Families’ Perception of the Bankruptcy Process

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The purpose of this research was to evaluate the bankruptcy process. The assessment is based on the responses given by the families who had been discharged from the bankruptcy court. The study identifies causes of declaring bankruptcy and its impact on families. The majority of the respondents identified marital problems and medical bills as important causes for declaring bankruptcy. The majority of families also reported that declaring bankruptcy improved their social position. Approximately half of the respondents reported it improved their marital relationship. The respondents identified specific areas of learning that resulted from this experience. The findings will be of value to family counselors, legislators, and creditors.

Bankruptcy is a procedure undertaken in federal court when a debtor is unable to reach agreement with his or her creditors outside of court. It is a process established to protect both the debtor and creditor. One of the main objectives of the bankruptcy process is to discharge debtors of their debts and thus give them a chance to make a "fresh start." Another objective is to ensure that all creditors are treated fairly when it comes to the satisfaction of claims.

The main purpose of this research was to evaluate the bankruptcy process as viewed by families who had experienced declaring bankruptcy. The specific objectives were to (1) identify the socioeconomic characteristics of the petitioner, (2) identify causes of bankruptcy as reported by the families, (3) identify the impact of bankruptcy on families such as effects on money management practices and their social and marital position, (4) ascertain whether the bankruptcy process fulfilled its main objective of giving the families a fresh start, (5) explore the satisfaction with the process as reported by the families, and (6) explore other alternatives that these families considered before declaring bankruptcy.

Previous Studies

Various studies have been done to ascertain the causes of personal bankruptcies in the United States and Canada. While many studies have focused on developing a socio-
economic profile of the families that declare bankruptcy and identifying factors leading to bankruptcy, only a few have focused on the evaluation of bankruptcy process. Most of these studies have shown that the typical bankrupt is male, usually below age 40, married, a blue-collar worker, and has more than the average number of dependents (Brimmer, 1981; Hira, 1982; Hughes, 1974; Liebhart, 1974; Marsen, 1966; Stanley and Girth, 1971; Ulrichson, 1982).

Brimmer (1981) found that the major impact of bankruptcy was loss of credit for the discharged families. Hira (1980) found families did not use credit at all or used it only under certain conditions after being through bankruptcy. Those who continued to use credit preferred to borrow from banks and credit unions rather than from finance companies. Finance companies usually give loans to high risk customers at higher interest rates. Studies have also shown that there is some effort by families to manage their money better after going through bankruptcy. Hira (1982) found a majority of families started to manage their family finances better after declaring bankruptcy through using less credit, keeping records, and saving some money. Brimmer (1981) reported that most families who were not budgeting their income before declaring bankruptcy started to budget after going through bankruptcy.

Both favorable and unfavorable attitudes have been reported by families after going through the bankruptcy experience. Brimmer (1981) reported that while families regretted their having to file for bankruptcy, they were glad that this opportunity was available for them to solve their financial problems. Generally, the majority of the families were satisfied about the way things worked out for them after bankruptcy. Stanley and Girth (1971) found that the majority of their respondents would prefer to pay off their debts rather than declare bankruptcy again.

Some studies in this area indicate that there is less stigma associated with bankruptcy, and hence an increase in the number of the filings. Brimmer (1981) found that for some respondents, there was a feeling of guilt and stigma associated with being a bankrupt, but a majority of the families felt little or no loss of social standing after declaring bankruptcy. Many studies indicate that bankruptcy is used as a last resort; families try other alternatives before selecting this option. Brimmer found that almost half of his respondents used credit counseling services, and a majority of them also considered a debt consolidation loan. Sullivan (1982) concluded that about one-third of the families had obtained a debt consolidation loan before filing for bankruptcy. In her study, Hira (1980) found that more than half the families tried to restore their indebtedness by negotiating new terms of repayment with creditors.

Methodology

Data for this study were obtained from the 1982 survey, Evaluation of the Bankruptcy Process in Iowa. This study was a follow-up to a study done previously by Ulrichson (1982). Ulrichson’s objectives were to evaluate the debt structure of the bankrupts, the extent of their debt, the number of creditors, and the types of consumer debts. The original population for Ulrichson’s study consisted of 2,050 cases. The petitions that she focused on were those filed during the six-month period from April 1 through September 30 of 1981. Ulrichson was interested in Chapter 7 non-business filings, and therefore the Chapter 7
business filings were removed from the sample. The remaining files were systematically numbered, and the first case was selected randomly. After that, every fifth case was selected, and the final sample consisted of 199 cases. For this study, the authors sent questionnaires to 199 families that were randomly selected by Ulrichson. One hundred one questionnaires came back undelivered because forwarding addresses were not available. From the rest of the 98 questionnaires, only 45 (23%) were returned. Five of the questionnaires were omitted because of lack of complete information. The present study was carried out, therefore, with these forty cases. Although this sample size is small and represents a low response rate, the researchers believe that the information reported by these respondents provides valuable information about the bankruptcy process and its impact on the families involved in the bankruptcy process. The authors recognize that due to the limitation of the sample size, these results cannot be generalized. As will be discussed in greater detail in the results section, the present subsample was compared with the original sample to check for bias.

Ulrichson's study was limited to the information that could be found in the files, mainly the debt structure, types, amounts and sources of debt, and the number of creditors involved. The present study provides descriptive information on the socioeconomic characteristics of the families who filed for bankruptcy, the factors leading to bankruptcy, the impact of the bankruptcy process, and the evaluation of the bankruptcy process as perceived by the families who went through it. This information is not available from the bankruptcy files.

Results

The majority of the respondents (60%) were male, while 40% were female. This is consistent with Ulrichson's results and whose sample consisted of 63% males and 37% females. The mean age of the petitioners was 33 years, and the age range was from 22 to 49 years. The majority of the respondents were less than 40 years of age.

Despite the small sample size, the results agree with the results from previous studies and with the general consensus among researchers that an average bankrupt is usually young. The majority of the petitioners (72.5%) reported that they were employed. Ulrichson, using the sample of 199 cases, found that 68% of the petitioners were employed and 32% were not. It may be that some of the petitioners who were unemployed at the time of filing had found jobs by the time this follow-up study was done. However, the results show that the unemployment rate (17.5%) among the petitioners was much higher than the national rate of unemployment, which was 7.3% in 1981. The results also show that the unemployment rate among bankrupt families was higher than the unemployment rate in Iowa, which was 5.7% in 1980 (Ulrichson, 1982).

The average before tax income reported by the families was $10,884. The income ranged from $2,400 to $21,600 per year. The income reported by the families was income from the employment at the time of filing. Of the 72.5% who were employed, 30% reported incomes of over $13,500, 35% reported incomes of less than $10,500, and the remaining 35% had income between $10,500 to $13,500. Ulrichson (1982), using the sample of 199
cases, found that the average income was $14,620. In her study, however, income included the petitioners’ income from employment and other sources such as assets and durable resources. This could explain the difference between the average income between the two studies. The difference in sample size could also be a contributing factor.

The majority of the petitioners (72%) had had 9–12 years of education. This is consistent with previous studies that have found the bankrupts to have as much education as average members of the society (Brimmer, 1981; Liebhart, 1974).

The majority of the families (91%) reported that they had three or less dependents. Other studies have reported families in bankruptcy to have more than three dependents (Liebhart, 1974; Hira, 1982).

Reported Causes of Bankruptcy

All potential factors that have been identified as causes for bankruptcy, through literature searches, were listed, and the respondent was asked to circle the factors that were most important in their decision to file for bankruptcy. These factors were then classified into three categories: (1) personal problems, (2) employment problems, and (3) credit and financial problems.

Personal Problems

Personal problems included medical bills, marital problems (divorce, separation, alimony, child support), natural disaster (floods, hurricanes), death in the family, and addiction and dependency (drugs, alcohol, and gambling).

As seen in table 1, slightly less than half of the respondents (42%) identified marital problems as a factor leading to bankruptcy, and 35% mentioned marital problems as the most important factor leading to bankruptcy. For 44% of these, divorce and separation were the contributing factors, and for 33%, it was lack of spousal support during the period of financial problems. Child support and alimony problems were cited by 22% as factors. Medical bills as causes of bankruptcy was reported by 39% of the families.

Employment problems. Employment problems included (1) cutback in the number of hours worked, (2) being laid off or fired from work, (3) business failure (petitioners’ or his employers’ business), (4) being unable to work due to illness or accident, and (5) loss of second income. Unemployment per se was indicated by 24% of the respondents as an important cause of bankruptcy. Unemployment and employment-related causes (cutback in hours, loss of second income) were identified by about 45% of the respondents as important causes of bankruptcy.

Credit and Financial Problems. Under this category, the factors leading to bankruptcy were classified into two subcategories: (1) poor financial management and (2) legal problems. Poor financial management was indicated by overextension of credit.

As can be seen from table 1, approximately 48% of the respondents identified credit problems as a leading factor in their decision to declare bankruptcy. Among the legal and related problems, “collection procedures” was indicated by 42% of the families as an important factor leading to declaration of bankruptcy. Frequent telephone calls, at home and work, and threatening letters sent by the creditors were cited as examples of collection procedures that affected the decision to file for bankruptcy. About 38% cited garnishment as an important factor in their decision to file for
Table 1

Distribution of Important Causes of Bankruptcy As Reported by the Families Who Have Gone Through the Process

<table>
<thead>
<tr>
<th>Causes</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>N = 40</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personal Problems</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medical bills</td>
<td>16</td>
<td>39</td>
</tr>
<tr>
<td>Marital problems</td>
<td>17</td>
<td>42</td>
</tr>
<tr>
<td>Dependency/alcoholism</td>
<td>4</td>
<td>9</td>
</tr>
<tr>
<td>Natural disaster/death</td>
<td>15</td>
<td>4</td>
</tr>
<tr>
<td>Employment Problems</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cutback in hours worked</td>
<td>5</td>
<td>12</td>
</tr>
<tr>
<td>Unemployment</td>
<td>10</td>
<td>24</td>
</tr>
<tr>
<td>Business failure</td>
<td>5</td>
<td>12</td>
</tr>
<tr>
<td>Illness/accident</td>
<td>7</td>
<td>18</td>
</tr>
<tr>
<td>Loss of second income</td>
<td>4</td>
<td>9</td>
</tr>
<tr>
<td>Credit/Financial Problems</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bought too much on credit</td>
<td>10</td>
<td>24</td>
</tr>
<tr>
<td>Credit was easy to get</td>
<td>10</td>
<td>24</td>
</tr>
<tr>
<td>Collection procedures</td>
<td>17</td>
<td>42</td>
</tr>
<tr>
<td>Sued by creditors</td>
<td>6</td>
<td>15</td>
</tr>
<tr>
<td>Wages garnished</td>
<td>15</td>
<td>38</td>
</tr>
<tr>
<td>Cosigned on a loan</td>
<td>6</td>
<td>15</td>
</tr>
</tbody>
</table>

*The respondents were asked to check “all that apply” and, therefore, cumulative frequency is greater than 100.

bankruptcy. Actual foreclosures on the families' home and repossession of personal property were mentioned by a smaller percentage (12%) of respondents.

Reported Changes in Financial Management Practices

The families were asked, “Is there anything different you do to manage your money now?” About 67% of them reported that they had changed their money management practices. Of those who reported changes in their money management practices, 62.5% had either stopped using credit or “started paying their credit bills promptly.” Furthermore, 64% of all respondents reported that they started budgeting their income after declaring bankruptcy, whereas only 48% had indicated that they budgeted their income before declaring bankruptcy. Seventy percent of the families reported a change of attitude toward consumer credit. Eighty-five percent of these indicated that they “avoid debts,” and about 10% said that they “give payment of loans first priority when budgeting.” Another evidence of reduction in use of credit after going through bankruptcy...
was that 81% of the respondents reported that they no longer use any credit cards, and the few (15%) who used credit cards used only one.

Reported Changes in Social and Marital Position

The respondents were asked, "How did the process of bankruptcy affect your social position?" There were four response categories: (1) improved, (2) deteriorated, (3) feel stigma, (4) no effect, and (5) other. About 60% felt that declaring bankruptcy improved their social position, and approximately 10% said it had no effect at all. However, 8% of the respondents felt stigma about declaring bankruptcy. On the other hand, approximately one-fourth (25%) of the respondents believed that declaring bankruptcy deteriorated their social position. In response to the question of how bankruptcy affected their marital status, of those who were married, 48% responded that the quality of their marital relationship improved, whereas about 44% reported that the bankruptcy had no effect on their marriage. A majority of the families found bankruptcy an easy solution to their debt problems that provided them a fresh start. Some couples in this study felt that reduction of debt due to bankruptcy removed pressure and strain on their marriage, thus improving the marital relationship.

Satisfaction with the Procedure

Satisfaction with the bankruptcy procedure was ascertained by the following two questions, (1) "Were you satisfied with the bankruptcy procedure?" and (2) "Would you advise somebody else to go through bankruptcy?" Approximately 90% of the respondents said they were satisfied with the process. Most of the respondents were satisfied because they felt "the procedure was easy and smooth" and "there were no complications." However, those who were dissatisfied claimed that "it took too long to declare bankruptcy" and "it was expensive." Eighty-four percent of the respondents would advise others to declare bankruptcy. However, of those who said that they would advise someone else to go through bankruptcy, 78% said that they would do so only as a last resort.

Best Things About the Availability of the Program

To further evaluate the bankruptcy procedure, the respondents were asked the question, "What, in your opinion, is the best thing about the bankruptcy program?" Table 2 summarizes the responses. Forty-one percent of the respondents viewed the bankruptcy process as a solution to their debt problems. Fourteen percent said there was nothing good about going through bankruptcy. When the respondents were asked if they would consider bankruptcy as a solution in the future, about 54% indicated they didn't intend to let this happen again, and only about 7% said they would consider bankruptcy in the future under similar circumstances.

Suggested Changes in the Procedure

Although the majority of the respondents were satisfied with their bankruptcy procedure, some of them made suggestions that could in their opinion further improve the bankruptcy process. About 27% indicated that time and cost involved in declaring bankruptcy should be reduced. Nine percent of these families suggested that Chapter 13 (management of debt repayment under court supervision) should be made more accessible. Many of them sug-
Table 2

Best Things About the Availability of the Bankruptcy Program

<table>
<thead>
<tr>
<th>Statement</th>
<th>Number</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Helps to have a new start</td>
<td>4</td>
<td>13.8</td>
</tr>
<tr>
<td>Gets rid of creditors</td>
<td>6</td>
<td>20.7</td>
</tr>
<tr>
<td>Gives one a solution</td>
<td>12</td>
<td>41.4</td>
</tr>
<tr>
<td>Saves marriages</td>
<td>3</td>
<td>10.3</td>
</tr>
<tr>
<td>Nothing</td>
<td>4</td>
<td>13.8</td>
</tr>
<tr>
<td>No response</td>
<td>11</td>
<td>—</td>
</tr>
<tr>
<td>Total</td>
<td>40</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Suggested that more explanation about the bankruptcy process should be made available. It was also indicated that more privacy should be provided to the petitioners. In another question, the respondents were asked if they agreed with the general belief that the bankruptcy process provided a fresh start. Approximately 74% responded positively. Those who said that the process gives a fresh start indicated that “it stops worries and pressure from creditors” and that “it gives one another opportunity to establish oneself.”

Questions exploring changes in attitudes toward debt after going through bankruptcy were also included in the instrument. Results showed that the majority of the families did not feel comfortable using credit for regular expenses after being through the bankruptcy process. Eighty-five percent said that they avoid credit, and 19% indicated that they give debt payment first priority in their budget. About 5% said that they are frightened to go into debt again.

Alternatives Sought Before Bankruptcy

Seventy-five percent of the petitioners in this survey had sought other alternatives before electing to declare bankruptcy. Among those who sought other alternatives, 50% said that they tried talking to the creditor in order to arrange different payment schedules. However, most of them reported that the creditors were uncooperative. Approximately 35% of the respondents said that they tried debt consolidation loans, but this did not work for them because they were not considered a good credit risk by lenders. Only a small percent (8%) had tried Chapter 13 or credit counseling services.

Conclusions and Implications

The results of this study indicated that most respondents found that declaring bankruptcy helped solve their debt problems. The majority of them also reported that declaring bankruptcy gave them a chance to start all over again. In spite of the observation that filing for bankruptcy helped many families to overcome their financial problems, many respondents reported that they would not want to see themselves in this situation again.

Results of this study should be helpful to
the families, legislators, lawyers, educators, financial counselors, and financial planners. Suggestions to improve the process that were given by the respondents can be of value to the legislators and lawyers who are involved with bankruptcy. Specific suggestions included reduction of time and cost, more explanation of the procedures, availability of the Chapter 13 option, and more privacy during the bankruptcy process. The fact that the families called for the availability of Chapter 13 implies that some of them would have liked to repay their debts. Another important suggestion made by the respondents was that the procedure be simplified enough so that bankruptcy can be filed without using lawyers since the cost of using lawyers was very high. The results are also helpful to educators and counselors. The results identify areas such as budgeting and credit that need to be given priority in teaching and counseling.

The findings of this study should also be of importance to the creditors. It was reported that some creditors were uncaring and demanding, and that some were too lenient in their lending practices. Although not all creditors fall under this description, there are some who could benefit from these findings. For example, creditors could re-examine their lending rules and regulations to the benefit of the borrowers and themselves. If the creditors tightened their lending rules, this could be one way of avoiding personal bankruptcy, since many potential bankrupts would not be able to borrow in the first place. Knowledge of the socioeconomic characteristics of the petitioners would also be very helpful to the financial counselors and creditors because it would help them recognize the potential bankrupts. This group could then be targeted to receive necessary help before the decision to declare bankruptcy.

Several studies (Brimmer, 1981; Hira, 1980, 1982; Stanley and Girth, 1971) stress that a major cause of bankruptcy is the inability of consumers to manage debts. In her study, Hira (1980) found that discharged bankrupts still lacked credit knowledge and credit management skills. Many of those interviewed were afraid to handle credit after declaring bankruptcy. Whether tied to a community agency or attached to the bankruptcy process itself, or offered by financial institutions extending credit, credit management education and rehabilitation services are strongly recommended. Provision of professional financial counseling coupled with debt liquidation can provide a realistic alternative to personal bankruptcy and an opportunity to "rehabilitate" persons who have to choose bankruptcy as the solution to their financial situation.

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