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# MANAGEMENT OF ECONOMIC EFFICIENCY IN SMALL AND MEDIUM-SIZED ENTERPRISES

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**Abstract:** Efficient management of economic resources is paramount for the sustainable growth and success of small and medium-sized enterprises (SMEs). This paper explores strategies for enhancing economic efficiency within SMEs, focusing on optimizing resource allocation, minimizing wastage, and maximizing productivity. Through a comprehensive review of literature and case studies, it identifies key factors influencing economic efficiency in SMEs, including financial management, operational processes, technology adoption, and human resource utilization. The findings underscore the importance of strategic planning, innovation, and adaptive management practices in fostering economic efficiency. Ultimately, the paper provides actionable insights to empower SMEs in navigating economic challenges and achieving long-term viability.

**Keywords:** Economic efficiency, management ,small and medium-sized businesses , return on equity.

## Introduction

Small and medium-sized enterprises (SMEs) play a vital role in driving economic growth and innovation globally. However, their sustainability and competitiveness hinge on effective management of economic resources. This introduction sets the stage for exploring the management of economic efficiency within SMEs. It highlights the significance of economic efficiency for SMEs' success and outlines the objectives and structure of the paper. By emphasizing the importance of optimizing resource utilization, reducing costs, and enhancing productivity, this introduction lays the foundation for examining strategies to improve economic efficiency in SMEs, thereby contributing to their resilience and long-term prosperity.

## Categorization of economic efficiency

Economic efficiency within small and medium-sized enterprises (SMEs) can be categorized into several dimensions to provide a comprehensive understanding of its management.

**Allocative Efficiency:** This dimension focuses on the optimal allocation of scarce resources such as capital, labor, and materials to different activities or projects within the SME. It involves assessing whether resources are allocated in a manner that maximizes the firm's overall welfare and productivity.

**Technical Efficiency:** Technical efficiency examines how well SMEs utilize their production inputs to generate outputs. It involves evaluating the effectiveness of production processes, technologies, and methods employed by the SME to minimize waste and maximize output levels.

**Cost Efficiency:** Cost efficiency pertains to the ability of SMEs to produce goods and services at the lowest possible cost while maintaining quality standards. It involves minimizing production costs, overhead expenses, and other operating costs through effective cost management practices.

**Operational Efficiency:** Operational efficiency focuses on the effectiveness of internal processes and systems within the SME. It involves streamlining workflows, reducing bottlenecks, and

improving operational performance to enhance productivity and responsiveness to market demands.

**Resource Efficiency:** Resource efficiency encompasses the sustainable use of natural resources and energy within SMEs. It involves minimizing resource consumption, optimizing resource utilization, and adopting eco-friendly practices to reduce environmental impact and promote long-term sustainability[1].

Historically, the measurement and management of economic efficiency shows the evolution from traditional approaches based on measurement of financial metrics

to modern approaches of measuring the value for the owner and shareholder.

Theoretical and practical field of measurement and management of economic efficiency have been extended in recent years by a variety of methods and approaches, such as the Balance Scorecard, QFD, Kanban, EFQM and more. The disadvantage of current approaches to be used in small and medium-sized enterprises are unaffordable sophisticated tools used to measure and manage economic efficiency, high cost of implementation, operation and updating. The main disadvantage is the unavailability of methodologies of implementation and the predominance of non-financial measures. For this reason, small and medium-sized enterprises still prefer approaches which are mainly focused on financial measures[2].

To measure the economic efficiency it is necessary to take into account the diversity of valuation according to the positions of subjects that are associated with the operation and existence of the company. Such subjects are owners, managers or customers. Owners consider the business effective, if it is able to reach the maximal appreciation of employed capital in the shortest time possible. Customers prefer companies with quality products at a price corresponding to their requirements. Managers, sometimes simultaneously in the position of an owner, evaluate the efficiency of business according to the level of prosperity, market stability, the level of economy and productivity, current status and future trends of cash flows, liquidity, reaction time at changes of the external environment.

Economic efficiency is typically measured as the ratio between profit (before taxes, respectively after tax) and the average amount of either total invested capital (ROA), or equity employed (ROE). Return indicates how large the return flow of money is in proportion to the capital used for business activities. At the same time return gives the company investors important information and enables comparison with alternative forms of deposit money. Return on equity expresses a measure of appreciation of own resources. It measures how much net profit is attributable to one crown of capital employed.

The capital is a production factor with a form of physical capital (buildings, machinery, supplies, etc.) and human capital. The accumulation of capital in addition to technical progress is the main factor of economic growth. Capital is also a residual item of the assets of business after deducting its liabilities. It is synonymous with the net assets. Act No. 513/1991 Coll., The Commercial Code uses the term equity specified in the denominator of the ROE[3].

The rate of profit calculated on equity is an indicator whether capital has sufficient yield, ie whether it is used with an intensity corresponding to the size of the investment risk. Investor understandably requires that the price he receives form the company for the capital (dividends from shares share from invested deposit, etc.) was higher than the price that would be received in any other form of investment (eg by buying bonds, saving money on financial institution, etc.)

This requirement is justified because the investor, who put his capital into equity firm, carries a relatively high risk. If the value of long-term ROE is less than or equal to the yield of securities guaranteed by the government (treasury bills, government bonds, etc.) the company will probably fail. Rational investor in such case will seek to invest his capital in a more convenient and more profitable way[4].

While Return on Equity (ROE) is a widely used financial metric for assessing a company's profitability and efficiency in utilizing shareholder equity, it also has several disadvantages and limitations:

**Limited Scope:** ROE focuses solely on equity financing and does not consider the company's overall capital structure. Therefore, it may provide an incomplete picture of the company's financial performance, especially if it relies heavily on debt financing[5].

**Ignoring Debt:** Since ROE does not account for debt, a company with high debt levels may artificially inflate its ROE due to the leverage effect. This can mask underlying financial risks associated with high debt levels, leading to a misleading assessment of the company's profitability and financial health.

**Variability in Equity Calculation:** Different accounting methods and adjustments can lead to variations in how equity is calculated, potentially resulting in inconsistent ROE comparisons across companies or periods.

**Susceptibility to Manipulation:** Companies may manipulate ROE by engaging in financial engineering techniques such as share buybacks, asset sales, or restructuring activities to artificially inflate profitability and equity levels, thereby misleading investors.

**Industry Comparability:** ROE may not be directly comparable across industries due to differences in capital intensity, asset turnover, and business models. As a result, using ROE for inter-industry comparisons may lead to inaccurate conclusions about relative performance.

**Short-Term Focus:** ROE measures profitability over a specific period, typically one fiscal year, which may incentivize short-term decision-making at the expense of long-term value creation. This can lead to suboptimal investment decisions and undermine sustainable growth prospects.

**Lack of Context:** ROE does not provide insight into the underlying factors driving profitability or the quality of earnings. It does not consider factors such as revenue growth, operating efficiency, or risk management practices, which are essential for a comprehensive assessment of a company's financial performance.

**Economic Environment:** ROE may be influenced by macroeconomic factors such as interest rates, inflation, and market conditions, which can affect profitability and equity returns independent of managerial actions or operational performance.

Effective management of economic efficiency is crucial for the sustainable growth and success of small and medium-sized enterprises (SMEs). Throughout this exploration, we have delved into various aspects of economic efficiency management, including strategies for optimization, key metrics for evaluation, and the challenges faced by SMEs in this endeavor. As we conclude, it is evident that enhancing economic efficiency requires a multifaceted approach that integrates strategic planning, financial management, operational optimization, technology adoption, human resource utilization, innovation, and risk management[6].

Firstly, strategic planning emerges as a cornerstone for managing economic efficiency within SMEs. By developing clear goals, identifying competitive advantages, and allocating resources effectively, SMEs can align their activities with long-term objectives and market dynamics. This strategic alignment ensures that resource allocation is optimized to maximize overall welfare and productivity[7].

Secondly, financial management plays a pivotal role in optimizing economic efficiency. Sound financial practices, including budgeting, forecasting, cost management, and cash flow monitoring, are essential for minimizing waste, reducing costs, and improving profitability. Moreover, effective financial management enables SMEs to make informed decisions about capital allocation, investment opportunities, and debt management, thereby enhancing overall financial health and stability.

Operational optimization emerges as another critical aspect of economic efficiency management. By streamlining processes, eliminating inefficiencies, and leveraging technology solutions, SMEs can enhance productivity, quality, and responsiveness to market demands. Operational efficiency not only reduces costs but also improves customer satisfaction and competitive positioning in the marketplace.

Technology adoption represents a transformative tool for enhancing economic efficiency within SMEs. By embracing digital solutions such as ERP systems, CRM software, and cloud computing, SMEs can automate tasks, improve data analysis capabilities, and optimize decision-making processes. Technology integration enhances resource utilization, operational effectiveness, and innovation, thereby driving sustainable growth and competitiveness[8].

Human resource utilization is also fundamental to economic efficiency management. Investing in employee training, development, and motivation enhances skills, productivity, and organizational performance. Effective workforce management practices, including task delegation, performance evaluation, and incentive programs, further optimize human resources and foster a culture of continuous improvement and innovation.

Innovation emerges as a catalyst for enhancing economic efficiency and driving long-term competitiveness. By fostering a culture of creativity, experimentation, and adaptation, SMEs can identify new opportunities, develop innovative solutions, and differentiate themselves in the marketplace. Continuous innovation enables SMEs to stay ahead of the competition, respond to changing customer needs, and capitalize on emerging trends.

Lastly, proactive risk management is essential for safeguarding economic efficiency and ensuring business resilience. By identifying potential risks, developing mitigation strategies, and establishing contingency plans, SMEs can minimize disruptions and losses. Risk management enables SMEs to navigate uncertainty, capitalize on opportunities, and protect shareholder value.

In conclusion, managing economic efficiency within SMEs requires a comprehensive and integrated approach that encompasses strategic planning, financial management, operational optimization, technology adoption, human resource utilization, innovation, and risk management. By adopting these strategies and overcoming challenges, SMEs can enhance their competitiveness, resilience, and long-term sustainability in the dynamic business environment. As SMEs continue to play a vital role in driving economic growth and innovation, effective management of economic efficiency remains essential for unlocking their full potential and achieving enduring success.

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