Debt Consolidation or Debt Management?

Contributed by Martin Sumner
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Both debt consolidation and debt management are widely advertised as solutions to debt problems. What's the difference between them, and which one is right for you?
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The number of people facing serious debt problems continues to rise inexorably, with recent research suggesting up to a million Britons could potentially be in genuine danger of bankruptcy. The situation will only get worse if, as predicted, the Bank of England starts to increase interest rates from their current historic lows, leading to higher mortgage payments having to be made from already overstretched budgets.

{bot_wrgoogle}If you're one of the many thousands facing real problems in meeting your repayments, you've probably been looking for ways out of your predicament, and you'll probably have come across sites advertising debt consolidation and debt management as possible solutions. What's the difference, and which one is right for you?

Debt consolidation is the simplest and most straightforward way of dealing with debt. The basic idea is that you take out another loan which is large enough to pay off all your current debts such as credit cards, personal loans, overdrafts and the like. This leaves you with one single monthly repayment to make, which is already a great step forward in making your finances easier to control.

By making sure that the loan you take out is at a comparatively low interest rate, you should find that your total monthly repayment is lower than it was when you were servicing many smaller, more expensive debts. Also, choosing a longer term to repay your new loan will lower the costs even more.

This sounds perfect in theory, but consolidation isn't without its problems. Firstly, you're not actually reducing your debt, just your monthly repayments. While this may take the pressure off in the short term, in the long term you're likely to be paying more interest overall as you'll be taking longer to clear the debt. You're also usually shifting unsecured debt onto a secured loan, which could put your home at risk if you start to struggle with your repayments.

Debt management is an altogether different and more drastic way of tackling your debt. By entering into a management program, you're handing over the day to day management of your debt to a company who specializes in negotiating with people's creditors. This debt management company will contact everyone you owe money to, and try to negotiate lower repayments by rescheduling your debt, freezing interest, or even canceling past charges and fees.

You'll still be responsible for repaying much of the debt of course, but in many cases large amounts of your debt can be wiped out almost overnight. There's also the advantage that you only have to make one repayment a month, direct to the management company, who will then distribute it among your creditors.

Entering into debt management can be a very effective way to reduce your debt and all but eliminate the stresses it causes, but there's also a pretty major problem with it. You'll effectively be breaking the credit agreements you signed, which will severely harm your credit rating for the future. However, once bitten by debt, you might not be too concerned about having problems taking out more credit in the future.

So which is right for you? Consolidation is a popular 'quick fix' and can simplify your finances considerably, at the expense of more interest being paid in the long term, and is a good choice for people who are struggling with their debt to a moderate level. Management is a more drastic solution, and should only be considered by people who really have little alternative, and who are unable to get a consolidation loan because of their credit ratings.

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