Why do people go bankrupt?

In 2016, research* was conducted by Melbourne Law School academics to provide insights into public views on bankruptcy and the prevalence of bankruptcy stigma in Australian. I'd like to delve further into the stigma another time, but for this piece I'm focusing on what causes people to declare bankruptcy. And it's often not what you think.

According to many of the survey respondents, bankruptcy was associated with poor financial management, extravagance, and greed – and many associated it with the stereotypical figure of the dishonest, 'high-flying' businessman (e.g., the likes of the Late Alan Bond and Christopher Skase). The most significant reasons respondents felt people get into serious or unmanageable debt included lack of self-control (the primary cause), extravagance or greed, 'advertising or easy access to credit', and the rising cost of living.

From a bankruptcy trustee's point of view, these were fascinating insights; however, many of the findings were way off the mark.

Firstly, if you slice and dice data from AFSA, the majority of those declaring bankruptcy aren't failed corporate entrepreneurs, but rather they come from relatively modest socio-economic backgrounds. In AFSA's August 2023 statistics on new personal insolvencies, those declaring bankruptcy came from sectors including construction; healthcare and social assistance; retail; transport, postal and warehousing sectors; and administrative and support services.

Furthermore, in the paper *The Incidence and Causes of Personal Bankruptcy in Australia***, the authors analysed a large and unique dataset from AFSA (nearly 29,000 de-identified records of individual bankruptcies initiated between 2007 and 2016), finding that professionals experienced a relatively low incidence of personal bankruptcy, while those in traditional blue-collar occupations, such as machine operators and drivers, and labourers, experienced much higher incidence rates. "Across a typical working life of 40-45 years, around 10 per cent of all adults in these 'blue collar' categories might be expected to experience personal bankruptcy," the report states.

Main reasons for bankruptcy

They come from all walks of life but often cite similar reasons as to why they've declared bankruptcy. The main reasons include:

- Job loss
- Rising cost of living (certainly something that resonates today more than ever)
- Mortgage stress
- Overextended credit
- Legal action

And there are some other not so well known causes including:

- Family / relationship breakdowns
- Death in the family
- Signed guarantees (e.g., trade credit applications etc.)
- Excessive gambling
- Mental health issues

When applying for bankruptcy, AFSA requires individuals to complete a Statement of Affairs and to give a reason as to what they believe is the main cause of their insolvency. It provides a comprehensive list of non-business related causes in addition to business related causes (which only applies if you have personally operated a business). The answers certainly provide invaluable insights, and I personally this information could be helpful for financial advisers when interacting with their clients.

This calendar year to date, our firm's bankruptcy trustees have handled over 30 bankruptcies and the main causes were personal guarantees (22%), adverse legal action (19%), and excessive borrowing (16%). Other reasons included injury/ill health, relationship breakdown, unemployment and fraud (claimed but not proven as yet). These statistics also provide a timely reminder to business owners about the risks of personal guarantees. It's important to go in with your eyes open, because traditionally a large proportion of personal insolvencies may be a by-product of failed businesses.

In conclusion, it could be one reason or a combination of financial setbacks that drive an individual to file for bankruptcy, and it could be a poor decision or circumstances that are out of your control. Regardless, it's important to seek help as soon as possible, to be able to get relief and start afresh.

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**Misfortune or Misdeed: an Empirical Study of Public Attitudes Towards Personal Bankruptcy – Paul Ali, Lucinda O'Brien, Ian Ramsay*
***The Incidence and Causes of Personal Bankruptcy in Australia – Paul Ali, Malcolm Anderson, Lucinda O'Brien and Ian Ramsay, Melbourne Law School*