

Payment Terms Optimisation: Systematically Managing Payment Terms

Payment terms optimisation refers to the systematic design and extension of payment terms towards suppliers without jeopardising their liquidity and delivery reliability. It is a central instrument of working capital management and has a direct impact on a company's liquidity and financing costs. The term covers both the contractual agreement of suitable payment terms and the operational steering of invoice receipt, approval and payment execution.

Key facts

- Days payable outstanding (DPO) typically measures the average duration in days between invoice receipt and outgoing payment.
- In practice, extending payment terms by ten days often ties up several per cent of annual revenue in additional free liquidity.
- Payment terms that are too long burden suppliers and can economically backfire through hidden price surcharges or supply shortages.
- Payment terms, early-payment discounts and supplier credit should ideally be negotiated jointly with the price in the sourcing process.
- In DACH industry, payment terms frequently range between 30 and 90 days, depending on the sector and bargaining power.
- Dynamic discounting and supply chain finance complement hard payment term extensions with flexible, cost-based variants.

Definition: Payment Terms Optimisation

Payment terms optimisation is the strategic and operational steering of the period that elapses between receipt of a supplier invoice and its payment. The aim is a balance between maximum liquidity retention within the company and acceptable financing of suppliers.

Distinction from Receivables Days

While receivables days describes how long a company's own customers wait for payment, days payable outstanding looks at the reverse direction: how long the company makes use of supplier credit from its suppliers. Together with average inventory, both figures form the central drivers of the cash conversion cycle. Optimisation therefore never means isolated maximisation, but rather the coordination of all three components.

Positioning within Working Capital Management

Days payable outstanding is, alongside the optimal invoice basis, a building block of networked working capital. Procurement departments play a dual role here: they negotiate payment terms within the framework of blanket orders and spot purchase vs. framework agreement, but must also keep an eye on supplier relationships and risk position. A risk heatmap of the supplier base helps to distinguish

sensitive suppliers from those resilient to liquidity pressures.

Methods and Approach to Optimisation

Successful optimisation follows a structured process: analysis of the current state, segmentation of suppliers, negotiation of new terms and continuous steering of payment behaviour. Ad hoc adjustments to individual invoices, by contrast, lead to inconsistent supplier experiences and frictional losses.

Current-State Analysis and Data Basis

The starting point is a clean evaluation of the data model from ERP and accounts payable: actual payment data per supplier, agreed payment terms, early-payment discount utilisation rate and proportion of overdue invoices. A data steward should be responsible for data quality and consistent supplier master data, as incorrect master data leads to duplicate payment runs or premature payments. The assessment is then carried out along defined evaluation criteria such as revenue relevance, criticality and bargaining power.

Supplier Segmentation and Negotiation

Not every supplier is equally suitable for longer payment terms. For strategic partners in single sourcing, the adjustment of terms should take place within the framework of a supplier development plan or as a counter-move for volume commitments. For interchangeable commodity groups, payment terms can be directly anchored as an evaluation criterion within the sourcing process and the opening of tenders. Transparency is important: changes to payment terms without compensation act like a liquidity levy from the supplier's perspective.

Flexible Instruments: Early Payment Discounts and Supply Chain Finance

Dynamic discounting allows suppliers to draw invoices early in return for an early-payment discount; the company trades return for liquidity steering. Supply chain finance extends the payment period via a bank while the supplier receives earlier payment from the bank – the burden on the supplier remains low. For hedging foreign payments, BIC/SWIFT connections and, where applicable, a bank guarantee play a role, for example with advance payments to new suppliers.

Key KPIs for Payment Terms

Without reliable KPIs, optimisation remains a matter of chance. The core metric is days payable outstanding, complemented by quality and behavioural indicators that make side effects visible.

Days Payable Outstanding (DPO)

DPO is typically calculated as trade accounts payable multiplied by the number of days, divided by cost of goods sold. As a benchmark, the manufacturing sector frequently shows a DPO of 45 to 75 days. What is decisive is less the absolute value than the consistency between agreed payment terms and actual payment behaviour.

Supplementary KPIs

The early-payment discount utilisation rate, the proportion of payments made on time, the number of manual approval loops and the supplier's backorder rate show whether the optimisation is producing side effects. If the backorder rate rises or delivery reliability deteriorates, the payment terms were set too aggressively. Comparing DPO with receivables days also reveals whether the company, as a debtor,

uses what it demands as a creditor.

Risks and Controls

Payment term extensions are not free money. They shift liquidity along the supply chain and can drive suppliers into financial difficulty – with consequences for security of supply, quality and price stability.

Identifying Supplier Risks

Before adjusting terms, a creditworthiness and dependency check is recommended: anyone in a single sourcing position or with no alternative sourcing options can hardly absorb a supplier's financial difficulties. A quality gate in the procurement process should verify whether critical suppliers can bear the changed terms. A risk heatmap supports the assessment of suppliers by criticality and financial strength.

Internal Controls and Governance

Payment terms are economically significant contractual components and belong under a clear delegation of authority: who may agree which payment terms within which limits? Compliance aspects must be observed – in particular, EU directives on payment terms in commercial transactions set upper limits and information obligations; the specific legal position should be reviewed in each individual case. Confidentiality level and the supplier code of conduct additionally ensure that terms data is not passed on improperly or misused as a lever of pressure.

Root Cause Analysis in Case of Disruptions

If, after adjustments to terms, escalation loops, returns process volumes or quality problems increase, a structured 5-why analysis helps to determine whether the cause lies in payment behaviour or in other drivers. This avoids either prematurely reversing terms or, conversely, ignoring genuine warning signals.

Current Developments and Digitalisation

The digitalisation of the invoice process is the greatest lever for payment terms optimisation: those who process invoices faster can steer payment dates precisely – in both directions.

Automation of the Invoice Workflow

Electronic invoicing, automatic account assignment and rule-based approvals shorten the lead time from invoice receipt to payment run. In practice, this lowers processing costs and reduces early-payment discount losses caused by slow processes. Real-time dashboards on payment status enable plannable cash management instead of weekend payments made on spec.

Procurement as Cash Manager

Increasingly, procurement and treasury are cooperating: payment terms are evaluated as a negotiable item alongside price and quality in the sourcing process, similar to how an outsourcing potential analysis weighs cost against risk. Even in international procurement – for example with freight data supported by air waybills (AWB) for scheduling – payment dates can be linked to delivery dates in order to shorten cash-to-cash cycles.

Typical metrics

Days Payable Outstanding (DPO): 45–75 days

Industry benchmark for the manufacturing sector; trend more important than absolute value

Early-payment discount utilisation rate: > 80%

A high rate reduces material costs but in fact shortens the period

Payments made on time: > 98%

A high level strengthens supplier trust and negotiating position

Cash Conversion Cycle: negative to < 30 days

Considered jointly with receivables days and inventory

Practical Example

A medium-sized mechanical engineering company with annual revenue of around €80 million analysed its days payable outstanding and found a gap between agreed payment terms of 60 days and an actual DPO of 41 days. The causes were slow invoice approvals and a lack of payment planning. Over six months, the payment period was gradually extended without overburdening critical suppliers.

- Segmentation of suppliers by criticality and bargaining power along defined evaluation criteria
- Shifting invoice approvals into an automated workflow with clear quality gates
- Negotiating dynamic early-payment discount models with strategic suppliers instead of blanket payment term extensions
- Monthly joint review of DPO, early-payment discount utilisation rate and backorder rate by procurement and treasury

Conclusion

Payment terms optimisation combines financial objectives and procurement strategy: it improves liquidity but requires fair, data-driven design towards suppliers. Success comes to those who treat payment terms as part of the sourcing process rather than as a downstream administrative decision. Clean master data, clear approval rules and segmentation of the supplier base are the operational pillars. Complementary instruments such as early-payment discount models and supply chain finance enable differentiation instead of a one-size-fits-all rule. Those who systematically keep supplier risks in view gain liquidity without jeopardising security of supply or price stability.

Frequently asked questions

How is Days Payable Outstanding calculated?

Days Payable Outstanding (DPO) is typically calculated as trade accounts payable divided by cost of goods sold, multiplied by the number of days in the period under review. Alternatively, revenue can be used instead of cost of goods sold; the resulting figure is then less meaningful. What matters is consistent application of the same formula across multiple periods.

What is a good DPO value?

There is no universally good value, as industries and bargaining power vary considerably. In the manufacturing sector, values between approximately 45 and 75 days are commonly found. More important than the absolute value is the alignment between agreed payment terms and actual payment

behaviour.

How can you extend payment terms without harming suppliers?

A combination of supplier segmentation, transparent negotiation and compensating offers such as volume commitments, dynamic early-payment discounts (dynamic discounting) or supply chain finance has proven effective. Critical sole-source suppliers should be treated preferentially and protected. In addition, automated invoice processes help to ensure payments can be made on time.

What legal limits apply to payment terms?

In the EU, directives on payment terms in commercial transactions set upper limits for payment periods and impose information obligations; national implementations may differ. Abuse clauses applying to unreasonably long payment terms are also relevant. The specific legal position should be reviewed legally in each individual case.

What is the difference between early payment discounts and supply chain finance?

With early-payment discounts (early settlement discounts), the buyer pays the supplier earlier directly and receives a price reduction. With supply chain finance, a bank pays the supplier early while the buyer makes full use of their payment terms; the financing costs are borne by one of the parties depending on the agreement. Both instruments enable differentiated liquidity management.

Who in the company is responsible for payment terms?

Operational responsibility typically lies jointly with procurement and financial accounting, while strategic steering sits with procurement and treasury. A clear delegation of authority governs who may negotiate payment terms and up to what amounts. Without defined responsibilities, inconsistent terms and supplier frustration arise in practice.