Unveiling the effects of sunk costs: barrier to entry vs. commitment

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In markets characterized by high sunk costs, the impact of sunk costs on entry could be controversial. Sunk costs could act as a barrier to entry if there is an incumbent likely to retaliate entry by preying on the entrant. In such case, a group of incumbent companies or an incumbent company act strategically in order to maintain market power and to discourage entry so sunk costs are a barrier to entry. In other cases sunk costs can be a deterrent to predation if they serve to commit entrants to staying in the market and thereby induce the incumbent to adopt a more accommodating strategy. This is called the Cabral Ross effect (Cabral-Ross 2008).
In a paper on the pharmaceutical sector Amisano and Giorgetti (2011) find a positive relationship between entry and sunk cost in many 1 digit (according to the Anatomical Therapeutical Classification - ATC) submarkets. In this paper, by controlling for more theoretically grounded regressors, we model entry into each specific submarket by adopting a narrow submarket segmentation and a more appropriate sunk costs measure. We investigate entry into each specific submarket in the United States over the period 1988-1999, where submarkets are identified using a 3 digit ATC classification.