to successfully grow, they would need to identify attractive growth markets.

In addition, the company would need to maintain capital levels to sustain growth, while maintaining cost controls and asset quality. Management was aware that opening new loan production offices and branches would incur increased operating costs before they could generate income from new customers. Additionally, management knew that earnings would be temporarily lower in the short-term even if the strategy was successfully implemented.

Section II.3: Bank Challenges

F&M Bank cited challenges in keeping up with bigger banks' specialized offerings and in-house technology investments. As the banking landscape is ever-changing, large banks can heavily invest in in-house technology improvements. Brian Moynihan, the CEO of Bank of America noted this advantage when he stated of his institution that, "we are clearly a technology company." Although community banks cannot match the internal technology developments of large banks, they have alternative solutions for incorporating technology.

F&M Bank partners with financial technology firms to compete with in-house technology investments.[7] There are disadvantages to using an external partner rather than developing technology features in-house. These disadvantages include a lack of flexibility and customization. F&M mitigates these challenges by recruiting the necessary specialized skills to keep up with changing consumer preferences.

At the beginning of 2022, F&M hired its first Director of Digital Banking. To gain additional insight on this topic of technological advancements in the banking environment, our team reached out to a bank equity focused hedge fund manager. This new position is crucial for F&M as he believes, "Smaller community banks that are proactive in their efforts to combat the threat of encroachment from FinTech and other technology-focused providers will be at a distinct advantage relative to peers over the next several years," says Joe Fenech, Chief Investment Officer of GenOpp Capital Management, a hedge fund primarily focused on the bank sector. Fenech added, "Community banks that are not able to meet this challenge will likely find themselves pressured to justify their continued independence." Fenech's remarks portray that technology will

[7] FinTech partnerships specifically helped with the following services: mobile, online, personal checking accounts, mortgage delivery services, small business delivery services, underwriting, back-end BSA compliance, and operations.

not only be important for F&M, but for all banks around the nation to remain competitive in the changing environment.

Secondly, F&M cited specialized offerings as a challenge in the past. While F&M can serve international needs, bigger banks are likely to have bigger investments for supporting trade between the Shenandoah Valley and an international location. Similarly, some offerings are out of the scope for most community banks including F&M. For example, if a large national company needs a $250m line of credit to run its business, it will have to look to larger banks to meet those needs, as regulation on loan size due to concentration risk exists.

Section II.4: Story Exemplifying Community Banks Serving the Community

Following the significant impacts of the COVID-19 pandemic on businesses, community banks were vital in the survival of local businesses. Mark Hanna described F&M's involvement with a local doctor's office. Even health care businesses were hit hard as they simply did not have the resources to support staff and, in turn, could not support its community. This is where F&M stepped in to help.

The government had just announced that PPP loans would be available, and no one was sure what they were or how they would work. Hanna recalls talking to representatives in Congress about these loans trying to determine how PPP loans could be used to help businesses in the Shenandoah Valley. PPP loans had a lot of question marks associated with them for F&M and other banks that were initially unfamiliar with how it might play out. Deciding to take a chance for the sake of those around them, F&M opted to provide PPP loans. Through this decision, they were able to help the doctor's office by supplying a PPP loan. This loan allowed the office to bring in all the employees it had been forced to put on furlough so they could continue to treat patients. This story stands out as Hanna recounts his ability to help those that were on the frontlines of the health crisis continue to operate and provide for the greater community during this worldwide crisis. Hanna states that this experience encompasses the goal of F&M: providing for the community and creating valuable long-lasting relationships.

Section II.5: Section Summary

In this section, we find that the bank's profile in 2022 is different from the bank's profile in 2012. We find that most of the bank's business in 2012 was centered around investment real estate, single-family homes, and some development projects that large banks would not finance.

In addition, we find that most of F&M's challenges throughout the last ten years have been due to the increasing technology gap between larger financial institutions and community banks. The importance of evolving in this changing technological banking environment is highlighted by an interview with a hedge fund CIO who specializes in the banking sector. Finally, we find that the strength of community banks in the last ten years has been their relationship with communities.

Section III: Looking Forward

Section III.1: Section Overview

In this section, we look at how F&M plans to move forward by talking to its executive team. We discuss what changes F&M sees in the future that will affect its operations and how F&M plans to stay competitive in a constantly changing market with new competitors. We also examine how F&M intends to balance innovation while valuing current customer relations and key relationships with local businesses and its community. Finally, we discuss what lessons F&M can take away from the COVID-19 pandemic to best serve its community in the future.

Section III.2 Expectations for Change

The future remains uncertain following the COVID-19 pandemic. One of the substantial changes to come in the next ten years for F&M is its investment strategy. It will be leaning more towards loans in the commercial and industrial sectors as opposed to its history of investing in real estate and single-family homes. This shift in strategy coincides with significant growth within the bank and the bank's operations. To survive, community banks must keep expanding and growing. In the words of Katherine Preston, “If you’re not growing, you’re going to be gobbled up.”

A crucial factor in survival is growth in technology. Figuring out the next disruptive innovation and having access to the newest technology is imperative for community banks to be able to stay afloat. Mark Hanna drew an analogy to a quote by the great hockey player, Wayne Gretzky, to describe how community banks try to keep pace with larger banks noting, “I don't skate to where the puck is. I skate to where the puck is going.” Community banks must anticipate the next technological move before it happens.

Larger banks have substantially more money that they can invest in research, development, and the integration of new technology to which community banks do not have access. For example, Bank of America reports in its annual report that it is amid a 10-year $300 billion commitment to adopt low-carbon technologies. Additionally, it spent $3.5B on data remediation, resiliency, and stability, and new clients in 2020 (Bank of America, 2020) of being able to develop their own technology, community banks must outsource these new technologies to achieve the same results.

FinTechs have been the solution that community banks employ to remedy this problem. According to Mark Hanna, FinTechs are realizing that their business model is more effective when partnering with banks. FinTechs may specialize in technological development but then partner with community banks. FinTech and community bank partnerships will become more prevalent as they allow smaller institutions to service a wider variety of customers while maintaining relationships.

Partnerships with FinTechs will allow community banks to streamline operations in nearly every department. Hanna observed that he envisions FinTech involvement in “mobile, online, personal checking accounts, mortgage delivery services, small business delivery services, underwriting, and back-end BSA compliance” (Hanna, 2022). There does not seem to be a world moving forward where FinTechs are not involved in community banking and vice versa. As Hanna explains, it can be better to partner with FinTechs so they win based on their business model, and F&M can continue to win on its business model.

Section III.3: Remaining Competitive

Going forward, F&M expects to compete with traditional financial institutions. These institutions are large national and regional banks, other community banks, nationally chartered savings banks, and credit unions. In addition, the bank also expects to compete with consumer finance companies, mortgage companies, FinTechs, mutual fund companies, and life insurance companies.

F&M believes the main way it can compete with traditional financial institutions is through excellent customer service and the flexibility its smaller size affords. The bank can offer loans tailored to customer needs, since it is familiar with the market in which customers will redeploy the funds. In addition, the bank has entered into participation agreements with several other institutions to provide larger loans. F&M would not be able to compete in large projects without participation agreements due to legal lending limits. These agreements help diversify risks even below the bank’s legal lending limit.

FinTechs are a new form of competition faced by banks, and not something they saw in the industry 10 years ago (F&M 2021 and 2013 10-Ks). F&M believes that the best way to remain competitive with FinTech is to form partnerships with them (Hanna, 2022). The bank is currently going through an internal technological renovation of its core system. Although they see the need to update processes and technology, they do not want to speed up its processes by acquiring FinTechs. The bank stated that acquiring FinTechs to boost internal technology is only a temporary solution (Hanna, 2022). The bank made it clear that it is the Director of Digital's role to investigate new FinTech partnerships that address changing customer needs; however, these agreements cannot compromise the ability of the bank to remain flexible (Hanna, 2022).

Going forward, the bank must continue to identify relevant competitors in the changing financial services landscape. In addition, the bank should continue exploring partnerships with other financial institutions as well as FinTechs to meet changing consumer product and service preferences.

Section III.4: Valuing Relationships

Committed customer service is what distinguishes F&M from its competitors. For F&M, service relationships are a "three-legged stool" composed of high-quality people, its brand, and technology. The Chief Banking Officer stated that to F&M, "Relationships are everything" (Knight, 2022). Community banks understand the importance of creating long-lasting, strong relationships and the tangible benefits that those relationships have on small business lending.

An F&M Senior Leader states that they transitioned from a larger bank to F&M during the pandemic. Through that transition, they noted that the pandemic showed what community banks could do through PPP initiatives. Community banks played an outsized role in PPP facilitation as the FDIC found that community banks hold nearly one third of all PPP loans, compared to only

15% of all bank-held loans (FDIC, 2021). F&M, like other community banks, played an outsized role in PPP loan facilitation. Because of its commitment to relationships and customer service, they were able to help small businesses stay afloat during the pandemic's hardships and uncertainties, which has led to "sticky relationships."[8] Almost all F&M customers who received PPP loans are now transferring their other banking business to F&M (Preston, 2022). PPP Lending was not the only notable impact on the banking industry from the pandemic, technology was also immensely important.

Prior to the pandemic, there was interest in technology investment for F&M, however now technology is a driving force. Consumer preferences are changing; therefore, technology must increase to keep up with customer demand. To keep up with this, F&M has chosen to partner with FinTech service providers. With these partnerships, it is important to make strong, strategic selections to have the best success.

Some recent partnerships have allowed F&M to completely revamp its mobile and online banking. In addition, F&M must consider scalability. As F&M wants to organically grow into surrounding markets, the FinTech partnerships must also be able to scale up to the bank's increasing customer base and asset size.

Moving forward, technology will remain a crucial part of bank operations, but F&M will face a challenge as they have an approximate 70-year age gap from customers. Although there is preference overlap, technology cannot be all things for all people. Additionally, technology does not entirely negate the need for relationships in banking. Different people define value in different ways. An example is PPP lending, where individuals transitioned their business to a community

[8] Sticky relationships are products/services that increase customer retention.

bank when they needed local assistance. Entering a higher technology- reliant environment, community banks must balance the competing fronts of service, technology, and consumer preferences.

Section III.5: Serving the Community

F&M primarily loans funds to those in its local community. As a result, F&M incentivizes local businesses to partner with them for financial support. This is the primary way F&M supports the communities they serve. For example, Barren Ridge Vineyards is a local winery in August County. Barren Ridge selected F&M to be its financial partner and regards its partnership as instrumental in celebrating its 10th anniversary (F&M, 2022). United Way of Staunton is another partner, located in Augusta Co. & Waynesboro. President & CEO Kristi Williams remarks F&M's "involvement with local businesses and nonprofits is unparalleled" (F&M, 2022).

In addition, F&M encourages employees to be directly involved in local organizations. Employees participate in Bowl for Kids, Big Brothers, etc. F&M also provides paid time off for employees to join local organizations (Knight, 2022).

In the next ten years, F&M anticipates growing its market share in the communities they already serve. F&M's focus is being the best bank in the Shenandoah Valley. Therefore, F&M is not looking to drastically grow in geographic scope but is focused on increasing market share in the markets in which they already exist. F&M is opening new branches in Stuarts Draft, Waynesboro, and Winchester, which are all located within the Shenandoah Valley.

Additionally, over the next ten years, F&M will adapt to changes in consumers' preferences. F&M is investing heavily in technology and software improvements. Recently, F&M added a chat feature and other mobile banking features.

Section III.6: Pandemic Lessons and Changing Strategy

The COVID-19 pandemic was a learning experience and a stress test for community banks. COVID-19 pushed community banks to implement new changes in terms of primary markets, loan types, and technology; however, some banks had been implementing these changes before the pandemic.

During the COVID-19 pandemic, the federal governent made Paycheck Protection Loans available through the CARES Act. Banks across the country were unsure of how these loans would work, and many of them decided to forego participating in the program. At F&M, management felt that despite this uncertainty, these loans would be good and helpful to the community and that they should participate in the program. The bank loaned to anyone in the community who needed help, even if they were not previously a customer at the bank (Comer, 2022). This strategy brought over many new customers, primarily small businesses who had not done business with the bank in the past. Moreover, the bank was able to bring in some middle-sized businesses who traditionally banked with larger institutions, but saw the value in banking with someone willing to do anything to help them. F&M was able to migrate customers from larger financial institutions (Preston, 2022).

Second, the bank saw the need to offer more technology to customers. In the past, the bank had not felt the need to match larger insitutions in technology. Because of COVID-19, the bank saw how they needed to offer more digital services to customers, and are committed to continuing to intergrate technology. They have done this by hiring a Director of Digital Banking, whose job is to research with which potential FinTech companies F&M can partner. The bank is not ready to absorb FinTechs as they feel that this strategy will only lead to temporary success since technology is ever changing, but they do see the value in strategic partnerships.

Section III.7: Section Summary

We find that F&M wants to increase the use of technology in its business, while prioritizing personal relationships with customers within the Shenandoah Valley. While larger banks have resources to devote substantially more into research and development, community banks must find ways to stay competitive. F&M has chosen to partner with FinTechs to enable strategic partnerships and hired a Director of Digital Banking to help remain competitive.

Conclusion

The community banking sector has evolved immensely over the past ten years and will continue to evolve moving forward. In *Section 1: Financial Analysis*, we found that the bank should monitor profitability amidst continuing pandemic uncertainties, coupled with compressed net-interest margin, high liquidity, and a decreasing loan-to-deposit ratio. In *Section II: Looking Back*, we described how F&M's size, strategic priorities, staffing methods, and services have evolved. F&M's biggest ongoing challenge is keeping up with in-house technology investments from larger banks. In *Section III: Looking Forward*, we analyzed changes in regulatory activity, lending strategies, and growing FinTech partnerships.

We conclude that the COVID-19 pandemic was a catalyst that sped up previously ongoing changes to the technological and operating environment. As stated by the hedge fund CIO we interviewed, increasing technology is needed for community banks to remain competitive. As exemplified by F&M Bank, community banks across the nation can accomplish greater technological capability by forming FinTech parternships.

Our case study brings forward additional questions that could be important to relevant stakeholders in the banking industry. An area of future policy oriented research should be to investigate the need for new FinTech regulation as they work with highly regulated banks. An area of investment oriented research should be to determine which types of technology are most likely to improve bank performance. Finally, an area of future research for community bank executives is how to continue to build personal relationships with clients as technology eliminates the opportunity for many face-to-face interactions. On the other hand, technology could allow banks to interact with clients in new ways. Although the future of technology is uncertain, our findings suggest that community banks will continue to commit making client relationships a top priority.

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