Set-Off: Offsetting receivables in industrial supplier relationships

Set-Off refers to the offsetting of receivables, whereby two companies offset mutual payment claims against each other so that only the balance needs to be settled. In industrial procurement, this process primarily concerns the relationship between customers and suppliers, for example with credit notes, defect claims or group clauses. Anyone who understands set-off rules avoids liquidity bottlenecks, payment term conflicts and disputes in order processing.

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Key facts at a glance

01 Set-Off is the mutual offsetting of receivables; in Germany it is legally governed as set-off (Aufrechnung) under Sections 387 et seq. of the German Civil Code (BGB).

02 Prerequisites are typically mutuality, due date, equivalence of the services and the creditor's capacity to set off.

03 In procurement, set-off operates through supplier credits, returned goods, defect claims and group instructions, extending right into payment run control.

04 Contract clauses such as set-off prohibitions or group clauses can significantly alter the statutory set-off position and must be examined in individual cases.

05 Set-Off reduces transaction costs and default risks, but can burden supplier liquidity and jeopardise the supply relationship.

06 Closely related processes are self-billing and advance payment, which systematically prepare offset transactions in the payment run.

Definition: Set-Off

Set-Off (English for 'offsetting' or 'compensation') describes the settlement of two opposing claims, whereby only the difference amount is paid. In a B2B context, a set-off frequently arises when a buyer holds a counterclaim against the supplier, for example from warranty, damages or a chargeback.

Legal foundations in German-speaking countries

In Germany, set-off is governed by Sections 387 et seq. of the German Civil Code (BGB). It requires that both parties hold mutual claims, the services are of equivalent nature, the counterclaim is due and set-off does not conflict with the contract or statute. Set-off is effected by a unilateral declaration to the other party; it is not merely an accounting convention. Comparable rules apply in Austria and Switzerland (e.g. the ABGB or the Code of Obligations), so different detailed requirements must be observed in DACH supply contracts depending on the choice of law. Whether a specific set-off is permissible should always be examined in the individual case, particularly with foreign contracting parties.

- Mutuality: both parties are creditor and debtor
- Due date: the principal claim of the party setting off must be due
- Equivalence: typically money against money

Distinction from remission, chargeback and early payment discounts

Set-Off is not identical to a mere payment reduction: with a chargeback, an individual claim is reduced, whereas with set-off two independent claims are netted. Likewise, early payment discounts are not set-off, but a price concession for early payment. A partial offset refers to only part of the counterclaim being offset; a total offset nets in full. In group structures, it is added that receivables of different companies can only be offset with an effective assignment of receivables or a group clause – a frequent review point in the order processing of international supply contracts.

Typical Set-Off constellations in industrial procurement

In practice, set-off situations arise at several points in the ordering and payment processes. Procurement should be familiar with these constellations because they directly affect the supplier relationship and the company's own liquidity planning.

Defects, returns and return claims

The most common case: the supplier delivers defective goods or the customer returns parts. Instead of waiting for payment from the supplier, the buyer offsets the damage amount against open invoices. Quality metrics such as parts per million (PPM) provide the documentation basis so that the counterclaim is substantiated. A clean notice of defects and a comprehensible demonstration of the value are important, otherwise the buyer risks consequences of payment default and a loss of trust with the supplier. Supply contracts should regulate in advance how defect deduction amounts are determined and communicated.

Group clauses and receivable transfers

Large customers frequently anchor group clauses in their terms of purchase, under which receivables may be transferred and offset between affiliated companies. For suppliers, this means that their receivable can suddenly be set off against another group member – for example, when that member

has liabilities from another business. Buyers use such clauses to simplify group-wide processing; suppliers should pay attention to due date differences and default risks. The admissibility and scope of such clauses is legally not uncontested and must be examined in the individual case.

Offsetting via self-billing and credit notes

With self-billing, the customer creates the invoice for the supplier and can incorporate corrective credit notes directly – in effect, a pre-structured set-off process. This reduces disputes and invoice runs, but requires clear agreements on acceptance criteria, quantity data and prices. Advance payments on work contracts are also typically offset against the final invoice at the end; the technical implementation then takes place as a set-off in the payment schedule. Such procedures are part of modern order processing, but presuppose coordinated data handling between ERP systems.

Methods and approach for buyers

Anyone using set-off systematically integrates offsetting into standardised processes rather than treating it as an isolated case. This begins as early as contract negotiations and ends with controlled payment release.

Contractual anchoring

Terms of purchase should regulate whether and under what conditions set-off is permitted: notification obligations, deadlines, evidence requirements and a defined escalation level. An escalation clause helps resolve disputes over affected amounts before the payment run is blocked. Conversely, suppliers must check whether a set-off prohibition in the contract restricts their own offsetting options. Bonus agreements and revenue models should be formulated so that the offsetting of bonus payments against ongoing invoices is unambiguously agreed.

Process integration and data situation

A clean set-off requires reliable data: order history, goods receipt documents, inspection results and invoice data must match. Anyone working with self-billing anchors the acceptance criteria in the system and subsequently avoids manual correction loops. For work contracts with advance payments, a defined payment schedule is recommended, showing how advance payments are offset against the final invoice. With cost-plus contracts too, it should be agreed how deviations between estimated and invoiced costs are to be reconciled.

Communication with the supplier

Set-Off directly affects supplier liquidity. A short-notice, unannounced invoice deduction acts like a forced extension of payment terms and strains the partnership. Established practice is an offset announced in advance with written justification, the amount and a deadline for responses. With recurring quality problems, set-off should be placed in a structured escalation format; a formal crisis meeting or a standardised supplier dialogue does not replace a legal review, but creates transparency and reduces conflict escalation.

Key KPIs and effects relating to Set-Off

Set-off transactions can be measured and integrated into supplier controlling. Their informative value depends on consistent data from purchasing and financial accounting.

Metrics for offset volume

Key metrics are the offset volume per supplier and period, the average processing time of offset cases and the share of disputed amounts in the total. The number of blocked payment runs due to open counterclaims is also a practical indicator: high values point to unclear quality or contract processes. If the rate of offset cases without supporting justification exceeds a tolerable threshold, the defect management process must be revised. Metrics alone do not decide – they are triggers for root cause analysis and supplier discussions.

Impact on working capital and supplier retention

For the buyer, set-off improves working capital because open receivables quickly become cash without the need for a banking route. For the supplier, by contrast, the predictability of incoming payments decreases; frequent offsets worsen the accuracy of his cash forecast. In the supplier evaluation system, offset intensity can be factored in as a contextual variable, for example when deciding which suppliers are preferred for critical parts. A balanced set-off regime is therefore also an instrument of supply base optimisation – provided it is applied fairly and predictably.

Risks, controls and legal pitfalls

Set-Off saves time and interest, but carries risks if counterclaims are overvalued or clauses are misapplied. Controls should therefore be firmly anchored in the ordering and payment process.

Main risks from the buyer's perspective

An unjustified or excessive deduction can trigger default and default interest, damage procurement relationships and in the extreme case push the supplier into financial difficulty – with supply risks for ongoing programmes. In addition, there are compliance and reputational risks if offsets are perceived as an instrument of power against smaller suppliers. A clear internal approval hierarchy with defined amount thresholds and a requirement for documented defects or contract breaches significantly reduces these risks.

Main risks from the supplier's perspective

Suppliers should watch out for unclear counterclaims, missing evidence and due date differences. Counterclaims from other contractual relationships within the same group are particularly problematic because they can burden the supplier's own claim independently of the specific project. As a rule of thumb: review every offset notice received immediately in writing, make use of objection deadlines and, in the case of systematic practice, have the contract clauses revised. In cross-border business, security instruments such as a current account reservation or agreements on separate payment accounts can help; their effectiveness must be legally examined in the individual case.

Controls and documentation

Effective controls include a four-eyes approval for offset notices, mandatory supporting documentation (defect report, acceptance certificate, correspondence) and regular reconciliation between procurement, quality and accounts payable. For recurring incidents, a short review of the contract clauses with the legal department is worthwhile. The effects on Intrastat reports and VAT advance returns should also be clarified, as corrected service values are relevant for reporting and tax purposes – here the tax department and, where appropriate, external advisers should be involved.

Current developments: digitalisation and payment practice

The practice of offsetting is changing due to digital invoicing processes, dynamic payment terms and growing regulatory attention to payment duration and fairness towards suppliers.

Digital processes and automated offsetting

With self-billing, electronic invoice formats and integrated supplier portals, offset cases can be processed considerably faster and more transparently. Modern ERP and e-invoicing platforms link credit notes directly to the purchase order and goods receipt, so that deviations are automatically flagged before the payment run starts. This reduces dispute costs and typically shortens clarification from weeks to a few days. Within e-sourcing and contract management systems, too, offset rules can be stored at the bid opening and contract creation stages.

Supplier financing and the regulatory framework

Increasingly, large customers are establishing supplier financing programmes in which offset transactions, payment terms and factoring arrangements interact. Buyers should examine here how set-off harmonises with such programmes and whether suppliers actually receive the expected liquidity. At the same time, regulatory pressure on excessively long payment chains is growing in several European legal systems; specific obligations and deadlines differ depending on the legal jurisdiction and must be reviewed before introducing new offset practices. Anyone deploying set-off fairly, documented and predictably benefits from more stable supply relationships and lower default risks.

Typical metrics

Metric	Typical value
Offset volume per supplier	individual, typically < 2 % of annual volume *High values indicate systematic quality or contract problems*
Processing time for offset cases	typically < 10 working days *Shorter throughput times reduce dispute costs and strain on supplier liquidity*

Share of disputed offset amounts	typically < 5 % *Threshold for process quality in defect documentation and evidence*
Documentation rate for offset notices	> 95 % *Share of cases with complete supporting documentation and approval*

Practical example

A medium-sized mechanical engineering company sources precision components from a system supplier. After a series of quality deviations with elevated PPM values, the parties agree on a documented offset mechanism: the supplier confirms rework costs, and the buyer offsets the amount against the next due invoice. In addition, both parties agree on a clause excluding offsets across group companies in order to avoid unexpected receivable transfers.

- Offset process with defined evidence requirements and approval thresholds agreed in writing
- Self-billing procedure introduced to automatically incorporate corrective credit notes into the payment schedule
- Quarterly reconciliation between procurement, quality and accounts payable on open counterclaims

Conclusion

Set-Off is more than an accounting technique: it touches contract law, liquidity, quality assurance and the balance of power in the supplier relationship. For buyers, a standardised, documented offset process with clear approval rules is worthwhile. For suppliers, early contract review and consistent communication discipline are decisive. Anyone designing set-off not as an instrument of pressure but as an efficient processing tool reduces transaction costs on both sides. Ultimately, fair set-off practice pays directly into supply reliability and working capital.

Frequently asked questions

? What does Set-Off mean in procurement?

Set-Off refers to the mutual offsetting of receivables between customer and supplier, whereby only the balance is paid. A typical case is the deduction of rework costs for defects against an open invoice. In Germany, this legally corresponds to set-off (Aufrechnung) under Sections 387 et seq. of the German Civil Code (BGB).

? When is set-off (Set-Off) permissible?

As a rule, mutual claims, the due date of one's own counterclaim and equivalence of the services are required. In addition, the contract must not effectively exclude set-off. In individual cases – in particular with group clauses or cross-border contracts – admissibility should be legally reviewed.

? Can the customer simply reduce my invoice?

No, a unilateral reduction is only effective if a genuine, documented counterclaim exists and set-off is permissible. Suppliers should immediately review offset notices in writing and make use of objection deadlines. Contract clauses on set-off prohibitions or group clauses significantly alter the legal position.

? What is a group clause in the context of Set-Off?

A group clause permits receivables to be transferred and offset between affiliated companies within a group. For suppliers, this can mean that their own receivable is set off against another group member. The legality of such clauses is disputed and should be examined by a lawyer in individual cases.

? What advantages does Set-Off offer both parties?

The buyer saves payment processes and interest and reduces default risk, as counterclaims are offset directly. The supplier benefits from faster clarification and fewer disputes when processes are clear. Set-Off is disadvantageous when it occurs without notice or without justification, as it burdens supplier liquidity.

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