

Working Capital Management: Controlling and Optimising Liquidity in Procurement

Working capital management refers to the systematic control of current assets, i.e. the cash cycle between inventories, receivables and liabilities. For buyers it is a central lever, because payment terms, early payment discounts and inventory levels directly influence a company's liquidity and cost of capital. Well-organised working capital management links financial goals with operational decisions in procurement, production and sales. This article explains the key metrics, methods and risks from a buyer's perspective.

Key facts

- Working capital is the difference between current assets and short-term liabilities.
- The cash conversion cycle (CCC) combines inventory days, receivable days and payable days in a single metric.
- In procurement, payment terms, discount utilisation, call-offs and inventory policy above all affect working capital.
- Payment terms extracted too aggressively can jeopardise supplier prices, delivery reliability and resilience.
- Supply chain finance and reverse factoring are established instruments for paying suppliers earlier without tying up own liquidity.
- In practice, working capital metrics are among the most important steering variables for both the CFO and procurement.

Definition: Working Capital Management

Working capital management encompasses all planning, control and monitoring measures aimed at optimising the size and structure of current assets. It links finance, procurement, production and sales, because each of these functions influences the three core components: inventories, receivables and liabilities.

Gross and Net Working Capital

Gross working capital comprises all current assets, including inventories, receivables and cash. Net working capital is obtained by deducting short-term liabilities; it shows which part of short-term assets is not externally financed. In practice, net working capital is often used as the steering variable because it reflects the capital tied up.

Distinction from Cash Management

Cash management focuses on short-term payment flows and liquidity planning, whereas working capital management looks at the underlying drivers: inventories, invoice cycle times and payment terms. For procurement, this means: whoever negotiates payment terms directly affects working capital, not just the liquidity position at month-end.

Importance for Procurement and the Supply Chain

Procurement controls a significant share of working capital because it decides on order quantities, call-offs, payment terms and contract structures. Every procurement decision thus has two dimensions: a cost dimension and a capital-tied-up dimension.

Payment Terms as a Negotiating Lever

Payment terms and early payment discounts are the classic levers. A discount such as 2/10 net 30 can be assessed as an annualised interest rate in the discount calculation and typically lies well above classic credit costs in practice, which is why taking the discount is usually advantageous as long as the company's own liquidity is sufficient. Conversely: whoever stretches payment terms beyond industry norms often pays for it through higher purchase prices or lower supplier priority.

Inventory Policy and Stock

Inventories are capital tied up with warehousing costs and the risk of depreciation or obsolescence. An inventory policy grounded in risk management separates strategic reserves from operational dead stock and prevents safety stocks from growing unnoticed. Blocked stock management and regular inventory clean-ups are therefore part of procurement's working capital management.

Fairness towards Suppliers

Extremely long payment terms act as silent credit at the supplier's expense and can weaken its liquidity. This increases default and supply risks in the medium term and contradicts sustainable supplier risk management. Balanced payment terms are therefore also a resilience issue, not merely a financing issue.

Methods and Approach to Optimisation

Optimisation typically follows a cycle of current-state analysis, target definition, implementation of measures and continuous monitoring. Coordination between procurement, finance, logistics and sales is important, as local optima often pursue contradictory goals.

Four-Step Process Model

First, the current state is made transparent through CCC, inventory and cycle-time analyses, including a risk analysis of the most important value streams. This is followed by target metrics per function, the implementation of concrete measures and monitoring with clear responsibilities. Often a small cross-functional team from procurement, finance and supply chain is established.

Instruments in Detail

The choice of instruments depends on the industry, supplier structure and access to capital markets. Medium-sized companies often start with payment terms and inventory clean-up before introducing financing instruments.

- Discount calculation and dynamic discounting models to value earlier payments
- Supply chain finance or reverse factoring for longer payment terms while paying the supplier early
- Inventory optimisation through ABC/XYZ analyses and planning parameters
- Streamlining goods receipt and invoice verification to shorten cycle times
- Contracts with clear provisions on payment terms, default and freight surcharges

Digital Support

ERP and e-procurement systems provide the data basis: open purchase orders, invoice status and inventory developments. In practice, the greatest leverage is achieved when processes are automated—for example invoice receipt, goods receipt matching and approvals—because this reduces invoice cycle times and makes discount windows realistically usable.

Key KPIs of Working Capital Management

Without metrics, working capital cannot be managed. The following figures are standard in practice and are suitable as target agreements between the CFO and procurement.

Cash Conversion Cycle and Its Components

The cash conversion cycle (CCC) results from inventory days plus receivable days minus payable days; it shows how many days capital is tied up between goods receipt and cash receipt. The shorter the CCC, the lower the financing requirement. It is important to consider the individual components, because improvements in one place can be offset elsewhere.

Further Steering Metrics

All metrics should be reviewed over several periods and compared within the industry. Absolute benchmarks alone are of little value, as capital intensity, industry and business model vary greatly.

- Days Payable Outstanding (DPO): average age of outstanding supplier liabilities
- Days Inventory Outstanding (DIO): average time inventory is held
- Days Sales Outstanding (DSO): average age of receivables
- Discount utilisation rate: proportion of invoices paid with an early payment discount
- Working capital turnover: revenue in relation to capital tied up

Risks and Controls in Working Capital Management

Working capital optimisation involves trade-offs: freeing up capital at the expense of supplier stability, security of supply or quality can prove expensive. Controls and clear escalation paths are therefore part of a professional approach.

Typical Pitfalls

Whoever weakens suppliers financially must expect longer reaction times, quality problems or supply failures. Supplier escalation may then become necessary, in serious cases with 8D containment in the event of quality deviations. Such consequential costs belong in every business case calculation.

- Unilaterally stretching payment terms and thereby putting suppliers under pressure
- Radically cutting safety stocks and jeopardising resilience
- Letting discount periods lapse due to slow invoice processes
- Reducing inventory without regard to spare part and single-sourcing risks

Controls and Governance

Effective controls include regular supplier evaluations including financial metrics, a risk management system with clear risk assessment—for example as a risk heatmap—and contractual instruments such as the right to audit where there are legitimate doubts about supplier statements. A business continuity plan (BCP) for critical parts ensures that liquidity optimisation does not create dependence on

failure-prone sources.

International Aspects

For international business, currency risks, differing payment practices and documentation requirements come into play. Instruments such as the ATA Carnet simplify temporary exports, and a clean payment processing set-up with correct BIC/SWIFT handling reduces friction losses. Legal frameworks, for example on payment terms in commercial transactions, should be reviewed on a case-by-case basis.

Current Developments and Outlook

Working capital management has evolved in recent years from a purely financial topic into an integrated supply chain topic. Supply chain disruptions, interest rate changes and sustainability requirements are changing the rules of the game and priorities.

Resilience versus Capital Tied Up

After supply chain disruptions, many companies increased safety stocks and thereby tied up working capital. The current debate revolves around how resilience can be built up in a targeted rather than blanket manner, for example through diversified sources, better supply chain mapping transparency and scalable contract models. Risk analysis and capital efficiency are considered together.

Dynamic Payment Models and Financing

Dynamic discounting and supply chain finance programmes reconcile the liquidity interests of both sides: the buyer extends payment terms while the supplier can sell invoices early at a discount. Reliable processes and approved invoices are a prerequisite; transparency and fairness determine the level of acceptance among suppliers.

Sustainability and Data

Sustainability requirements along the supply chain, such as reports on Scope 1 emissions from one's own operations as the starting point for emissions accounting, expand supplier evaluation and thus also the basis for payment and financing decisions. At the same time, data models and AI-supported analyses improve the forecasting of inventories and incoming payments, which agile procurement can use for capital planning.

Typical metrics

Cash Conversion Cycle (CCC): industry-dependent, typically 30–120 days

The shorter, the lower the capital tied up; comparison over time and across the industry is essential.

Days Payable Outstanding (DPO): typically 30–60 days

Shows the average age of outstanding supplier liabilities.

Days Inventory Outstanding (DIO): industry-dependent, often 30–90 days

Length of time inventory is held; reducing it lowers capital tied up but may cost resilience.

Early payment discount (skonto) utilisation rate: > 80% of discount-eligible invoices

A high rate indicates efficient invoice processes and exploited interest advantages.

Practical example

A medium-sized mechanical engineering company with around 300 employees discovered during a financing negotiation that its cash conversion cycle had risen continuously over several years. The causes were high safety stocks for long-lead parts, unused discount periods and inconsistent payment terms. A joint team from procurement, logistics and controlling defined target metrics and implemented several measures within two quarters.

- Discount calculation for all A-suppliers; prioritising invoice processing within the discount period
- Inventory clean-up with blocked stock management and ABC/XYZ analyses; eliminating outdated planning parameters
- Establishing a supply chain finance programme for selected suppliers with liquidity needs
- Including working capital metrics in monthly reporting, including a risk heatmap for critical parts

Conclusion

For technically oriented buyers, working capital management is far more than a financial metrics topic: it determines cost of capital, negotiating power and security of supply all at once. Successful companies manage payment terms, inventories and financing instruments as a package and explicitly include supplier fairness. Clear KPIs, clean processes and active risk management prevent short-term liquidity gains from turning into long-term supply problems. Those who integrate procurement, finance and the supply chain early on create capital headroom that can be invested in innovation and resilience.

Frequently asked questions

What is meant by working capital management?

Working capital management is the planning and control of current assets, i.e. inventories, receivables and short-term liabilities. The aim is to minimise tied-up capital without jeopardising liquidity or the ability to deliver. In procurement, the main levers are payment terms, early payment (skonto) discounts and inventory policy.

How is working capital calculated?

Net working capital is calculated as current assets minus short-term liabilities. Alternatively, the cash conversion cycle is often used, which combines inventory days, receivable days and payable days. Both figures should be reviewed over several periods and compared against industry benchmarks.

How can procurement improve working capital?

The most important levers are payment terms, consistent use of early payment discounts based on a clean discount calculation, and disciplined inventory policy. Faster invoice and approval processes as well as instruments such as supply chain finance also have a positive effect. It is important not to jeopardise the financial stability of suppliers in the process.

What is a good cash conversion cycle?

There is no universally good value, as it depends heavily on the industry. What matters is the development over time and comparison with competitors in the same sector. As a general rule: the shorter the CCC, the lower the capital tied up—provided security of supply and quality do not suffer.

Is an early payment discount really worthwhile for the buyer?

As a rule, yes, provided liquidity is sufficient: a 2 per cent discount for payment in ten days instead of 30 days equates to a very high annualised interest rate. The discount calculation should compare this annualised return with the company's own financing costs. Short discount windows, however, require fast invoice processes.

What are the risks of payment terms that are too long?

Very long payment terms weaken suppliers' liquidity and can lead to higher prices, lower delivery reliability or, in extreme cases, supply failures. For strategic and single-sourced parts, this is a significant resilience risk. Balanced terms and, alternatively, supply chain finance are usually the better solution.