Chinese state-owned bank expansion into Europe

Bank branches and subsidiaries

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Abstract

This paper seeks to deepen the understanding of how global banking networks are constituted, and how global banks' expansion strategies interact with strategic (financial) entry points in Europe. This is discussed on the example of Chinese banks via their distinct bank branches-cum-subsidiaries strategies that locate in economically specialized international financial centers (IFCs), here Luxembourg. The IFC Luxembourg ranks among Europe's most prominent strategic entry points, in which major Chinese banks have located their European headquarters. Chinese banks, embedded in the broader logic of China's financial opening and expansion policies, respond to two different – partly conflicting – logics: the Chinese state and the global market. They therefore bridge geoeconomic and geopolitical boundaries. China's extensive network of overseas banks – linked through various IFCs – helps to govern takeovers of firms abroad, investments in the large Belt and Road Initiative, and the shift toward a multipolar currency system.

Setting the scene

During the past decades, Chinese banks have been building an extensive network of branches and subsidiaries across Europe. Concomitantly, Chinese enterprises have started to invest in Europe more assertively while the Chinese government has launched the Belt and Road Initiative (BRI), supported the internationalization of its currency, that is, the renminbi (RMB), and opened progressively its financial markets to foreign investors. As an integral part of this concerted undertaking, Chinese banks have driven China's gradual integration into the international financial system. This paper concentrates on the European part of this new, fast-growing Chinese banking network. Banks, however, do not only locate in specific places, but these places also actively promote their regional assets to attract financial activity. Surprisingly at first sight, Luxembourg hosts the headquarters of all leading Chinese banks and is one of Europe's key hubs for RMB pooling. In this regard, Chinese banks may be perceived as important geoeconomic and geopolitical actors; they act also, however, as strategic boundary spanners who respond to two different logics, that is, the global market and the Chinese state. China channels more than 40% of its foreign direct investments (FDI) to Europe through Luxembourg (Arendt 2018). This significant concentration of financial activity concurs with the fact that Chinese banks have chosen Luxembourg as their main base in Europe. With geopolitical interests vital on both sides, we argue it makes the state-owned Chinese banks irreducibly political; they are important economic and political actors shaping new markets and enabling capital flows outside China. Whilst the political side of the argument needs more room to be developed elsewhere, this paper predominantly concentrates on the geoeconomic part of China's bank expansion.

Despite much recent work on global financial networks (GFNs, cf. Coe et al., 2014), little is known about these networks' constituting features in the first place. The literature on banks' concrete expansion strategies is rather thin, and its explanatory power to unpack important constituting elements of a GFN remains limited. By explicitly focusing on branches-cum-subsidiary strategies of banks, we provide analytical depth into concrete mechanisms that transpose banks' expansion strategies. A timely case, which this paper seeks to unpack, is that of Chinese banks, linked with the research question, why they chose to locate their European headquarters in Luxembourg. We hypothesize that the combination of Luxembourg's unique specialization as an IFC in the cross-border investment fund industry, its pool of knowledge and expertise, alongside its sophisticated financial and tax regulatory framework, is a reason why Chinese banks clustered in Luxembourg.

This paper aims at shedding light on the role of Luxembourg within China's banking expansion into Europe. This helps to understand better how China is organizing its expansion into European financial markets and, in a broader and more general perspective, how global banks' expansion strategies interact with strategic financial entry points in Europe. Thus, we hope to contribute more comprehensive insights into a core building block of global financial networks. In so doing, the paper critically reviews the theoretical and empirical literature on banks' organizational forms and expansion strategies, and it cross-fertilizes the diverse bodies of literature on China's geoeconomic expansion and integration into global markets.

The paper makes three contributions to the literature. First, by providing insights into China's financial expansion into Europe, it engages analytically with practices of setting up specific subsidiary-branch networks 'hidden' behind banks' observable spatial structures. Although providing much empirical description about the architecture of such networks (Pan et al. 2018), scholars largely fail to provide evidence of such strategies in form of mechanisms and practices, that is, concrete agency of banks. Second, it complements the political dimension of finance with the economic dimension of Chinese banks' concrete agency and therefore adds to the analytical project in economic geography, which so far privileges the manufacturing firm over the financial firm, and extends the discipline's focus to the finance industry, especially banks. Banks' complex nature as intermediaries and financial services and credit producers implies a different degree of embeddedness in their host economies than examples of industrial producers suggest. Third, we show that the clustering logic of banks in IFCs is not only one of information asymmetries but also has a strategic dimension that is closely linked to an IFC's concrete regulatory base and functional specialization, and which mobilizes distinct locational patterns of foreign bank branches and bank subsidiaries.

Therefore, after introducing the Chinese banking system and Luxembourg's IFC in Section 2, Section 3 reviews the literature of the organizational forms of banks, thus forming an analytical lens to help identify the conceptual angle for the empirical study on the strategies of Chinese banks' expansion on the example of Luxembourg, covered in Section 4. Section 5 summarizes and discusses core points and proposes avenues for further research.

Chinese banks

Although "[t]he banking sector is [widely] considered as the backbone of any economy" (Jabbar 2014, p. 109) and despite the repeated claim of the global financial system's convergence, some states rely more on the national banking system than others (Dixon 2014). There are important differences between banking in China (Stent 2017) and banking in the West (Hardie and Howarth 2013); and in line with the tradition of the East Asian developmental state (Johnson 1982, Weiss 1999), in China, the "banking system dominates the financial system" (Cousin 2011, p. 228), and it is "the lynchpin for the entire economic model" (Epstein 2014, p. 870), in which "about 80% of finance is provided either by banks or by other lenders that act like banks" (Kroeber 2016, p. 128). At the beginning of the 2000s, Chinese banks, especially state-owned commercial banks (SOCBs), "[whose] four presidents are government officials with the ranks of vice-ministers," acted "more like government agencies than commercial enterprises" (Peng 2007, p. 8). Implications echo until today, and not least for these reasons we deem it important to identify the specific functions and ecosystems that define the clusters of Chinese banks, e.g., spanning the boundaries for China's international economic expansion.

Besides expanding globally, Chinese banks underwent strict processes of professionalization and innovation, with notable outcomes. Today, Chinese SOCBs are the world's largest banks. Multilateral financial organizations such as the Financial Stability Board (FSB) and the Bank for International Settlements (BIS) consider Chinese banks to be at the forefront of compliance with and commitment to global regulatory standards (BCBS 2017), including reporting standards on international information sharing (FSB 2019). The realm of liquidity rules is another case in point, in which the Basel Committee on Banking Supervision (BCBS) recognizes that "compared with the Basel rules text, the Liquidity Rules [issued by the China Banking and Insurance Regulatory Commission (CBIRC)] have a wider scope and set higher requirements in selected areas in a more prudent way" (BCBS 2017, p. 7; see also BCBS 2017, Annex 9). Further, Chinese banks increased the weight of regulatory compliance by outsourcing their annual audits to the Big Four audit firms, which, "[i]f major accounting problems emerge that had not been flagged" (Stent 2017, p. 137), would suffer damage reputation. In short, Chinese banks applied new regulations in the aftermath of the financial crisis seemingly more strictly than many of their counterparts in the West, indicating China's immense effort to professionalize its banks.

China's banking system builds on three main categories of banks: policy banks, commercial banks, and credit cooperatives. Commercial banks are subdivided into several further categories commonly referred to as SOCBs, joint stock commercial banks (JSCBs), city commercial banks, village and township banks, rural commercial and cooperative banks, and foreign commercial banks (Cousin 2011). Eighteen banks, that is, six SOCBs including the postal bank, and twelve JSCBs form China's tier-1 banks. The Ministry of Finance and the Central Huijin Investment Company, the latter being a state-owned investment company dependent on the China Investment Corporation, are the state entities that normally hold the shares of tier-1 banks in China. Chinese SOCBs receive capital from the Chinese state in the form of deposits and, importantly, support the operations of China's real economy (Stent 2017). Having established a first overview of the key financial actors in China, the organizational setup of the Chinese overseas' branch-cum-subsidiary framework reveals insights into their strategic expansion and networking activities, particularly across Europe.

In 1979, the Bank of China (BOC) established a branch and later, in 1991, set up a subsidiary in Luxembourg. BOC's organization took the dual branch-cum-subsidiary form it still has today. Few years later, in 1998, BOC's major rival, the Industrial and Commercial Bank of China (ICBC), opened a representative office in Luxembourg. In 1999, the ICBC's office became a full operational branch. Until the financial crisis in 2008/09, the organization of Chinese banks in Luxembourg did not change. After the crisis, when Chinese state-owned enterprises (SOEs) started to invest more assertively in Europe, the BOC subsidiary in Luxembourg began to open up sub-branches in other EU member states through its EU-passport banking license (Briault 2015). Between 2008 and 2019, the BOC established six sub-branches in as many EU countries, followed by the ICBC, which, in 2011, established a subsidiary in Luxembourg and five further sub-branches.

Between 2013, when president Xi Jinping launched the BRI, and 2017, Chinese banks started to cluster in Luxembourg after decades of limited presence. Following the example of BOC and ICBC, five Chinese banks deployed the same branch-cum-subsidiary strategy and structure. Two of them, the China Construction Bank (CCB) and the Bank of Communication (BOCOM), expanded to other EU member states by establishing sub-branches. Empirical results affirmed that the pioneering presence of BOC and ICBC in Luxembourg has been a crucial motivation for other Chinese banks to cluster, thus, revealing traits of contingency and path dependence on both sides.

As of January 2021, seven Chinese tier-1 banks, i.e., five SOCBs and two JSCBs, comprise the current Chinese banking cluster in Luxembourg (Table 1). Together, they account for more than 45% of total bank assets in China, totaling more than US$18 trillion. In Luxembourg, these seven banks organize their business in 14 distinct entities of branches and subsidiaries, which allows for specific functions and strategic purposes in their host countries. It makes China the second largest presence of foreign banks in Luxembourg along with France and just after Germany with 23 banks (CSSF 2020).

Table 1. *Chinese banks in Luxembourg.*

Bank	Acronym (category)	Year of entry
Bank of China	BOC (SOCB)	1979
Industrial and Commercial Bank of China	ICBC (SOCB)	1998
China Construction Bank	CCB (SOCB)	2013
Agricultural Bank of China	ABC (SOCB)	2014
China Merchants Bank	CMB (JSCB)	2015
Bank of Communications	BOCOM (SOCB)	2016
China Everbright Bank	CEB (JSCB)	2017

Source: authors

Importantly, Chinese banks have established in London a similar banking network to that in Luxembourg. It reproduces the same organizational model of branches and subsidiaries but differs in that the London-based subsidiaries set up sub-branches in the UK only, except for a single sub-branch in Ireland. The EU, however, is supplied with Chinese bank sub-branches controlled from Luxembourg, although with some exceptions (Table 2). We develop this argument in more depth by examining Luxembourg's cluster of Chinese commercial banks, especially those that have established sub-branches in other EU member states.

Table 2. *European banking networks of four Chinese banks headquartered in Luxembourg*. (B=branch; S=subsidiary; SB=sub-branch; SB (country)=sub-branch of a third country's subsidiary).

	ICBC	BOC	CCB	BOCOM
LUXEMBOURG	B / S	B / S	B / S	B / S
NETHERLANDS	SB	SB	SB	
BELGIUM	SB	SB		
FRANCE	SB	B	SB	SB
SPAIN	SB		SB	
PORTUGAL		SB		
ITALY	SB	B	SB	SB
GREECE		SB		
SWEDEN		SB		
GERMANY	B	B		B
AUSTRIA	B / S	SB (Hungary)		
HUNGARY		B / S		
CZECH REP.	B	SB (Hungary)		
POLAND	SB	SB	SB	
SERBIA		S		
UK	B / S	B / S	B / S	B / S
IRELAND		S / SB (UK)		
SWITZERLAND	B		B	

Source: authors based on the banks' annual reports 2018 and 2019.

Luxembourg's importance for foreign banks, especially from China, has been growing quietly with little critical reflection in academia, and with rare analytical drills to understand not only their concrete mechanisms but also important implications. While scholars have focused broadly on the banking sector in China (e.g., Peng 2007; Cousin 2011), less is known about the global reach of China's SOCBs, their strategies that form and determine international expansion to specific locations (cf. Daniels, 1986), and the more general logic of banks' spatial organization in and across foreign jurisdictions. This paper seeks to address these gaps in an analytical manner, after positioning our argument in the broader literature.

Positioning the argument in the literature

Connecting Chinese banks with European financial centers

China's integration into the world economy is a key driver of the actual reconfiguration of global finance as scholars from different disciplines diagnose (e.g., Pan et al. 2018). Some of them, for example, analyzed the cases of Chinese bank subsidiaries in Canada (Yang and Lin 2019) and in Australia (Zhu 2019) mainly through the lens of human resource management. Others recognize the increasing importance of the integration processes of Chinese banks into the global financial system and China's steep rise as a global net creditor and increasingly trusted debtor

(The Economist 2020; Tooze 2018). Scholars have examined, for example, China's state policy towards the RMB internationalization process via European financial centers like London and Frankfurt (Töpfer and Hall 2018; Hall 2017, 2018; Pacheco Pardo et al. 2018) and China's state-led activities (Xin and Mossig 2020), including the state's ability to build and govern global economic networks (Töpfer 2017, 2018; Chen et al. 2020).

A recent special issue in Eurasian Geography and Economics (Lai et al. 2020) has cemented this interest further and specifically shed light on financing the BRI, a geopolitically and geoeconomically thorny issue often embedded in the powerful, yet contested narrative of 'debt-trap diplomacy' (Bennett 2020). This research agenda focuses on understanding foreign economic development through Chinese aid and FDI (Liu et al. 2020, Dunford 2020) as well as on the effects of huge infrastructural projects (Rowedder 2020) and potential domestic costs for BRI countries. The paper at hand, however, seeks to apprehend China's growing ambition to (re-)shape the world's financial markets and augment its influence via its global banking strategy.

In this vein, IFCs like London, Singapore, and Frankfurt have been referred to as the strategic hubs from which to inject an RMB-based financial regime into the world. Smaller, yet equally vital IFCs in the European part of the Eurasian project, however, are systematically overlooked in this debate. Luxembourg is a case in point. Its long-standing knowhow as the world's largest IFC for cross-border investment funds (Dörry 2015; 2016) matches specific needs of Chinese banks for both specific financial investment vehicles and strategic location, from which they create and govern new European financial markets. Luxembourg's specialization in designing cross-border investment vehicles, e.g., special purpose vehicles (SPVs) for corporate clients (Fang and Pan 2021) second only to the Netherlands (Claassen and van den Dool, 2013), is an attractive feature for banks. These features, knowledge and specialization, alongside Luxembourg's welcoming regulatory framework for foreign banks, we argue, are reasons why Chinese banks decided to cluster in Luxembourg to govern their geoeconomic expansion across the European Union and beyond.

Christophers (2013) captured the relevance of Western banks' internationalization as a major driver of financial globalization and showed how banks' new organizational architecture enabled them to move across international borders "before it became possible for money […] to do so" (p. 146). Although Chinese banks' international operations are still limited, especially regarding their potential and compared with their operations at home, Christophers' assessment of early US banking seems to hold true also for China's banks today. China's bank cluster in Luxembourg can be interpreted as part of China's early-stage financial expansion into Europe.

Bank expansion strategies

Specifically after 2008, management and organization scholars developed a keen interest in banks' organizational forms to understand: (1) how banks transmit financial shocks across national boundaries (Cetorelli and Goldberg 2012; Goldberg 2009); (2) the determinants of banks' organizational forms (Cerutti et al. 2007;

Thalassinos et al. 2013); (3) how foreign branches affect lending activities in their host economies (Claessens and van Horen 2012; Kowalewski 2019); and (4) the role of regulation in banks' organizational preference and efficiency (Berlin 2015; Curi et al. 2013; Harr and Rønde 2003). Confined in an aut-aut logic, that is, the exclusive choice of one (subsidiary or branch), this literature reveals that banks are not rigid in their approach to deploying the two organizational forms of branch and subsidiary, which makes it difficult to identify the precise patterns of bank expansion in foreign jurisdictions. Despite illuminating insights, this literature falls further short in informing about the logic (and broader strategies) of the parent banks in establishing both forms of branch and subsidiary in the same foreign jurisdiction. This is important given the increasing commodification of law (Pistor 2019) implicit in global banks' location decisions in IFCs.

To expand their business overseas, banks can open either a branch or a subsidiary in the new jurisdiction: "If the foreign operation is incorporated in the host country, with a separate legal identity, it is a *subsidiary*, and if not, it is a *branch*" (Porter 2005, p. 85, original emphasis). In general, we can identify three main strategies from the literature, which banks employ to expand to foreign jurisdictions. One refers to the establishment of a branch and the creation of a centralized network of branches, which is generally functional to those banks whose main objective to follow their corporate clients abroad. Another refers to the establishment of subsidiaries and the creation of a decentralized set of sub-networks, which is theoretically useful for expanding into retail markets. The third, instead, refers to the takeover of banks in the target jurisdictions. These banks, once acquired, become subsidiaries that can rely on ready-made networks of knowledge and customers, such as savers and SMEs, which scholars have assessed with regard to Western European and American banks' diffusion in former Soviet countries after the collapse of the Soviet Union in the 1990s (Epstein, 2017).

By analyzing changes in state-bank relationships, Epstein (2017) has found that previously strong state-bank ties have weakened over the past 30 years in Europe. Although she refers to the case of bank takeovers in Central and Eastern European states, Luxembourg is no exception, as foreign investors, including from China, have taken over Luxembourg national banks (Balmas 2018). However, despite valuable insights into banks' internationalization process through bank takeovers and the weakening of state-bank ties in Western Europe under the European Banking Union, Epstein and others remain rather silent on banks' expansion through a carefully orchestrated setup of bank branches and subsidiaries.

To be clear, branching and setting up subsidiaries are no new features observable in expansion strategies of banks. On the contrary, the expansion of Deutsche Bank to Luxembourg in 1967 to participate in the lending business on the Euromarkets via a subsidiary (and a branch in London for the same reason), which was added by a Luxembourg-based branch in 1993 to invest liquidity reserves in a tax-efficient manner, is a rather relevant example. Yet, the meaning of choosing a branch or a subsidiary is not well elaborated in the literature. With the forming of large – increasingly competing – global networks of banks against the political shifts in the world, however, the economics of such strategies, which create specific spatial patterns, are of increasing interest. Chinese state-owned banks have added a particularly political flavor to such analysis and stress the need to engage with the distinct branches and/or subsidiary strategies.

Bank branches and subsidiaries

Reasons for strategic decisions to set up branches and subsidiaries include the following: (1) the parent bank has different motivations for establishing one rather than the other organizational model, e.g., when a foreign jurisdiction offers the right conditions to raise funds at a lower cost, which a branch easily reallocates to where it earns higher returns (Fiechter et al. 2011); (2) branches and subsidiaries operate in a different arena of competition (Heinkel and Levi 1992); (3) the setup of branches is less costly, as compliance needs with the host country's company law are low (Schön 2001), but subsidiaries are less costly to resolve in case of failure (Fiechter et al. 2011). These theoretical distinctions can vary in practice, but as a rule of thumb, branches are primarily oriented toward wholesale activities, subsidiaries more towards retail services (Table 3). However, this is not the case for Chinese banks in Luxembourg as none of their subsidiaries is engaging in the local retail market.

From a different perspective, the goal of such strategic decisions is to manage liquidity effectively by transferring assets routinely among branches and subsidiaries (State Street 2019). A foreign branch can take advantage of its parent's balance sheet (Abrahamson 2020), while the subsidiary is incorporated in the host country and therefore partly independent from its parent bank. Branch networks are centralized, which helps capital move easily within the network of branches, that is, from jurisdictions where raised capital is cheaper to jurisdictions where returns are higher (Fiechter et al. 2011), which echoes the necessary organizational logic for enabling transfer pricing like that in globally operating firms. However, the legal foundation for the banking industry and its employment of transfer pricing is still being negotiated.

Although implying different ways to raise capital, the decision to establish either a branch or a subsidiary depends not only on the parent bank's strategy. Rather, regulations in both the host and the home country tip the scales, specifically with regard to a bank's business objectives and the associated risk exposure that varies between both organizational models. Fiechter et al. (2011) illustrate with data from the financial crisis that failing branches received support directly from their network, whilst subsidiaries were more likely to be left to manage distress themselves.

Table 3. *Main differences between banks' branches and subsidiaries in foreign jurisdictions.*

	Supervision and regulation	**Operations**	**Risk**
Branches	- Home and host institutions - Rules may change when the branch becomes systemically important for the host economy	- Wholesale oriented - Within the borders of the host country - Strategic direct investments - Funds raised for group's global activities at lower capital cost	- Parent control - Less costly to establish - Risk spillovers only inside the branch structure - Preferred when political risks in the host country
Subsidiaries	- Host institutions - Local banking law - Local company law	- Retail oriented - Cross-border operations - Financial investment, i.e., a profitable employment of capital	- Local/parent control - Less costly to resolve in case of failure - Risk spillovers may affect the host economy - Preferred when potential macroeconomic risks in the host country

Source: authors, based on Heinkel and Levi (1992), Schön (2001), Harr and Rønde (2003), Fiechter et al. (2011).

While insights offered by the literature on bank branches and subsidiaries are valuable, important gaps remain unaddressed. First, it overlooks cases in which banks deploy a combined branch-subsidiary strategy in the same jurisdiction for their expansion. Second, it remains largely Western-centric and fails to incorporate increasing evidence to explain important transformation drivers in global finance, that is, how a banking industry from an emerging economy (China) has been organizing its banking networks across advanced economies (Europe) through specific forms of centralized/decentralized banking networks, which in turn shape very distinct financial geographies. Third, while the literature has disentangled the differences between branches and subsidiaries and outlined implications for host and home countries, the mechanisms behind these processes remain opaque.

Presentation and discussion of the empirical results

Methods

Empirical findings draw on a range of sources. Besides academic literature, an array of grey literature on China and Luxembourg, e.g., international newspaper articles, government reports, statistics, corporate reporting, industry papers, and reports from multilateral organizations (BIS, FSB, etc.) helped examine rationales and strategic action by both banks and financial centers.

In addition, in 2019 and 2020, interviews with 14 experts from both financial and political circles in Luxembourg and China were conducted. Summarized insights from desk research were carefully addressed in the interviews. In most cases, sensible topical issues – particularly with regard to civil servants and policymakers – and different cultural backgrounds suggested not to record the interviews to enable a higher degree of comfort for interviewees and to encourage them to speak freely. Memory-based transcripts were fixed directly after each interview, not least based on vigilant notetaking during each interview.

Two current political processes reappeared to flank and influence the conversations: the economic and geopolitical contrasts triggered by changing positions towards China of the US government and the EU Commission, and a moment of friction between Luxembourg's government and parliamentary opposition over the decision to maintain the BRI agreement secret in the summer of 2019. Although not anticipated at the beginning, we deemed these insights very useful, as they revealed the larger political setting in which strategic thinking of representatives from banks and IFCs had been taking place. Interview results were triangulated with other information sources, and this iterative process was repeated several times.

A third important source that inform parts of this paper were conversations at conferences in Luxembourg, Brussels and Beijing between 2018 and 2020, organized by state agencies and multilateral organizations, such as Luxembourg for Finance, Luxembourg Chamber of Commerce, China-Lux Chamber of Commerce, and the Asian Infrastructure Investment Bank. Informal conversations with participants from the public and private sectors revealed also their own questions that they deemed puzzling. Such questions comprised Chinese bank activities in Europe and specifically in Luxembourg, but also questions around investment opportunities via Chinese alternative investment funds. Such questions helped kick off longer informal conversations, which also have informed aspects of this paper. Further, such questions illustrated that this topic sparks broader interest, curiosity and is deemed important in both public and private audiences. We processed the transcribed interview data with NVIVO and analyzed it according to our hypothesis.

Expanding into new markets

Overall, a setting of, specifically, three tightly connected reasons seem to be important for Chinese banks to locate in Luxembourg: Luxembourg's specialization in the cross-border investments fund industry, its large pool of financial knowledge and long-standing experience to service foreign markets, and its 'welcoming' regulatory framework for the financial sector. Knowledge, here, refers particularly to the capability of lawyers, financial advisers, and other para-financial intermediaries to design tailored investment vehicles according to banks' specific needs and third-country regulations. Luxembourg's specialized knowledge and capability is backed by accommodating regulations.

Foreign bank branches in Luxembourg have access only to Luxembourg's internal market and are prevented from marketing their products outside Luxembourg (interview L12/2019), which means that banking operations in Luxembourg are highly limited as compared to larger EU member states. However, this disadvantage is seemingly trumped by bank branches being able to tap into Luxembourg's investment fund industry, including its comprehensive knowledge and experience to create SPVs. This enables bank branches to pursue operations in third countries while benefiting from their parent banks' balance sheets, and interview results confirmed that Luxembourg is specifically "interesting for the [business of] branches" (interviews L09/2019; C06/2019). Luxembourg's regulation allows non-EU "bank branches to capitalize through their parent company" (interview C06/2019), which is not possible in other EU member states, such as Germany, where "a foreign branch needs to be fully capitalized" (interview L09/2019). Luxembourg's success in attracting foreign branches worked, along with others, as the blueprint for London's IFC a few years later in 2014 (interview C06/2019).

However, the empirical observation of international banking presence in Luxembourg seems to be in contrast with interviewees' suggestions. Overall, in Luxembourg, there are more foreign subsidiaries than branches. In 2018, from the 135 banks located in the country, 89 were incorporated in Luxembourg. Of these 89, more than 90% were subsidiaries of foreign banks. Of the remaining, 14 out of 46 branches were from non-EU member states (PwC 2019), including the seven Chinese banks' branches. Japanese banks, for instance, have established subsidiaries only. There is no pattern even with regard to banks from the EU. Some of them operate in Luxembourg through branches and others through subsidiaries. Only few opted for both, for example, Germany's Deutsche Bank and Commerzbank, the French Société Générale and BNP Paribas, and UniCredit from Italy. Besides the Chinese, only three non-EU banks, Credit Suisse, HSBC, and State Street established both branches and subsidiaries in Luxembourg. This suggests that only some, but not all, globally operating commercial banks that pursue specific strategies have reasons to establish both legal entities in Luxembourg. In any case, the absence of a clearly identifiable pattern should be subject to further research.

Luxembourg's widely associated 'inviting tax regime' (Palan et al. 2010; Zucman 2015) was an important interview-focus. Interviewees confirmed unanimously that lower taxes attract banks to establish physical presence via offices in Luxembourg, especially subsidiaries under the local company law. However, interviewees further noted that corporate tax advantages are not a decisive factor (cf. Bouvatier et al. 2017). Rather, extensive tax advantages are enjoyed by administered investment vehicles (e.g., SPVs and sophisticated fund structures) in Luxembourg, especially by alternative investment funds that are increasingly set up for investments in infrastructure and private equity within the BRI project. According to one interviewee (L12/2019), SPVs can be established to perform just one single transaction. The same interviewee suggested to follow the SPVs to understand the precise organization of Chinese banks' global financial networks, which we highlight as another fruitful avenue for research, indeed.

The comprehension of a bank's financial network requires in-depth understanding of the need for, and deployment of, financial vehicles and balance sheets (interview L09/2019). Global banks that engage in corporate finance and other investment operations often do so via SPVs. Yet, SPVs differ in their nature and are difficult to associate to the bank that lends the capital for the transaction(s). However, SPVs are not only a matter of balance sheets and taxes, but also a matter of corporate and banking strategies that link a specific SPV to specific forms of financial and tax engineering, for which Luxembourg provides the knowledge base.

Indeed, interviewees stressed the value of Luxembourg's pool of financial knowledge and expertise (interviews L02/2019; L07/2019; L09/2019; L10/2019; C06/2019) beyond taxation. Notwithstanding the banking union, the EU banking market is still highly fragmented (Howarth and Quaglia 2016), and a bank that seeks to promote and sell a product in another EU member state needs to amend it according to the respective national regulations and patterns of demand (interview L12/2019). The necessary and long-standing expertise to design and market financial products and instruments but also to understand third-countries' regulations, also beyond the EU's borders (interviews L10/2019; L12/2019), is echoed by Luxembourg's disproportionately strong presence of legal and taxation specialists compared to their number in Frankfurt and Paris (Dörry 2015).

Remarkably and in accordance with explanations in Section 3, Chinese bank subsidiaries that have established sub-branches in other EU member states, and are not involved in local retail operations as branches of other banks usually do, function as governance bodies (Interview L12/2019). Interestingly in this regard, while responding to different regulations and logics, in Luxembourg, Chinese branches and subsidiaries share not only the same physical location (office building) but also the same staff (interviews L02/2019; L12/2019). This is not unique to Chinese banks. However, all Chinese banks organized their business systematically in the same fashion, while few other banks from EU and non-EU countries are organized under a branch-cum-subsidiary model. We suggest that this setting of complementary functions is one of the major reasons for Chinese banks' decision to establish both branches and subsidiaries in Luxembourg.

Creating new markets

Considering the recent removal of investment quotas by China's financial regulators (SAFE 2020), Luxembourg offers a platform to invest in China through its Foreign Qualified Institutional Investor (FQII) scheme. This includes the RMB FQII (RQFII) (cf. Hall 2017), for which a fund's capital can be deposited in Luxembourg (interview L07/2019). This is "probably" the reason why Luxembourg hosts the largest pool of Chinese RMB in Europe (interview L07/2019), which not least challenges scholars' consideration of Hong Kong, London, Frankfurt, and Singapore as the largest RMB hubs. In Luxembourg, RQFII's assets under management exceed the equivalent of €5.1 billion, including portions of quotas from other RMB centers such as London, Singapore, and Hong Kong. More than 80% of European investment funds with an exposure to China's RMB-denominated securities markets are based in Luxembourg (LFF 2019b). It may hence lay the economic foundation for Luxembourg's future as a strategic RMB hub. Obtaining the RMB clearing license from the People's Bank of China (PBOC) can be considered a key reason for Chinese SOCBs to compete with one another in international markets. Three of them operate in Europe: the ICBC obtained the license for Luxembourg and Moscow, the BOC for Paris, Frankfurt, and Budapest, and the CCB for London and Zurich.

Despite a wide academic and non-academic consensus in assuming London as the leading RMB hub in Europe, Luxembourg, on the one hand, is the world leader in two crucial RMB markets. Luxembourg hosts the largest number of investment funds with an exposure to China's RMB-denominated security markets and the Luxembourg Stock Exchange lists the largest number of RMB bonds outside mainland China (LFF, 2019b). On the other hand, London is the world leader for RMB payments and foreign exchange transactions, but – as just mentioned – not for investment funds and bonds. Investors from third countries confirmed their growing interest in RMB products. One revealed that, as a personal experience and not as a market trend, RMB investments grow to the detriment of Japanese yen-denominated investments (interview L01/2020). The other stated that (s)he takes the role of Luxembourg for granted as all RMB investments present in the portfolios that (s)he knows of refer to investment vehicles domiciled in Luxembourg (interview I02/2020). (S)he added that today, in 2020, it is common practice to have at least a small exposure to RMB markets, while it was almost inexistent only two years ago, when many asset managers defined Chinese securities as "esoteric."

Indisputably, these findings spark interests for further research, mainly regarding the architecture of processes and strategies in the RMB internationalization. However, interview partners stressed that the operations of China's banks are still limited as compared to their potential (interviews L02/2019; C06/2019), and Luxembourg is keen to attract higher sums of investment rather than more banks from China (interview C06/2019).

Overall, Luxembourg's well-developed fund industry is predestined to act as the necessary channel to direct investments from China to Luxembourg and the EU, as well as from Luxembourg and the EU back to China. Indeed, Luxembourg's financial ecosystem is distinctive with regard to its expertise in designing and administering a large range of investment vehicles. By establishing development and alternative investment funds that route capital to the 'BRI regions' and back to China, Chinese banks are be(com)ing experts in providing knowledge about structuring financial products for these emerging markets, which includes the expansion of the RMB business, but – as a result – develop themselves into an asset for and of Luxembourg's IFC.

Conclusions: Forming China's global banking network through Luxembourg

This paper empirically discussed the spatio-economic organization of Chinese banks in Luxembourg through a branch-cum-subsidiary strategy. Three main findings can be summarized. They emphasize the need to better comprehend the distinct organizational and legal setups of global banking networks with specific regard to banks' branches and subsidiaries, which may also lead to a more careful accentuation of the importance of IFCs' geopolitical and geoeconomic dimensions in the global webs of finance.

First, Luxembourg is a strategic node of China's global financial architecture. Chinese banks have clustered in Luxembourg by deploying a branch-cum-subsidiary model because Luxembourg has positioned itself well and is able to respond to Chinese banks' strategic needs. The combination of Luxembourg's specialization in the cross-border investment fund industry, its knowledge, expertise and experience, and its financial regulatory framework provides Chinese banks with a platform to expand into European markets and integrate into global finance in the (supposedly) most efficient way. China funnels more than 40% of its FDI into Europe through Luxembourg. As the location for the headquarters of extensive networks of Chinese bank branches across the EU, Luxembourg also acts as one gateway to the Chinese securities markets.

Second, Luxembourg's IFC capitalizes on Chinese banking presence. Luxembourg has recently become a vital center for RMB internationalization. It is the first market worldwide for two distinct RMB businesses: investment funds with an exposure to China's RMB-denominated securities, and RMB bond listing. This primacy gives Luxembourg the foundations to become a leading financial center of the future with regard to being a privileged entry point for Chinese growing and economically increasingly attractive financial markets.

Third, Chinese banks – both branches and subsidiaries – expand according to the Chinese state's mandate. Whilst Chinese banks serve clients in financing their overseas' projects, they also provide essential services to SOEs to help them expand in line with state objectives. This includes setting up legally specific investment vehicles in IFCs best suited, e.g., to fund BRI projects and build a set of networks that can be interpreted to be groundwork for future RMB internationalization; all of which is in accordance to China's political economic agenda.

Chinese banks are access points to both China's financial markets and the financial geographies of the BRI. Having such banking heavyweights onsite helps Luxembourg develop its overall asset as an internationally recognized IFC, specifically regarding a future (re-)combination of established and new market knowledge in finance and taxation. Interview results, however, confirm the still limited commitment of Chinese banks' real financial operations in Luxembourg, and local stakeholders hope to see Chinese operations in Luxembourg and the EU rising in the near future. Compared to its European peer IFCs, Luxembourg has good prospects to continue to grow by competing for market share. This is especially true in a Brexit situation where London may be less well positioned to provide access to the EU single market. As strategic gatekeepers that control this future growth market, Chinese banks' bargaining power towards Luxembourg and other European IFCs will, however, surge. Such power-induced politico-economic settings define further research avenues.

Echoing Töpfer (2018), our empirical findings call for more attention to the role(s) of the state(s) in building economic and financial networks that serve strategic interests on each side, and we suggest taking a more integrated, multi-disciplinary approach to understand the complexities of these processes revolving around a range of interests and legal-technical issues. The example at hand provides empirical evidence for such claims as one of our interviewees with most awareness of the matter argued: the "power [of Chinese banks in Luxembourg] is at the Embassy [of China]" (interview L02/2019). This is an apt statement indeed to bring the state to the analytical fore. It should further be linked with the political interests and activities to promote the Financial Silk Road (LFF 2019a) by Luxembourg's government, that is, a program aimed at facilitating investments from and to the EU and China, involving private partners from both sides in financing infrastructure projects through private and public partnerships. In-depth understanding of such 'financial diplomacy' is indeed important in contributing to our comprehension of the creation of (new) global financial networks. Finally, unpacking the precise value chains of SPVs and other vehicles revolving around the finance-cum-tax engineering would not only provide an illuminating starting point into the functions, motivations, and broader strategies of the involved firms, but also into the geopolitical activities on both sides and their wider implications for a worldwide increasingly financialized economic regime.

In conclusion and although some scholars have suggested that Chinese banks are far from building financial networks as compared to the Chinese SOEs building global production networks (Wójcik 2018), our results suggest that Chinese SOCBs, backed by powerful state agencies, are well capable of building such financial networks, thus functioning as geoeconomic and geopolitical boundary spanners. This recent phenomenon requires more analytical insight and a better understanding specifically with regard to its future far-reaching implications.

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