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## VENTURE CAPITAL AND STRATEGIC DEVELOPMENT OF INNOVATIVE BUSINESS

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**Abstract.** One of the most important sources for improving the financial support of innovative activity is venture capital. The development of venture financing in developed countries is one of the defining areas of support for medium and small innovative businesses. The purpose of the article is to identify the key features of venture capital, the selection of structural characteristics of venture capital, and the functional features of venture financing for the strategic development of innovative businesses. The survey is based on the following methods: analysis, systematization, and generalization to identify the key features of venture capital, as well as to select structural characteristics of venture capital, and the functional features of venture financing; tabular representation for the visual display of the results of research and analytical data. The article analyzes the interpretations of venture capital. A significant expansion of the key features of venture capital was noted. The structural characteristics of venture capital for the strategic development of innovative businesses are highlighted, which are systematized according to the following signs: elements of the classic form of venture capital, functions of venture capital, characteristics of the venture capital market, phases of the venture capital investment process, reasons for the refusal to receive venture capital, results from the implementation of venture capital at the macroeconomic level. Functional features of venture financing for the strategic development of innovative businesses must be considered in the context of such features forms of venture financing, types of venture financing, features that are characteristic of venture financing, steps of the venture financing process, stages of venture financing, the most common exit strategy for venture capital investors, principles of venture financing, advantages of venture financing, disadvantages of venture financing. The obtained results are the basis for further scientific research in the part of venture financing of the strategic development of innovative businesses in Ukraine and attracting investments for the development of innovative activity.

**Keywords:** venture capital, venture financing, innovative activity, innovative businesses, strategic, development, process, startup, investment, venture fund, risk.

**JEL Classification:** G 24, G 32, O 31

## 1. INTRODUCTION

In the modern world, it has been proven that investments in the development and implementation of innovations are the most profitable (Zhang et al., 2012). It guarantees the highest return, laying a reliable foundation for maintaining the innovative potential of business at a high level, ensuring the country's competitiveness. The main reason holding back the strategic development of innovative businesses in Ukraine is insufficient funding (Yurynets, 2016). The problem of innovative business is the problematic financing of innovative projects with high risk. New alternative sources of investment resources are needed to improve the financial support of the innovative activity. One of the most important sources is venture capital. The development of venture financing in developed countries is one of the defining areas of support for medium and small innovative businesses, financing of scientific and research works. Despite the numerous risks associated with venture capital, many companies prove that this form of investment can give an investment «push» and lead to the creation of a real giant. Companies using this financing form include Amazon.com, Facebook, and Google (Bustamante et al., 2021). Without the support of private investors and venture capital, it would be difficult for the founders of these global brands to turn their innovative ideas into businesses.

Thus, the development of venture financing, the accumulation of financial resources, and the effective use of venture capital for the development of innovative businesses become an important issue for the state, especially after the end of the war. This requires a deeper understanding of the features of venture financing in the strategic development of innovative businesses.

## 2. THEORETICAL BACKGROUND

The problem of venture financing of innovation activity, effective formation, and use of venture capital is not new for scientists. In the scientific publications of scientists (Block et al., 2019; Bustamante et al., 2021; Williams, 2017; Shao & Sun, 2021) the main attention is paid to the evolution of venture business development, the role of venture investments in national and global innovation processes, and the foreign experience of venture financing of innovation activity. Among the scientists who actively researched the problem of the formation and use of venture capital, we can single out Frimpong et al. (2021); Gutterman (2022); Park and LiPuma (2020); Rudra et al. (2020). They studied changes in the global venture capital market, conditions of venture capital investment, and startup requirements. Researchers among others have also studied the venture financial strategies, venture funds, and availability of investment to the business. The availability of venture funds is one of the sources of competitiveness of innovative businesses and by extension, economic efficiency. Many scientists in the field of business management, such as Pradhan et al. (2019); Siddiqui et al. (2016); Zhang et al. (2012) have investigated the consequences of long-term (strategic) and short-term financing of innovative businesses. The authors paid much attention to the process of venture financing, the differences between venture financing and traditional investing, and the stages of venture financing.

However, there is still no research on the structural and functional features of venture capital and venture financing and their role in the strategic development of innovative businesses.

## 3. RESEARCH OBJECTIVE, METHODOLOGY AND DATA

The research methodology in the article develops the idea of «venture capital as an effective tool for creating a new business», where venture capital is the basis for solving the problem of lack of funds in the innovation sector in the future. Therefore, the formation of structural characteristics and functional features of venture capital should be carried out taking into account the strategic

development of innovative business. The substantiation of the relevance of the problem is confirmed by the results of studies (Pradhan et al., 2019), which proved the impact of venture financing on the successful development of innovative projects, and startups, taking into account the system of strategic tasks. The materials of the article are based on research by scientists regarding the use of venture capital from a strategic perspective. Analysis of the features of venture capital made it possible to identify signs, structural characteristics and functional features of venture capital for the strategic development of innovative businesses. The systematization made it possible to group the key features of venture capital, to develop a classification of structural characteristics and functional features of venture capital for the strategic development of innovative businesses. Generalization is necessary to form a research conclusion. The conclusions are the basis for the justification of the prospects for the development of venture funds in Ukraine in the future and further research on venture financing of innovative activities. The article uses tabular representation for the visual display of the results of research and analytical data. The purpose of the article is to identify the key features of venture capital, the selection of structural characteristics of venture capital, and the functional features of venture financing for the strategic development of innovative businesses.

#### 4. RESULTS AND DISCUSSION

An innovative business that needs venture capital is a young business structure that has growth potential and attracts venture capital to implement innovative projects, modernization, or technological re-equipment of production, bringing new products (works, services) to the market, which helps to increase their market value. An innovative business that operates in a growing market has an idea, and is looking for investment to implement it, should consider the possibility of using venture capital. This is a form of financing promising strategic innovation projects of small and medium-sized businesses. Venture capital is a special form of investment that can benefit innovative businesses and venture capital funds in the future. Venture capital provides financing for product development or further entry into international markets.

The definition of the concept of «venture capital» is given in Table 1.

Tab. 1

*Interpretation of the concept of «venture capital»*

<b>Sign</b>	<b>Characteristic</b>
Capital, primarily monetary capital in a new enterprise or the expansion of an existing business	Capital invested in a project with a significant level of risk, especially cash capital invested in a new enterprise or the expansion of an existing company in exchange for a controlling stake in its shares
Tool of innovative development	An instrument of innovative development; financing of companies with development potential and the possibility of transformation into a powerful business entity
Investments for the development of companies not registered on stock exchanges	Investments in the equity capital of unlisted companies, both at the initial and later stages of development, when significant financial resources are required for the acquisition of the company
Equity or share capital for the implementation of an innovative project	Equity or share capital invested in a small or medium-sized business company that implements an innovative project related to the development and use of new technology and/or the release of a fundamentally new product
Equity risk financing for management support	Risk financing, which involves equity participation in the company's capital and support in the field of management

Formation and stimulation of growth of small and medium-sized enterprises	A special form of financial capital associated with the formation and stimulation of the growth of small and medium-sized enterprises characterized by high business activity and the potential for obtaining profits higher than average
Long-term risk capital to obtain a high profit	Long-term risk capital invested in the shares of new fast-growing companies to obtain high profits after the registration of these companies on the stock market

Source: Compiled by the authors based on (Fifteenth Annual Report (2023); European Private Equity and Venture Capital Association (2022); Zhang et al. (2012); Williams (2017); Gutterman (2022); Siddiqui et al. (2016))

It is possible to notice a significant expansion of the key features of venture capital. Therefore, the following key features of venture capital can be identified:

- capital, primarily monetary capital;
- directed to a new enterprise or the expansion of an existing business;
- tool of innovative development (investing in innovative enterprises);
- aimed at the implementation of an innovative project;
- investing mainly in projects at an early stage of development;
- focused on the development of companies not registered on stock exchanges;
- equity or share capital (equity financing);
- high investment risk based on equity participation;
- basis for management support;
- formation and stimulation of growth of small and medium-sized enterprises;
- medium and long-term nature of investments;
- participation in the formation of added value;
- focused on obtaining high profit (income mainly in the form of capital gains);
- investing in companies with a high rate of return.

Venture capital is a long-term, strategic investment (mostly 3-7 or 10 years). It is invested by individual and institutional investors (venture funds) for the creation and development of young innovative enterprises.

The structural characteristics of venture capital for the strategic development of innovative businesses are given in Table 2.

Tab. 2

*Structural characteristics of venture capital for the strategic development of innovative businesses*

Sign	Types, interpretation
Elements of the classic form of venture capital	<ul style="list-style-type: none"> <li>– innovative enterprise;</li> <li>– venture fund (venture capital company);</li> <li>– original donors of capital;</li> </ul>
Functions of venture capital	<ul style="list-style-type: none"> <li>– accumulation and mobilization of funds for the state, population, enterprises, investment funds, as well as foreign persons;</li> <li>– investment support for scientific, technical, and innovative activities;</li> <li>– research and production function (stimulation of innovative activity);</li> <li>– function of incubation of innovative entrepreneurship through commercialization results of scientific and technical activity;</li> <li>– function of guarantor of economic stability of new innovative business structures;</li> <li>– function of structural renewal of the economy (transformative function);</li> <li>– provision of professional skills and experience in running innovative business enterprises</li> </ul>
Characteristics of the venture capital market	<ul style="list-style-type: none"> <li>– the number of collected funds;</li> <li>– the amount and value of investments;</li> <li>– the value of assets at a certain point in time;</li> </ul>

<p>Phases of the venture capital investment process</p>	<ul style="list-style-type: none"> <li>- acquisition of capital;</li> <li>- search for investment attractive objects;</li> <li>- analysis of project investments;</li> <li>- conducting negotiations and starting investments;</li> <li>- participation in the management of an innovative enterprise;</li> <li>- disinvestment, i.e. withdrawing the fund from the investment project</li> </ul>
<p>Reasons for the refusal to receive venture capital</p>	<ul style="list-style-type: none"> <li>- a weak or banal business idea;</li> <li>- lack of idea regarding the further development of the product;</li> <li>- low growth potential or low rate of return on investments;</li> <li>- incompetence or immaturity of the team;</li> <li>- blurred structure;</li> <li>- the inadequacy of entrepreneurs in business valuation issues (overestimation of the company);</li> <li>- low quality of execution and implementation of the proposed investment project;</li> <li>- ill-conceived strategy;</li> <li>- lack of proof of profitability of the project for companies already operating in the market;</li> <li>- lack of agreement between the parties regarding the amount;</li> <li>- lack of agreement between the parties regarding the vision of achieving business goals and conditions of cooperation</li> </ul>
<p>Results from the implementation of venture capital at the macroeconomic level</p>	<ul style="list-style-type: none"> <li>- promotes breakthrough growth of new industries and sometimes individual industries;</li> <li>- transformation of the economy to an innovation-oriented type;</li> <li>- support of economic growth due to innovative growth and improvement competitiveness of the economy;</li> <li>- ensuring the country's financial security;</li> <li>- contributes to the development of the stock market</li> </ul>

Source: Compiled by the authors based on (Bustamante et al. (2021); Park & LiPuma (2020); Shao & Sun (2021); Williams (2017); Gutterman (2022))

Venture financing is:

- a hybrid form of providing innovative companies with investments that combine the most effective functions of both capital markets and banks (Rudra et al., 2020);
- a process where venture capital is invested in exchange for a share in the company's statutory fund (a package of shares) with the aim of its rapid development and prosperity (Block et al., 2019).

On the one hand, venture investors generate income by participating in the ownership of innovative companies, on the other hand, venture funds, just like banks, have at their disposal a system of informal monitoring and control of borrowers' activities.

Venture financing is aimed at stimulating the practical use of technical and technological inventions, the results of scientific achievements. Its purpose is to obtain high income from investments in a risky enterprise working on the implementation of an innovative idea or project into production.

In Ukraine, the main active venture capital funds are, as a rule, members of the UVCA. The fundamental difference between funds in Ukraine and abroad lies in the level of their activity.

By 2022, the number of venture funds in Ukraine was growing. According to official statistics, by the end of 2021, 312 asset management companies were registered in Ukraine, and their assets have doubled. Over the past 5-6 years, the number of joint investment institutions has increased to 1,623 units, and the size of their assets amounted to almost UAH 500 billion (Market in numbers, 2022).

In Germany, in 2022, venture funds concluded 346 agreements to invest in startups. In Ukraine, the number of deals is at least five times lower – in 2021, there were 78 deals. The average amount of investment is USD 500,000 for one innovative project (UVCA, 2023). A venture fund can invest in innovative business money, access new customers and new regions, and help in attracting the next round of investments. The rapid growth of innovative businesses and capitalization are important for funds. The minimum capitalization growth is 10 times over 5 years. Venture funds are present in various sectors in Ukraine. Software, online services, hardware, mobile, marketplaces, and e-commerce are the most popular sectors for venture financing by the number of deals in Ukraine.

Each venture fund forms an individual investment policy. Usually, the quality of the business model, the level of the breakthrough of the idea, the experience of the founders and the team, and the prospects of the market are evaluated. Sometimes venture funds look at the presence of other funds among shareholders. Funds give money on equity terms, as a rule, from 5 to 25% of the business, but it can be more (Frimpong et al., 2021). Funds do not take a large percentage of shares to leave motivation to the founders to drive business. Often, as a result of communication with foundations, startups go through several business model changes. Such support allows innovative businesses to rapidly innovate, fill gaps in the market, and generate satisfactory revenue.

Each venture fund has its investment strategy and terms of cooperation. Venture funds help innovative businesses in forming strategies and business models, optimizing processes, as well as in legal and marketing issues. The involvement of funds in strategic activities and constant supervision allows fast and efficient business development and reduce the risk of project failure. Business mentoring involves elements of know-how in the material, legal and business spheres.

Venture capital investors are looking for innovative businesses that have good management personnel, and demonstrate an advantage over competitors in terms of product offerings, services, or technology used. The advantage is the work of an innovative business in a growing market and the presence of a significant share in it.

The main functional features of venture financing for the strategic development of innovative businesses are given in Table 3.

Tab. 3

*Functional features of venture financing for the strategic development of innovative businesses*

<b>Sign</b>	<b>Types, interpretation</b>
Forms of venture financing	<ul style="list-style-type: none"> <li>– direct cash investments in shareholders (share capital);</li> <li>– attraction of investment resources through the issuance of debt obligations with the possible conversion of such obligations into ownership shares of venture enterprises;</li> <li>– mixed financing, combining previous forms</li> </ul>
Types of venture financing	<ul style="list-style-type: none"> <li>– internal;</li> <li>– external;</li> <li>– independent</li> </ul>
Features that are characteristic of venture financing	<ul style="list-style-type: none"> <li>– a venture fund provides capital in the form of shares to an innovative enterprise, without requiring generally accepted forms of collateral and interest;</li> <li>– the venture fund is liable only within the limits of the number of contributions made;</li> <li>– the venture fund is obliged to contribute to the management of the innovative enterprise;</li> <li>– shareholders seek to obtain a high profit in case of successful development of an innovative enterprise;</li> <li>– the desire to maximize long-term profits, which should reflect the growth of the company's market value;</li> </ul>

Steps of the venture financing process	<ul style="list-style-type: none"> <li>– search for sources of investment funds, formation and attraction of venture capital funds;</li> <li>– venture investing, that is, the transformation of incoming financial (venture capital), material, and intellectual resources into the output products of venture activity;</li> <li>– the transformation of invested investment resources into growth (capitalization) of market values of invested objects (enterprises);</li> <li>– achievement of the goals of venture activity through the receipt of income (effects) by both venture investors and other subjects of venture entrepreneurship</li> </ul>
Stages of venture financing	<ol style="list-style-type: none"> <li>1. Funding of initial stages <ul style="list-style-type: none"> <li>– pre-seed – stage of business idea;</li> <li>– seed stage - product development;</li> <li>– startup - product launch;</li> </ul> </li> <li>2. Expansion/development capital stage. Market penetration.</li> <li>3. Buyout and sale of shares on the stock exchange. Product maturity</li> </ol>
The most common exit strategy for venture capital investors	<ul style="list-style-type: none"> <li>– sale of purchased shares on the stock market (Initial Public Offering or IPO);</li> <li>– sale of equity to a strategic investor;</li> <li>– sale of shares to other shareholders or the company's management</li> </ul>
Principles of venture financing	<ul style="list-style-type: none"> <li>– the principle of diversification of investment objects;</li> <li>– the principle of phased funding;</li> <li>– the principle of risk sharing between the venture investor and the company, which financed;</li> <li>– the principle of active participation in company management;</li> <li>– the principle of the flexibility of financing conditions;</li> <li>– the principle of balancing risks with income;</li> <li>– the principle of accepting the risk of complete loss of financial investments;</li> <li>– the principle of continuous search and selection of funding objects;</li> <li>– the principle of a differentiated approach to the selection of financing objects;</li> <li>– the principle of maintaining the reputation of the successful selection of objects for financing;</li> <li>– targeting an increase in the value of the investment;</li> <li>– participation in the authorized capital of the investment object;</li> <li>– the principle of finding «smart money»</li> </ul>
Advantages of venture financing	A venture capitalist as a shareholder implements experience in management and finance, which allows the company to further progress
Disadvantages of venture financing	It is within the competence of the investor to carry out staff reshuffles. The process of obtaining financing is long and complicated. Problematic extraction of venture capital

*Source: Compiled by the authors based on (Frimpong et al. (2021); Pradhan et al. (2019); Siddiqui et al. (2016))*

Venture financing is still non-financial support. Innovative business gets access to the know-how and knowledge of specialists. An investor becomes a partner by buying shares. Thanks to this, the investor controls the business activity and assumes part of the investment risk. Large and small enterprises have one common goal - to achieve success and increase the value of the enterprise. In addition, the investor's capital contribution positively affects the image of the supported company. This is a signal to external entities that it is worth investing in.

Venture financing has some drawbacks. The investor's repurchase of part of the shares is equivalent to a partial loss of control over the business. This implies the need to share profits, and power and takes into account the partner's opinion. Venture investment improves the capital structure of a business, increases creditworthiness, and facilitates obtaining further funds for

business development. Attracting investors increases confidence in the business in the market and it becomes possible to attract new business partners more easily.

## 5. CONCLUSION

The presence of venture capital in the country leads to significant activation of innovative activity and the development of innovative businesses. It is possible to notice a significant expansion of the key features of venture capital. Venture financing plays a special role, ensuring the attraction of long-term, risk capital aimed at the activation of the strategic development of innovative business, which is the key to the economic development of the country. The venture capital market of Ukraine is not yet sufficiently developed. However, despite the war and the economic crisis, there are prospects for the development of venture funds in Ukraine in the future. For this, it is necessary to systematize the basic foundation of knowledge in venture capital and venture financing. For a better understanding, venture capital and venture financing need to be seen in the context of the main structural characteristics and functional features with a clear sign.

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Юринець Зорина, Юринець Ростислав. Венчурний капітал та стратегічний розвиток інноваційного бізнесу. *Журнал Прикарпатського університету імені Василя Стефаника*, 10 (2) (2023), 15-23.

Одним із найважливіших джерел удосконалення фінансового забезпечення інноваційної діяльності є венчурний капітал. Розвиток венчурного фінансування в розвинених країнах є одним із визначальних напрямків підтримки середнього та малого інноваційного бізнесу. Метою статті є визначення основних ознак венчурного капіталу, виділення структурних характеристик венчурного капіталу та функціональних особливостей венчурного фінансування. Дослідження базується на таких методах: аналіз, систематизація та узагальнення для виявлення основних ознак венчурного капіталу, а також виділення структурних характеристик венчурного капіталу та функціональних особливостей венчурного фінансування; табличне представлення для наочного відображення результатів дослідження та аналітичних даних. У статті проаналізовано трактування венчурного капіталу. Відзначено значне розширення ключових характеристик венчурного капіталу. Виділено структурні характеристики венчурного капіталу, які систематизовано за такими ознаками: елементи класичної форми венчурного капіталу, функції венчурного капіталу, характеристика ринку венчурного капіталу, фази процесу венчурного інвестування, причини відмови від отримання венчурного капіталу, результат реалізації венчурного капіталу на макроекономічному рівні. Функціональні особливості венчурного фінансування необхідно розглядати в контексті таких ознак: форми венчурного фінансування, види венчурного фінансування, риси, характерні для венчурного фінансування, етапи процесу венчурного фінансування, етапи венчурного фінансування, найбільш поширені стратегії виходу інвесторів з венчурного капіталу, принципи венчурного фінансування, переваги венчурного фінансування, недоліки венчурного фінансування. Отримані результати є основою для подальших наукових досліджень у частині венчурного фінансування стратегічного розвитку інноваційного бізнесу в Україні та залучення інвестицій для розвитку інноваційної діяльності.

**Ключові слова:** венчурний капітал, венчурне фінансування, інноваційна діяльність, інноваційний бізнес, стратегічний, розвиток, процес, стартап, інвестиції, венчурний фонд, ризик.