

Consignment agreement: managing supplier stock at the buyer's premises

A consignment agreement is a contractual model in which a supplier holds goods in a warehouse operated at the buyer's premises without yet supplying them. Ownership only passes to the buyer when the goods are withdrawn for production or consumption. For buyers, this model combines high availability with reduced capital tie-up, but requires precise contractual and process control.

Key facts

- Ownership typically transfers only upon withdrawal from the consignment warehouse, not upon delivery.
- Capital tie-up and inventory on the buyer's side decrease while physical availability remains high.
- Minimum fill levels, reporting intervals and stocktake arrangements are usually agreed in the contract.
- In practice, the model is frequently used for C-parts, fasteners, cutting tools and standard components.
- Legally, it is usually a combination of a warehousing contract and a sales contract with staged transfer of ownership.
- Digital consignment solutions rely on automatic withdrawal reporting and reconciliation with the supplier network.

Definition: consignment agreement

A consignment agreement governs that a supplier holds defined items in a warehouse at the buyer's premises or at a neutral location without these goods already being regarded as supplied. Only upon withdrawal for production or consumption does the payment obligation arise; until then, the stock remains the property of the supplier. The model is also referred to as a consignment warehouse or Vendor Managed Inventory with a consignment element.

Distinction from call-off orders

A call-off order obliges the parties to quantities and dates once releases are made; goods receipt typically triggers the liability. In consignment, goods receipt exists physically, but liability only arises later upon withdrawal. Both instruments can be combined: the call-off order defines items, prices and fill quantities, while the withdrawal report triggers invoicing and replenishment.

Possible warehouse formats

In practice, several variants have become established, differing in ownership of the warehouse, location and responsibility. The buyer can provide its own consignment rack in its goods receiving area, the supplier can operate a field warehouse with its own warehouse personnel, or a third-party warehouse near the plant can be used. Supplier-side consignment warehouses with call-off characteristics are also common.

Typical areas of application

Consignment agreements are particularly suitable for items with high withdrawal demand, low value per unit and stable consumption, such as screws, seals, small electrical parts or packaging. Long-lived spare parts with critical availability are also consigned so that no procurement lead time arises in the event of a breakdown. The ABC analysis usually provides the basis for selecting suitable items.

Methods and approach for introduction

The introduction of a consignment agreement follows a structured implementation process: item classification, supplier selection, contract negotiation, system set-up and continuous monitoring. Buyers should validate the consumption of candidate items in advance using procurement data analysis in order to set fill quantities realistically.

Item selection and data basis

The starting point is an evaluation of consumption figures, stock cover and procurement lead times, often supplemented by a duplicate check of the material master, because consignment solutions stand or fall with clean item master data. Unit and currency master data must be consistent, since withdrawal and settlement quantities are processed automatically. Prices and price adjustment mechanisms are fixed contractually.

Contractual foundations

The contract should clearly govern transfer of ownership, insurance of the consignment stock, stocktake procedures, minimum and maximum fill levels, reporting processes and procedures for scrap and returns. Supplementary points are limitations of liability, set-off clauses for offsetting and integration into the parties' existing terms and conditions. For extensive cooperatives, connection to a Master Service Agreement (MSA) is recommended, which governs framework conditions such as confidentiality and compliance in advance.

Process and system set-up

In practice, clear identification of the consignment stock in warehouse management has proven its worth, for example via separate storage locations or labels with supplier allocation. Depending on maturity, withdrawal reporting is carried out manually by list, via self-billing procedures with automatic settlement, or fully integrated via interfaces to the supplier network. High supply chain visibility over stock and consumption data significantly reduces reconciliation effort on both sides.

Key KPIs for consignment programmes

Consignment agreements can only be steered if availability, stock quality and billing accuracy are measured. The following metrics have established themselves as standard; benchmarks vary by industry and item class.

Availability and fill level

Availability from the consignment warehouse should typically be above 98 per cent, as availability is the model's central user promise. The fill level shows whether the agreed minimum quantities are being maintained; persistent under-filling indicates incorrectly dimensioned fill quantities or the supplier's logistics problems.

Billing accuracy and lead time

The match between withdrawal reports and invoices or self-billing items should in practice exceed 97 per cent; deviations cost clarification time and undermine the model. The lead time from withdrawal to settlement should be a few days up to a maximum of one settlement period. Stock accuracy from stocktakes, often targeted above 99 per cent, is also one of the core metrics.

Capital tie-up and total cost of ownership

The central economic effect is reflected in the reduction of capital tie-up and total cost of ownership for the supplied item groups. Buyers should present the effect in isolation, for example as a comparison of tied stock values before and after introduction. In addition, it is worth examining the administrative effort per withdrawal transaction, as this quickly becomes dominant for small batch sizes.

Risks and controls

Although the model reduces capital tie-up, new risks arise: hidden costs, ownership and liability issues, and dependencies on the supplier. These can be controlled through clear contracts, stocktake discipline and ongoing monitoring.

Economic risks

Consignment is not automatically cheaper: suppliers typically factor warehousing and capital tie-up into their prices, and minimum fill levels can lead to excess stock that becomes worthless when technical changes occur or series are phased out. Particularly when materials change or after the series release of new components, legacy stock must be governed contractually, for example through take-back obligations or staggered run-down phases.

Legal and liability aspects

Since the stock remains in the supplier's ownership until withdrawal, questions of retention of title, insurance, transfer of risk and liability in the event of loss or damage must be clarified in the contract. The transfer of product liability and inspection obligations at goods receipt must also be precisely governed; legal and tax aspects, such as VAT treatment and documented provision, should be professionally reviewed on a case-by-case basis. Warranty and complaint channels must likewise be contractually stipulated.

Operational controls

Regular stocktakes and sampling between buyer and supplier prevent stock discrepancies and unwanted duplicate stock. Risk scenario planning helps to assess the impact of consumption peaks or supplier failures on the fill strategy. Even with a consignment warehouse, a structured supplier dunning process with escalation levels remains necessary in the event of delivery delays, as the model does not replace supplier performance.

Current developments and digital implementation

Consignment solutions are becoming increasingly digitalised: instead of paper-based withdrawal lists, companies are relying on automated withdrawal sensors, barcode and RFID capture, and cloud-based platforms that share stock and consumption data with the supplier network. This also facilitates integration into further procurement models such as project procurement or outsourcing scenarios.

Automated withdrawal and settlement

Modern systems record every withdrawal automatically and generate settlement items from it, frequently using a self-billing procedure, which largely eliminates invoicing and invoice checking. Replenishment planning is event-driven, allowing fill levels to be managed more tightly. The prerequisites are well-maintained master data including unit and currency master data, as well as clear supplier identification, for example via the DUNS number in the master record.

Integration into supply strategies

Consignment is increasingly regarded as a building block of a differentiated supply strategy and combined with other instruments: for A-items, individual call-offs or works contracts remain common; for stable C-parts, consignment dominates; for new technical parts, a supplier feasibility review before series provision remains sensible. Logistics clauses such as DDP for delivery into the consignment warehouse are also contractually anchored in order to allocate responsibility for transport and customs unambiguously.

Resilience and scenario planning

In times of disrupted supply chains, consignment warehouses are gaining importance as buffers, provided the fill strategy is actively managed. Procurement data analysis supports this by identifying critical items and adapting fill quantities to changes in demand. Supplier network platforms also make it possible to supply several locations of a buyer from one consignment warehouse and to create transparency across all stock.

Contract practice: content and checklist

A robust consignment contract clearly defines the commercial, operational and legal framework. The following content should be anchored in every agreement, regardless of industry and item scope.

Commercial provisions

Prices and validity, price adjustment mechanisms including regulated surcharge components such as an energy price surcharge agreement for energy-intensive products, and the settlement procedure with due dates should be fixed in writing. Take-back terms for superfluous stock in the event of range or technology changes protect against legacy burdens. In addition, it should be clarified whether minimum offtake or consolidation benefits are agreed.

Operational provisions

The mandatory content includes item and location lists, minimum and maximum fill levels, reporting and replenishment processes, stocktake frequency and discrepancy offsetting. Labelling obligations, the supplier's access rights to the warehouse and notification obligations in the event of disruptions complete the picture. A defined implementation process with named contacts on both sides reduces friction losses in day-to-day business.

Legal provisions

Transfer of ownership, insurance, allocation of risk and liability, warranty, limitation periods and the relationship to the contracting parties' terms and conditions must be explicitly governed. For cross-border consignment warehouses, customs and foreign trade issues arise, which should be reviewed in advance. All legal statements must in principle be verified on a case-by-case basis.

Typical metrics

Availability from consignment stock: > 98%

Core benefit of the model; persistently falling below this indicates fill strategy or supplier problems.

Billing accuracy withdrawal/invoice: > 97%

Low deviations are a prerequisite for efficient self-billing.

Stock accuracy (stocktake): > 99%

Regular stocktakes and sampling required.

Reduction in capital tie-up for C-parts: often 30–60%

Typical benchmark compared with conventional procurement, strongly dependent on item structure.

Lead time from withdrawal to settlement: < 10 working days

In practice depends on the system landscape; longer periods cause clarification effort.

Practical example

A medium-sized mechanical engineering company with around 300 employees suffered from high stock levels of fasteners, seals and small electrical parts while at the same time experiencing shortages of critical items. Following an ABC analysis, the company introduced consignment agreements with two main suppliers for around 1,200 items. One supplier operates a field warehouse with its own personnel in the goods receiving area, while the second supplies a neutral third-party warehouse near the plant. Withdrawals are made via barcode scan, and settlement runs as self-billing on a monthly cycle.

- Selection of items via ABC analysis and consumption data from procurement data analysis
- Contractual stipulation of fill levels, stocktake procedures and take-back terms for obsolete stock
- Automatic withdrawal reporting via barcode scan and reconciliation via a shared supplier network
- Quarterly evaluation of availability, stock accuracy and capital tie-up to steer the programme

Conclusion

The consignment agreement is a proven instrument for reconciling availability and capital tie-up. However, it only delivers its benefit with sound item selection, precise contractual provisions and disciplined stock and settlement control. Buyers should deploy the model specifically for stable, high-volume item groups and integrate it into a differentiated supply strategy. Digital withdrawal capture and self-billing significantly reduce operational effort and make the programme scalable. Those who regularly measure economic efficiency and clarify legal points at an early stage benefit permanently from lower total cost of ownership and higher supply security.

Frequently asked questions

What is a consignment agreement?

A consignment agreement governs that a supplier holds goods in a warehouse at the buyer's premises without yet supplying them. Ownership only transfers when the goods are withdrawn for production or consumption, and it is precisely at that point that the payment obligation arises. This gives the buyer high availability with low capital tie-up.

When is a consignment agreement worthwhile for procurement?

It typically pays off for items with stable, high consumption and low individual value, such as screws,

seals or small electrical parts. Decisive factors are predictable quantities, a reliable supplier and a clean material master. For custom parts or highly fluctuating demand, the model is usually unsuitable.

Who owns the stock in the consignment warehouse?

Until withdrawal, the stock remains in the supplier's ownership, even though it is physically stored at the buyer's premises. Ownership transfers upon withdrawal for production or consumption. This arrangement, along with insurance and liability, must be precisely stipulated in the contract and reviewed on a case-by-case basis.

How does consignment differ from Vendor Managed Inventory?

In consignment, the transfer of ownership at the time of withdrawal is the key focus. Vendor Managed Inventory describes more broadly that the supplier takes over stock planning at the buyer, which is also possible without a consignment element. In practice, both elements are frequently combined: the supplier manages the stock and only invoices upon withdrawal.

What risks does a consignment agreement entail?

Typical risks are excessive fill quantities and obsolete stock when technology or product ranges change, stock discrepancies due to inaccurate withdrawal reporting, and storage costs implicitly priced in by the supplier. In addition, legal questions arise regarding liability, insurance and product liability. Regular stocktakes, clear contracts and ongoing KPI monitoring minimise these risks.

How is a consignment agreement settled?

Settlement typically takes place after withdrawal reporting, either via invoices from the supplier or via a self-billing procedure in which the buyer prepares the settlement itself. Clear withdrawal documentation, short clarification channels for discrepancies and defined settlement intervals are important. Digital systems record withdrawals automatically and significantly reduce the reconciliation effort.