Transfer Pricing

Setting the internal price between divisions.

Accounting & Finance

Bases and their effects.

Bases

- Market price — where a market exists
- Full cost — simple but distorts decisions
- Marginal cost — good decisions, poor motivation
- Negotiated — depends on bargaining power
- Cost plus — a compromise in practice

Effects

- Too high and the buyer sources outside
- Too low and the seller refuses to supply
- Affects reported divisional profit only
- Tax authorities scrutinise cross-border prices

Educational reference. Cross-border transfer pricing is heavily regulated; the arm's length principle governs it in most jurisdictions.