

Factoring in procurement: managing liquidity and strengthening supplier relationships

Factoring in procurement refers to the deliberate use of factoring arrangements to optimise payment flows between companies and suppliers. While classic factoring primarily serves to secure the company's own receivables, in the procurement context the focus shifts to supply chain financing. Buyers can use it to extend payment terms, pay suppliers earlier and actively manage the cash-to-cash cycle. The term is closely related to reverse factoring and early payment programmes.

Key facts

- Factoring in procurement encompasses classic factoring and reverse factoring (supply chain finance) with different risk allocations.
- Under reverse factoring, a bank or factoring institution pays the supplier early; the buyer settles the invoice later on the agreed date.
- In practice, interest rates of around 1 to 6 per cent p. a. are typically agreed, depending on creditworthiness and term.
- Reverse factoring can be recognised in the balance sheet as debt or as trade payables – the classification requires an assessment of each individual case.
- Key criteria for implementation are supplier acceptance, data quality in accounts payable and IBAN verification as a basic anti-fraud measure.
- A well-designed programme typically reduces supplier financing costs and improves schedule adherence, because suppliers are more liquid.

Definition: factoring in procurement

At its core, factoring is the ongoing purchase of receivables by a credit institution or factoring company. In procurement, the term is used more broadly and describes all forms of receivables-based supplier financing that the company actively helps to shape.

Classic factoring from the supplier's perspective

In classic factoring, a supplier sells its receivables to a factor and receives immediate liquidity. The buyer initially notices little of this, apart from payments going to the factor instead of the supplier. Of particular interest to procurement is that liquid suppliers deliver more reliably and less frequently get into payment difficulties. This stabilises security of supply in the long term and reduces the effort required for contingency management.

Reverse factoring as a procurement instrument

Reverse factoring, also known as supply chain finance or a supplier financing programme, starts with the buyer. The buyer approves the invoice, a bank pays the supplier early minus a discount, and the buyer settles the amount only on the original or extended due date. The interest rate is often based on

the buyer's creditworthiness, not the supplier's. This particularly benefits medium-sized suppliers with limited access to financing.

Distinction from early payment programmes

Under an early payment programme, the buyer pays discounts in return for early payment directly from its own liquidity, without a financing partner. The difference lies in the cost distribution: early payment trades an early payment discount for the buyer's liquidity, while reverse factoring uses third-party debt capital. Both approaches can be combined when suppliers have different financing needs. The choice depends on the company's own cash flow position and the early payment discount rate in the supplier portfolio.

Methods and approach for implementation

A factoring programme in procurement follows a clear sequence: preparing the data foundation, selecting the financing partner, supplier communication and gradual rollout.

Data foundation and master data governance

The foundation of any programme is clean accounts payable data: verified IBANs, valid payment terms and consistent invoice approval. Without effective master data governance, there is a risk of mispayments and delayed approvals, which make the programme more expensive. IBAN verification should be established as a standard check before every disbursement, since factoring and reverse factoring processes are attractive targets for fraud involving altered bank details. In addition, a defined blocked stock management process in the ERP system is recommended so that disputed items do not enter the financing.

Partner selection and contract design

Selecting a factor or bank partner involves a tender with clearly defined terms, limits per supplier and service levels. The contract should contain a right-to-audit clause so that the company can inspect statements of account and the fee structure. Also important are provisions on invoice disputes, clawback cases and liability in the event of incorrect approval. Extensions of payment terms must be examined separately, as they can have commercial and possibly tax law consequences; in case of doubt, an assessment of each individual case by auditors or tax advisors is advisable.

Supplier communication and rollout

Supplier acquisition for a financing programme differs from classic supplier acquisition: it is not about awarding contracts but about communicating benefits. A pilot with the 10 to 20 most important suppliers makes sense, with participation typically remaining voluntary. In practice, the ease of onboarding and the transparency of costs determine acceptance. A rollout in several waves reduces the load on accounts payable and allows lessons to be learned before scaling.

Key KPIs for managing factoring programmes

Factoring in procurement can only be managed if liquidity effects, costs and supplier behaviour are measurable. A handful of key figures is sufficient for this.

Cash-to-cash cycle and payment term reality

The central measure is the cash-to-cash cycle, i.e. the span between payment to suppliers and cash

inflow from sales. Reverse factoring extends the calculated payment term; at the same time, the supplier can in fact receive money earlier. Buyers should report both perspectives separately: the balance sheet payment term and the effective liquidity duration for the supplier. Only then can it be assessed whether the programme saves liquidity or merely shifts costs.

Acceptance rate and participation rate

The acceptance rate shows what share of the relevant invoice volume runs through the programme. In practice, rates of 30 to 60 per cent of the addressed volume in the first year are considered realistic. Low rates often indicate complicated processes, poor communication or unattractive terms. The rate should be analysed by supplier size and commodity group hierarchy in order to follow up in a targeted manner.

Keeping costs and discounts in view

Costs include interest, programme fees and internal process costs. In addition, the early payment discount rate remains a benchmark: if a supplier voluntarily offers early payment discounts of 2 to 3 per cent within 14 days, this is often cheaper than external financing. The approval speed, measured for example by the requisition cycle time upstream and the invoice approval time, determines how early the factor can pay out. Delays here cause interest costs directly.

Risks and controls in factoring

Factoring programmes carry economic, balance sheet and operational risks, which can be controlled with clear checks.

Balance sheet classification and covenants

The classification of reverse factoring liabilities is not trivial from a regulatory perspective: depending on the structure, liabilities may have to be recognised as trade payables or as financial debt. This affects leverage ratios and may touch credit agreements with covenants. Since the classification standards have evolved over time and depend on the specific contract design, the accounting treatment should be agreed with auditors and tax advisors before the contract is signed.

Fraud prevention and process controls

Immediate pre-financing makes invoice fraud particularly lucrative because recoverability decreases. In addition to IBAN verification, four-eyes principles for approvals, reconciliation with order data and reference numbers, and a netting procedure for intra-group settlements should be considered to reduce errors. Disputed invoices or those with open change-order clauses must only enter financing once clarified. Regular spot checks and a documented control system are mandatory.

Dependency and supplier relationship

Anyone who finances suppliers permanently through a single programme creates dependencies. Extensions of payment terms can burden supplier margins and impair delivery readiness – visible in declining schedule adherence or falling call-off reliability. For critical materials with a high dual-sourcing share, the risk can be spread across several financing partners or supplementary early payment options. Transparent communication prevents the impression of one-sided exploitation of the supplier base.

Current developments in factoring in procurement

Digitalisation, the sustainability agenda and closer procurement financing are driving the further development of factoring programmes.

Dynamic financing terms

Modern platforms link the interest rate to criteria such as delivery performance, quality or sustainability data. Suppliers with high schedule adherence or documented CO2e progress receive more favourable terms. This turns supplier financing into an incentive instrument alongside price and volume. Such linkages require reliable metrics and clear warranty agreements over the data basis, for example for attested emission values.

Standardisation and automation

The technical basis is standardised, machine-readable invoice and order data. Standardisation reduces disputes and speeds up approval, which lowers interest costs. AEO certification and documented internal controls also make collaboration with banks easier, as compliance checks are shortened. Companies with a mature supplier innovation culture increasingly use financing programmes to co-finance supplier investment in new developments as well.

Supply chain resilience

Experience with supply failures has shown that the financial strength of suppliers is a direct risk factor. Procurement organisations therefore systematically review supplier liquidity metrics, in addition to considerations of vertical integration or dual-sourcing strategies. Factoring thus moves from being a purely treasury topic to becoming part of supplier risk management. Those who link purchase requisitions, materials planning and financing information detect payment difficulties earlier.

Typical metrics

Acceptance Rate (Participation Rate): 30–60%

Share of the addressed invoice volume in the programme; in practice measured after the first year

Cash-to-Cash Cycle: depends on the programme

Change compared with the baseline as the core impact measure

Financing interest rate: typically 1–6% p. a.

Benchmark, depending on creditworthiness, term and market conditions

Invoice approval time: < 5 working days

Determines how early the factor can pay out; delays cost interest

Schedule Adherence: > 95%

Indicator that financing does not impair supplier performance

Practical example

A medium-sized machinery manufacturer with around 120 active suppliers suffered from long payment terms of its own, typically 90 days, while many sub-suppliers bore high bank financing costs. Individual suppliers signalled a need for capital, and two critical suppliers temporarily faced liquidity bottlenecks, jeopardising the supply of materials. Together with the finance department, procurement initiated a reverse factoring programme with a bank as financing partner.

- Building a verified data foundation with IBAN checks and uniform payment terms before launch
- Pilot phase with the 15 most important suppliers and voluntary participation, promoting the benefits through personal conversations
- Anchoring a right-to-audit clause in the factor contract and four-eyes approval for all disbursements
- Linking interest rates to supplier performance, through which two suppliers noticeably reduced their financing costs and on-time delivery improved

Conclusion

Factoring in procurement combines liquidity management with supplier relationships: properly implemented, it relieves sub-suppliers, stabilises supply and manages the cash-to-cash cycle. Prerequisites are clean master data, robust controls such as IBAN verification and contractual safeguards including audit rights. The balance sheet classification should be professionally reviewed before implementation. Those who continuously measure acceptance rates, costs and supplier performance recognise early whether the programme delivers on its promise. In this way, factoring becomes a strategic lever in the supplier portfolio rather than a mere financing instrument.

Frequently asked questions

What is factoring in procurement?

Factoring in procurement refers to the use of receivables purchase and related financing instruments to manage payment flows between buyer and supplier. The focus is usually reverse factoring, in which a bank pays the supplier early and the buyer pays at a later date. The aim is greater liquidity on both sides of the business relationship.

What is the difference between factoring and reverse factoring?

In classic factoring, the supplier sells its receivables directly to a factor. In reverse factoring, the buyer initiates the programme, approves invoices and benefits from extended payment terms, while the supplier receives liquidity earlier. Under reverse factoring, the financing costs are often based on the buyer's creditworthiness.

Is reverse factoring worthwhile for medium-sized companies?

Yes, provided there is sufficient invoice volume and suppliers are interested in earlier liquidity. In practice, the effort pays off once a relevant share of the procurement volume is covered and the buyer is liquid and creditworthy. What matters are data quality, simple processes and a fair distribution of costs between the parties.

How does factoring affect the balance sheet?

Depending on the structure, reverse factoring liabilities may have to be recognised as trade payables or as financial liabilities. This affects leverage ratios and potential credit agreements. The assessment depends on the specific contract and should be clarified in advance with auditors or tax advisors.

What risks does factoring pose for buyers?

The key risks are invoice fraud through manipulated bank details, balance sheet reclassifications and a one-sided burden on suppliers through extended payment terms. Controls such as IBAN verification, the four-eyes principle and right-to-audit clauses reduce these risks. In addition, supplier performance, such as schedule adherence, should be monitored continuously.

When is early payment better than reverse factoring?

Early payment is suitable when the company itself has liquidity reserves and wants to use discounts for fast payment. Reverse factoring is a better fit when the buyer wants to keep long payment terms but suppliers need money earlier. Both options can coexist and be applied depending on the supplier group.