

## **Hidden Debt and the Selectivity of Professional Partnerships**

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### Abstract

Levin and Tadelis (2005) argues that the partnership form is a signal to uninformed clients that the firm will be very selective about the professionals it hires. In contrast, this paper shows that increases in debt obligations cause partnerships to lower their hiring standards. If debt levels are not observed by clients, then partnerships are nearly as profitable and as selective as corporations. Financial transaction costs cause partnerships to be more selective than corporations. Large expansions in the ranks of senior employees will be more costly to partnerships than corporations when there are costs to issuing debt. The Goldman Sachs IPO is discussed in light of this result. Finally, credit constraints can raise clients' expectations for the quality of the partners and the profitability of the partnership.

Keywords: debt, information, partnerships, and profit sharing

JEL Classifications: G32, G34, L2, L15