Market-Based Transfer Price

• Sets transfer price equal to the price of the product in a competitive market.
• Requires:
  • Competitive market
  • Little or no synergies between subunits
  • Little or no transaction costs with market

Variable Cost Transfer Prices

• Set the transfer price at the variable cost of production
• Disadvantages
  – Do not allow the transferring department to cover fixed costs
  – Excludes unavoidable fixed costs
  – Incentives to distort variable and fixed costs
  – “Cheap” product increases demand beyond that which is optimal

Full Cost Transfer Prices

• Set the transfer price at full cost - average fixed and variable costs
• Disadvantages:
  – All costs appear variable to the purchasing department – may lead to dysfunctional decisions
  – “Expensive” product results which may lead to dysfunctional decisions

Negotiated Transfer Prices

• Subunits negotiate the transfer price themselves
• Disadvantages:
  – Time-consuming
  – Increases conflicts between subunits
  – Outcome often depends on the bargaining power of subunits