

Retention: managing security and leverage correctly in supply contracts

Retention refers to a portion of the agreed remuneration that the client withholds from invoice payments and releases only once defined conditions have been met. In the manufacturing and supply industry, it serves as protection against defects, non-delivery or outstanding residual services. For buyers, it is an effective but legally and relationally sensitive steering instrument.

Key facts

- Retention is a percentage or amount-based withholding of payments until final acceptance or expiry of the warranty.
- Typical rates in practice are often between 5 and 10 per cent of the invoice amount, usually with partial release upon acceptance.
- Release must be clearly tied to documented milestones such as acceptance, Run at Rate or end of warranty.
- Retentions can strain suppliers' liquidity and should therefore be taken into account in pricing and creditworthiness assessments.
- Legal permissibility and interest depend on the contract and applicable law; an individual review is required in each case.

Definition: retention

Retention (German: Einbehalt) is the contractually agreed share of a payment that the buyer withholds until the contractor has fully and defect-free performed the contractually owed services. It is not a discount and not a contractual penalty, but a form of security from the ongoing payment flow.

Distinction from contractual penalty and early payment discount

Unlike a contractual penalty, retention does not aim to sanction misconduct but to secure outstanding performance components. It differs from a prompt payment discount (early payment discount) in that the amount is not paid immediately and reimbursed later, but withheld permanently until the release event. The contractual wording must document this distinction cleanly in order to avoid later disputes over terms and conditions.

Typical use cases in industry

Retentions are common in plant engineering, toolmaking, prototype programmes and long-running framework agreements. Frequently, the buyer ties release to the successful acceptance of first articles, a passed Run at Rate or the end of the warranty period. Retention can also safeguard the handover of complete documentation and tools in supplier transfers.

Methods and approach: anchoring retention contractually and operationally

An effective retention requires a clear contractual basis. It should never be deducted ad hoc by accounting, but run as a controlled process with defined release events and responsibilities.

Contractual design

In the contract or framework agreement such as a Master Service Agreement (MSA), the retention rate, assessment basis, release conditions, due dates and interest are specified. In public or formal procurement, the retention, together with the award documentation, forms part of the documented payment terms. It is important to formulate clearly when acceptance is deemed granted and which evidence (inspection reports, documentation, tool handover) must be available.

Process implementation in master data and accounting

In practice, retention is often mapped via a separate general ledger account or a retention account so that it remains visible within the accounts payable master data environment and in reporting. Procurement coordinates with quality management and accounting on when release events have occurred. Without a regulated release process, amounts typically remain tied up unnecessarily long and strain the supplier relationship.

Integration into supplier evaluation and price negotiation

Since retention reduces the supplier's liquidity, it should be included in the overall assessment, for example alongside the supplier score and supplier credit limit. For financially weak but technically strong providers, a moderate retention can be offset against other concessions such as adjusted Incoterms CIP or FCA arrangements or longer payment terms. The procurement policy should transparently regulate when retentions are used.

Important KPIs and metrics for retention

Retention can be managed via several metrics used jointly by procurement controlling and accounting. Transparency about the amount, age and cause of open amounts is crucial.

Retention rate and retention volume

The retention rate describes the proportion of the withheld amount relative to the invoice amount, typically 5 to 10 per cent in project and plant business. The absolute volume shows how much liquidity is tied up overall at the supplier. Both figures should be reported per contract and per supplier portfolio.

Lead time and release quota

The release lead time measures the span between the occurrence of the release event and actual payment; in practice, values under 30 days are customary and realistic. The release quota indicates what proportion of retentions was released on time in accordance with the contract. High residual amounts with high age indicate unresolved defect cases or process gaps and belong in procurement's deviation analysis.

Impact on supplier metrics

Retentions indirectly influence the solvency of suppliers and thereby metrics such as the backorder rate if suppliers get into pre-financing difficulties. For critical components, procurement should therefore

examine whether a high retention jeopardises the supplier's detailed capacity planning. If necessary, a lower rate or staggered release is more sensible.

Risks and controls: applying retention effectively but fairly

Retention is a double-edged instrument: it protects the buyer, but can place unnecessary strain on suppliers and damage relationships. Controls and clear governance are therefore central.

Legal and tax pitfalls

The permissibility of retentions depends on the contract type and applicable law; it is established in construction and plant engineering, less so in the sale of goods. The accounting and VAT treatment as well as interest issues should be reviewed on a case-by-case basis with the tax or legal department. A uniform wording is also important for international contracts with differing terms and conditions.

Governance and data quality

Retention agreements must be kept up to date in the supplier master data and in contract management. Master data governance makes an important contribution here: clear data owners ensure that retention rates, release conditions and deadlines are correctly stored in systems. Otherwise, amounts remain unnoticed or are paid out prematurely in error.

Fair treatment and supplier retention

Excessive retentions can lead to capable suppliers declining orders or being assessed more critically in future material classification. Procurement should therefore use retention in a targeted and proportionate manner, for example only for new parts, risky development projects or proven quality issues measured against the supplier quality objective.

Current developments: digitalisation and alternative securities

The classic retention is complemented by digital processes and alternative forms of security. The trend is towards transparency, automation and a fair balance of interests.

Automated release processes

Digital contract and invoice workflows increasingly detect release events automatically and trigger payment. This reduces manual rework and prevents retentions from being forgotten. Interfaces between contract management, the quality system and accounts payable are the key here.

Alternative forms of security

Instead of payment holdbacks, some buyers rely on bank guarantees, sureties or a staggered payment model with retention insurance. These variants preserve the supplier's liquidity and are often the better choice for financing-weak or strategically important providers. The choice of instrument should be made within the contract strategy per supplier and order risk.

Retention in the context of procurement risk management

In view of disrupted supply chains, many companies are reconsidering the balance between protection and partnership. Retention is only one of several instruments alongside contract renewal strategies, qualification measures and portfolio diversification. What matters is that the retention is documented, proportionate and comprehensibly justified.

Typical metrics

Retention rate: typically 5–10 %

Proportion of the invoice amount withheld

Release lead time: < 30 days

Time from release event to payment

Release quota: > 95 % on time

Proportion of retentions released in accordance with the contract

Outstanding retention volume: report by project and age

Total tied-up liquidity; high aged balances indicate process gaps

Practical example

A mid-sized mechanical engineering company commissions a toolmaker with the design and testing of an injection moulding tool. To safeguard complete documentation, tool handover and proof of production-ready process capability, the buyer agrees a retention of 8 per cent on the advance payments.

- Release of 5 percentage points after successful first article inspection and a passed Run at Rate.
- The remaining 3 per cent is released 90 days after start of series production and handover of all documentation.
- Retention is recorded in accounting in a separate retention account and reconciled with the supplier quarterly.
- In the next price comparison, the supplier explicitly factors in the retention; procurement then evaluates the total costs including capital tie-up.

Conclusion

Retention is a proven instrument for securing residual services, defect remediation and documentation obligations from suppliers. However, its value depends largely on contractual clarity and a reliable release process. Buyers should use it in a targeted and proportionate manner and factor in the impact on the supplier's liquidity. Those who systematically integrate retention into supplier evaluation, price negotiation and risk management gain a security instrument that burdens neither relationships nor costs unnecessarily. If in doubt, it is worth coordinating with the legal and tax departments on the design in the individual case.

Frequently asked questions

What is a retention on a supplier invoice?

A retention is the portion of the invoice amount that the buyer withholds until the supplier has fulfilled all contractual obligations, such as acceptance, documentation or warranty. Typical rates in practice are 5 to 10 per cent. Release takes place according to defined milestones.

How long may a retention be withheld?

The duration is governed by the contractual agreement and depends on the release event, such as acceptance or the end of the warranty period. Periods ranging from several months up to half the warranty period are common. Without a clearly defined deadline, disputes loom, so the period should

always be contractually fixed.

What is the difference between retention and a contractual penalty?

Retention secures the fulfilment of outstanding services and is released once these are successfully completed. A contractual penalty, by contrast, sanctions a breach of contract and is not refunded. The two can be combined, but must be clearly and separately formulated in the contract.

What retention is customary for tooling or plant engineering contracts?

In practice, retentions of 5 to 10 per cent of the invoice amount are common, often staggered with partial release upon acceptance or first article inspection. For high-risk new developments, higher rates may also be agreed. What matters is that the rate and release conditions are clearly documented.

What tax or accounting aspects are associated with retention?

Retention is typically recorded in a separate account and is only posted as a payment upon release. Tax treatment and interest may vary depending on the contract and legal situation. In individual cases, the treatment should be clarified with the tax or legal department.

Can a supplier refuse or sue over a retention?

A contractually agreed retention is binding; without an express agreement, the supplier may in some circumstances demand full payment. Disputes may arise over unclear release maturity or defects, which in extreme cases may have to be resolved in court. Clear wording and documented evidence are therefore crucial.