

# Determining Factors of Private Investment Performance: Scientific Focus in Sodo City, Wolaita Zone, Southern Ethiopia

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## Abstract

To make private investment more attractive, most African countries have liberalised the market and attempted to create enabling environment in recent decades. Like many African countries, Ethiopia took steps towards liberalising the market and the macroeconomic regime and introducing measures to improve the investment regulatory framework. This study analyses the determinants of private investment performance in Wolaita Sodo city. Data for the study were collected from 165 investors from different categories. Data was collected using primary and secondary sources; a Multi-stage sampling technique was used to meet with the study points. To attain the study's stated objectives, different data analysis methods, i.e. descriptive analysis and econometric analysis, were used to identify the effect of independent variables on the dependent variable. Descriptive analysis percentages, graphs, charts, and tables were presented, affecting private investment. In logistic regression analysis, the variables positively related to the probability of investment are investment incentive, marital status, land, investment experience, labour, and credit facility. On the other hand, the variables negatively correlate with the probability of investment interest on the loan, age, sex, education, and inflation. From 11 explanatory variables, 5 of the variables: investment incentive, credit facility, interest on the loan, sex, and inflation have a significant effect on the private investment at the significance level at 1 per cent, 5 per cent, and 10 per cent.

**Keywords:** Logit Regression Model, Private Investment, Investors, Wolaita Sodo

## Introduction

### Background of the Study

Economic literature shows that investment is, both empirically and theoretically, the critical determinant of economic growth. Economic growth refers to increasing a country's production or income per capita. It is usually measured by gross national product or gross national income, used interchangeably, an economy's total output of goods and services. Investment is the source of manufactured goods used to produce other goods. It is the principal foundation of enhance literacy, improvement in technology, and increased capital stock (Hussain et al., 2010).

Economic growth has long been one of the primary goals in virtually every country, whether developed or developing. To this end, capital formation, proper mobilisation and allocation of resources and reduction of unutilised resources to the economy's productive sector are crucial.

Moreover, growth requires an investment of both domestic and

foreign, both public and private, which calls for increased domestic mobilisation (Todaro & Smith, 2012).

Investment activity plays a crucial role in the economic growth of a country. Investment can increase a country's productive capacity, provided that investment expenditure regards durable goods that have comparatively long valuable lives and embody the latest technological advances. In addition, changes in investment expenditure can potentially result in shifts in the level of employment and personal income by affecting the demand for capital goods. Although gross fixed capital formation usually represents a substantially smaller fraction of an economy's total expenditure compared to consumption expenditure, it is a highly volatile component that causes strong fluctuations in a country's economic activity (Todaro & Smith, 2012).

In the process of investigating the economic performance or growth of a country, one of the key determinants that need to be considered is an investment (Augustine, 2014). Countries that are developed have invested much in their economies, whereas countries investing slowly are developing slowly and remaining poor (Solow, 1956).

(Geda & Degefe, 2005) explored the role of investment as one of the long-run determinants of Ethiopia's growth rate. Concerning the relative contribution of public investment and private investment to economic growth, they confirmed that private investment is a more significant contributor than a public investment to the country's economic growth; a 10% increase in private investment leads to an approximately 1.5% increase in output, while a similar increase in government investment leads to a 0.95% increase. Recently, economists have developed a common opinion about the constructive effect of sustainable investment on economic growth. Moreover, the sustainability of investment depends on the investment sector (IMF, 2013).

In Ethiopia, Private Investment is a key to long-term economic growth (Singh, 2019). However, private sector investment has shown improvement following the 1996 economic reform; it still has a fluctuating feature (Singh, 2019). Declining investment ratios and levels are a problem, firstly

because investment matters for growth, and secondly because low investment increase vulnerability in the economy (Sisay, 2010). One of the key challenges facing the country concerning private investment is the lack of awareness among the investors about the modern business system (Sisay, 2010). In the case of the Ethiopian context, although private sector investment has shown improvement following the 1995 economic reform, it still has a fluctuating feature (Geda & Degefe, 2005). Additionally, the role of the private sector in the economy is minimum compared with that of the public sector (Agenor et al., 2005).

Since private investment is below expectation, the Federal Democratic Republic of Ethiopia government has recognised and paid due attention to the promotion and development of private investment, which includes working a lot to attract private investors for investment in different sectors of the economy. Those investment incentive packages are implemented in all country cities, including Wolaita Sodo.

The evidence shows that private investment anywhere depends on many variables that significantly affect the sector's growth. So, identifying and monitoring those variables is a precondition for the growth and development of the private investment sector. Therefore, it can be seen as the surest way of enhancing private investment. However, the absence of research on the area, Wolaita Sodo city, has long been facing serious problems in minimising private investment hassles to benefit from the actions. Therefore, the purpose of this study is to explore and explain determinants that affect private investment in the city and thereby contribute its level best in this scenario.

## **Objectives of the Study**

### **General Objective**

The study's general objective is to understand the determinants of private investment in Wolaita Sodo city.

### **Specific Objectives**

- To identify the leading causes of low performance of the investment in Wolaita Sodo.
- To examine the determinants of private

investment in Wolaita Sodo

- To investigate the different economic variables that affect private investment

## Research Methodology

### Description of the Study Area

This study was undertaken in Wolaita Sodo city, located in the Wolaita zone. The zone is one of the zones in SNNPR, and it borders with Gamo Gofa zone in the South, With Dawro Zone in the West, with Sidama region in the East, with Kamabata & Tamabro, and Hadiya Zones in the North and with Oromia regional state in the Northern East. The total area of the zone is 4,471.3 km<sup>2</sup> or 447130 hectares. The zone is classified into 16 woredas and 6 towns, including Wolaita Sodo city (Tsegaye and Bekele, 2010).

In the administrative hierarchy, the town has equal status with other woredas. Spatially the city is surrounded by Zodo Zuria Woreda. Wolaita Sodo city is located at 329 km and 170 km southwest of Addis Ababa and Awassa. Astronomically, the city is located 6046' - 6053' North latitude and 37042' - 37056' East longitude. The city's altitude ranges from 1784 - 2346 meters above sea level. The mean annual temperature of the city is 200c, and the mean annual rainfall is 1,212 mm; the city has a strategic place where mainly transport lines cross the town and make the city a ring of all roads. The city has been the busiest and core trade centre where many people from different parts of the country enter the town via seven significant gets. The promising result has been social, economic, and infrastructure development in the last couple of years. However, due to the unprecedented growth of population in the city need for social, economic, and infrastructure series are ever-increasing (WSTMO : Wolaita Sodo Town Municipality Office, 2013)

### Types and Source of Data

Self-administered interview schedules were used as primary data from the investment office and the private investors. Among the total 280 private investment projects 165, projects were selected through a systematic sampling technique. The study used both primary and secondary sources of data. The primary data source was derived from respondents'

answers in the interview schedule. An interview schedule was used as a data collection method for the two objectives to collect quantitative data, whereas focus group discussion was used to collect qualitative data. Secondary data was derived from the findings stated in published and unpublished documents and literature related to the research problem, taken from the recent literature such as; articles, journals, reports, working papers, books, and internet sources related to private investment.

### Sample Size Determination

The city has 280 investors who are investing permanently in the city, and out of these investors, the researcher selected 165 investors by using Yemane Formula, which is written as

$$n = N / (1 + N (e)^2)$$

where n = number of samples,

N = Total population and e = Error tolerance

Therefore, the (Yemane, 1967).was employed to find the sample size.  $n = N / 1 + (e)^2$

Where N=total population (investors) =280

n=the required sample size=165

e=merging error (5%)

$$n = 280 / 1 + 280(0.05)^2$$

$$n = 165$$

### Sampling Technique

Multi-stage sampling techniques will be used to generate the required primary data. In the first stage, Sodo city was selected purposively. In the second stage, out of 280 investors, 165 investors were selected by random sampling techniques. Then, a probability proportionate size technique(s) was employed to determine sample size from each sector, and finally, 165 were selected using systematic random sampling.

### Method of Data Analysis

The tools for quantitative data analysis were descriptive statistics. Percentages, frequencies, mean and standard deviation were employed for demographic variables and objective one. In addition, a chi-square test was used in identifying the relationship between Private investment and dummy independent variables, and a t-test was used to test the differences between private investment

and continuous independent variables. Moreover, Binary logistic regression analysis was applied for identifying significant factors affecting private investment. The qualitative data gathered through Focus Group Discussion will be analysed through narration and description.

Two types of data analysis, namely descriptive statistics and econometric models, were used to analyse the data collected from the investors. First, quantitative categorical types of data were analysed using percentage, frequency. At the same time, continuous quantitative types of variables were minimum, maximum, mean, and standard deviation. After computing the descriptive statistics, Binary logistic regression was used to identify determinants of private investment where the dependent variable was the binary outcome. The data analysis was conducted using the statistical package that is STATA 11.

**Econometric Model**

**Binary Logit Model Specification**

Logistic regression analysis examines various factors on a dichotomous outcome by estimating the probability of events. The logit model was used when the dependent variable is binary (also called dummy), taking 0 or 1. It is a non-linear regression model that forces the output (predicted value) to be either 0 or 1. This model’s parameters were estimated using the maximum likelihood estimation rather than the movement estimation on which the Ordinary least square regression technique relies.

The logit method gives parameter estimates that are asymptotically efficient and consistent. Indeed, the logit approach produces statistically sound results (Gujarati, 2004). The logit model usually takes two forms. It may be expressed in terms of logit or terms of event probability. When described in logit form, the model is specified as

$$\log \left( \frac{p(y=1)}{1-p(y=1)} \right) = \sum_{k=1}^k B_K X_K$$

This particular study deal with the probability to invest or not, and this is expressed in mathematical

form as follows

$$\Pr(y=\frac{1}{x}) = pr(y = 1) = \frac{e^{\sum_{k=1}^k B_K X_K}}{1+e^{\sum_{k=1}^k B_K X_K}}$$

The above equation represents the probability of an event occurring. For a non-event, the probability is just 1 minus the event probability.

$$pr \left( y = \frac{1}{x} \right) = pr(y = 0) = \frac{e^{-\sum_{k=1}^k B_K X_K}}{1+e^{-\sum_{k=1}^k B_K X_K}}$$

The equation is of the form:

$$y_i = \alpha + \beta_1 x_1 + \beta_2 x_2 + \dots + \beta_k x_k + \varepsilon$$

Where;

$y_i$ = probability of household to save in financial institutions

$\alpha$ = Intercept (constant) term

$\beta_k$ =Coefficient of the explanatory variable

$x_k$ = Explanatory variables

$\varepsilon$  = Disturbance (Stochastic) term.

Predicted logit of investment =  $\beta_0 + \beta_1 \times \text{Age} + \beta_2 \times \text{Gender} + \beta_3 \times \text{Marital} + \beta_4 \times \text{Education} + \beta_5 \times \text{experience} + \beta_6 \times \text{Inflation} + \beta_7 \times \text{Credit facility} + \beta_8 \times \text{Loan Interest rate} + \beta_9 \times \text{Investment incentive} + \beta_{10} \times \text{Labor} + \beta_{11} \times \text{Land}$

**Assumptions of Logistic Regression**

1. Assume a linear relationship between the logit of the independent variables and dependent variables; however, it does not assume a linear relationship between the actual dependent and independent variable.
2. Independent variables all not linear function of each other, i.e perfect multicollinearity makes estimation impossible,
3. The model is correctly specified, i.e
  - The actual conditional probabilities are a logistic function of the independent variables:
  - No important variables are omitted
  - No extraneous variables are included and
  - The independent variable is measured without error

**Table 1: Variables and their Expected Sign**

Variable Name	Description of Variable	Measurement	Expected Sign
<b>Private investment</b>	Probability of private investment	Dummy (1= invest, 0 = not-invest)	Dependant
<b>AGE</b>	Age of the investor	Continuous variable measured in years	+
<b>GDR</b>	Sex of the investor	Dummy(1=male,0=female)	-
<b>MRS</b>	Marital status of the investor	Dummy(1=married,0=unmarried+divorced + widowed )	+
<b>EDU</b>	Education of the investor	The continuous variable measured in years of schooling	-
<b>IEX</b>	Investment experience	Continuous measured in years	+
<b>CRD</b>	Credit facility to the investor	Dummy(1, if there is access to credit, 0 otherwise)	+
<b>IRL</b>	The interest rate on a loan	The continuous variable measured in percent	-
<b>IFN</b>	Inflation	The continuous variable measured in percent	-
<b>ININC</b>	Investment incentive	The continuous variable measured in incentives given	+
<b>LD</b>	Land	The continuous variable measured in acre	+
<b>LR</b>	Labor	The continuous variable measured in workers	+

**Result and Discussion**

The descriptive statistics and logit regression results were done in light of the study’s objectives.

**Descriptive Analysis**

**Age of the Respondents**

**Table 2: Age Distribution of Respondents**

Age	Number of respondents	%
20-29	15	9.09
30-64	131	79.39
64	19	11.52
Total	165	100

Source: own survey 2021

As the above table 2 indicates, 15 (9.09%) of respondents were under age category 20-29; 131 (79.39%) of respondents were age category 30-64, and 19 (11.52%) of the respondents were age greater than 64. According to table 2, most of the respondents were under the age category 30 to 64, and their response to private investment is highest than the rest of the age category. Adults can work more hours and are more producers than the oldest age.

**Education Level of Respondents**

Education level plays a significant role in determining the saving level of households through the improvement of income; by increasing the knowledge of how to use the new technology, participating in different income-generating activities, family planning, and improving the management of resources. All those are lead to good productivity of the household and can enhance income level, which is directly related to investment.

**Table 3: Educational Level Distribution of the Respondents**

Education level	Sample unit	%
Illiterate	26	15.76
Grade 1-8	17	10.30
Grade 9-12	49	29.70
Diploma and above	73	44.24
<b>Total</b>	165	100

Source: own survey 2021

As the above table 4.2 shows, 26(15.76%) of the respondents were illiterate, 17 (10.30%) of the

respondents were completed primary education, 49 (29.70%) of the respondents were completed secondary education and 73 (44.24%) of the respondent’s education level diploma and above.

According to table 4.2, most respondents were educated with a diploma and above the level. At the same time, their response to investment is highest than other education categories.

**Econometric Analysis**

**Model Specification**

Before regression of the model, the researcher tested the model specification test. Model specification error can occur when one or more relevant variables are omitted, or irrelevant variables are included. Therefore, it can substantially affect the estimate of regression coefficients. Moreover, in this study, the model specification error was checked by link test; the test of hat and hatsq were 0.000 and 0.281. Therefore, it shows that the link test has failed to reject the hypothesis that the model is specified correctly. Accordingly, it seems to us that we do not have a specification error.

In addition to the basic descriptive statistics, the logistic regression model was employed to identify factors affecting private investment in the study area. The variables included in the model were tested for the existence of multi-co linearity. In addition, contingency coefficient and variance inflation factor were used for multi-collinearity tests of discrete and continuous variables, respectively.

Contingency coefficient value ranges between 0 and 1, and a rule of thumb variable with a contingency coefficient below 0.75 shows a weak association. A value above it indicates a strong association of variables. The contingency coefficient for the discrete variables included in the model was less than 0.75 that did not suggest multicollinearity to be a serious concern. As a common practice, continuous

variables with a variance inflation factor of less than 10 are believed to have no multi-collinearity. Those with a VIF of above 10 are subjected to the problem and excluded from the model (Gujarati, 2004). Apart from per cent correct predictions, the model Chi-Square with “n” degrees of freedom and Hosmer and Lemeshow’s are used to test the goodness-of-fit test. Accordingly, p-values associated the Chi-Square with 11 degrees of freedom. The value of .0000 indicates that the model is statistically significant and shows the model fit the data well.

Another commonly used test of model fit is Hosmer and Lemeshow’s goodness-of-fit test. The hosmer-Lemeshowgoodness-of-fit statistic is computed as the Pearson chi-square from the contingency table of observed frequencies and expected frequencies. Similar to a test of a two-way table, a good fit as measured by Hosmer and Lemeshow’s test yields a significant p-value. Therefore in this study, the test result shows that p=1, which suggests that the model is correctly fitted with the data.

Robust logistic regression was used to control for heteroscedasticity in binary outcome models. Heteroscedasticity in binary outcome models will affect the “Betas” and standard errors (Wooldrige, 2001).In this study, both regression, i.e. earlier and robust logistic regression, have the same result. None of the coefficients changed, but the standard errors and Z values differed slightly.

**Estimation of Determinants of Private Investment in the Study Area**

The binary logit model was used to estimate determinants of private investment in the study area. Logistic regression Number of obs = 165  
 LR chi2(11) = 81.60  
 Prob > chi2= 0.0000  
 Log-likelihood = -73.544098 Pseudo R2 = 0.3568

**Table 4: Parameter Estimation of the Logit Model Regression**

Private Investment	Coef.	Std. Err.	z	P>z	Odds Ratio
<b>Invinc</b>	.5189493	.1624481	3.19	0.001 ***	1.680261
<b>Intloan</b>	-.7551589	.1960239	-3.85	0.000***	.4699359
<b>Age</b>	-.0238093	.0217561	-1.09	0.274	.9764719
<b>hmst</b>	.452834	.3878494	1.17	0.243	1.572763

<b>sexfi</b>	-1.663483	.654283	-2.54	0.011**	.1894779
<b>lnd</b>	.6399898	.4164294	1.54	0.124	1.896461
<b>hhse</b>	.0594127	.4919062	0.12	0.904	1.061213
<b>lbr</b>	.96696	1.224763	0.79	0.430	2.629937
<b>edu</b>	-.3707819	.462814	-0.80	0.423	.6901944
<b>infn</b>	-.9512615	.5076759	-1.87	0.061*	.3862535
<b>crdtf</b>	2.603505	.6727821	3.87	0.000***	13.511

NB: \*\*\* significant at 1%, \*\* significant at 5% and \* significant at 10%

Source: Survey result using Stata, 2021

In logistic regression analyses, the variables positively related to the probability of investment are investment incentive, marital status, land, investment experience, labour, and credit facility. Conversely, the variables negatively correlate with the probability of investment interest on the loan, age, sex, education, and inflation.

In the table above, out of 11 explanatory variables, 5 of the variables: investment incentive, credit facility, interest on the loan, sex, and inflation have a significant effect on the private investment at the significance level at 1 per cent, 5 per cent, and 10 per cent. The negative values of explanatory variables in the table above indicate that the unit change in the independent variable leads to a decrease in the probability of private investment.

### The Interest Rate on Loans and Probability of Private Investment

In this study, the annual interest rate on loans was one of the factors determining the private investment. As was expected, the variable is negatively related and statistically different from zero at less than 1% level. However, they held other variables constant at their mean level when a unit increases the loan interest rate. As a result, the odds ratio in favour of probability to invest increases at about 0.469. The possible explanation for this finding is that when the interest rate on loans increases, people’s motive to invest decreases.

### Credit Access and Probability of Private Investment

One of the model variables in this study is access to credit to investors. As hypothesised, the variable is positively related and statistically different from zero at the 1 per cent level. Moreover, they held other

variables constant at their mean value when access to credit changes from no access to access odds ratio in favour of probability of private investment increases at about 13.51. The result was that access to credit could increase an opportunity to invest and participate in a different income-generating activity, enhancing the investors’ capacity and aggregate investment level.

### Investment Incentives and Probability of Private Investment

One of the model variables in this study is investment incentives to investors. As hypothesised, the variable is positively related and statistically different from zero at the 1 per cent level. Holding other variables constant at their mean value, when investment incentives change from no incentive to incentive, the odds ratio favours the probability of private investment increases at about 1.68. The result was that investment incentives can encourage investors to invest and participate in different investment activities, which can enhance the investors capacity and aggregate investment level

### Inflation and Probability of Private Investment

One of the model variables in this study is inflation. As hypothesised, the variable is negatively related and statistically different from zero at the 10 per cent level. Holding other variables constant at their mean value, when inflation increases, the probability of private investment decreases at about 0.38. The result was that inflation can affect investors’ purchase of raw materials as they need, increase the cost of production, and reduce their ability, which can, in turn, affect the investors.

## Conclusion

The study was conducted to identify determinants of private investment in Sodo city. Data for the study were collected from 165 investors from Sodo. To attain the study's stated objectives, we have used different data analysis methods, i.e. descriptive analysis and econometric analysis, to identify the effect of independent variables on the independent variable. With descriptive percentages and tables were presented factors affecting investment.

The significant findings are:-

The result shows that 15 (9.09%) of respondents were under age category 20-29; 131 (79.39%) of respondents were age category 30-64, and 19 (11.52%) of the respondents were age greater than 64. According to Table 4, most of the respondents were under the age category 30 to 64, and their response to private investment is highest than the rest of the age category. Adults can work more hours and are more producers than the oldest age.

The finding of this study shows that 26 (15.76%) of the respondents were illiterate, 17 (10.30%) of the respondents were completed primary education, 49 (29.70%) of the respondents were completed secondary education and 73 (44.24%) of the respondent's education level diploma and above. Most of the more significant respondents have a diploma and are above the level, while their investment response is higher than other education categories.

In logistic regression analyses, the variables that are positively related with the probability of investment are investment incentive, marital status, land, investment experience, labour, credit facility; the variables that are negatively correlated with the probability of investment interest on the loan, age, sex, education, and inflation.

From 11 explanatory variables, 5 of the variables: investment incentive, credit facility, interest on the loan, sex, and inflation have a significant effect on the private investment at the significance level at 1 per cent, 5 per cent, and 10 per cent.

## Policy Implication

From analysing the micro-level determinants of private investment performance in Wolaita Sodo city, the study recommends the following policy implications.

For sufficient economic growth and sustainability of the economy, the government needs to promote access to credit for a private investor is which is found to have a positive and significant impact for private investment to grow, thus addressing the need to extend the operation of financial institutions such as commercial banks should strive to expand and distribute financial institutions such as banks and microfinance institution and promote saving mobilisation and credit availability to the growth of private investor. Furthermore, the financial institution (both the Government and Private) have to improve their policy of credit availability for the private sector so that the newly emerging business community will have better access to financial services.

The commitment of the current Ethiopian government in enhancing the private sector is appreciable. This government commitment to improving the regulatory policy has contributed to the significant growth of the private sector at the national level. However, given that the country still lies at the bottom occupying among the least rank in terms of development, much has to be done further to facilitate the participation of domestic and foreign investors so that they make the largest contributions to the capital accumulation effort the economy.

The government should avoid unfavourable business climate, including being reluctant to implement economic reform programs and bureaucracies that hinder the implementation of investment projects, and eye-catching incentives should be given to those private investors starting their projects write way and the interest rate on loan should be checked.

Government should have to provide more incentive packages and encourage investors who invest at distant places from the centre that come equally compensate for the advantage they can get at the central parts of the country. Furthermore, rather than restricting the role of the government in economic affairs, the government should provide public infrastructures which equally distributed throughout all parts of the country so that all the business community and the society at large have been benefited accordingly. Finally, inflation has to be managed and should be done on different monetary and fiscal policies to manage it.



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## Conflict of Interest

The authors have commonly agreed that they have no conflict of interest among this research publication.

## Technical Terms

The following are the technical terms used by Ethiopians

- Woreda called as District
- Kebele called as Village
- Kolla means Lowland
- Woye-Dega means Mid-land
- Dega means Highland

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