How profitable is venture capital? V2

What is the purpose of this article?
This article enables a discussion regarding the profitability of VC (Venture Capital) funds. The focus is on traditional VC funds with a fixed liquidation date. The article scope excludes: evergreen and perpetual funds.

The audience for this article includes: LPs (Limited Partners), GP (VC fund General Partners), and VC fund portfolio companies.

This article does not provide tax, legal or financial advice.
You must do your own research and fact-based analysis using current and relevant information.

What are the critical learnings in this article?
1) The median VC funds had returns about 3% higher than the public market indices. Picking the right VC GPs is critical to better performance than a public market index.
2) Past performance is the best predictor of future performance. Past performance does not 100% guarantee future performance.
3) The VC markets have undergone massive change in the past 20 years.
4) The future environment for VC GPs will be different from the past, turbulent and with regular new challenges.
5) There won't be fact-based analysis of the impact AI on GP Direct Alpha performance for several years.

How do you read this article?
This article uses Direct Alpha as the measure of GP performance. See Appendix A for a definition of Direct Alpha.

How profitable have VC GPs been for their LPs? [1]
The median VC funds had returns about 3% higher than the public market indices.
1) 25% of VC funds annual returns10% (or more) higher than public market indices.
2) 25% of VC funds had annual returns at least 4% lower than public market indices.
Picking the right VC GPs is critical to better performance than a public market index.

How can you predict future performance of VC GPs?
Past performance is the best predictor of future performance. Past performance does not 100% guarantee future performance.
1) Interim results of current fund have generated Direct Alpha. "Persistence is also apparent using the interim performance of the previous fund…at the time of fundraising. This persistence translates into economically significant benefits of using interim performance data available to LP Investors." [2]
2) When VC GPs introduce new funds, the performance is broadly in line with their established funds. [2]
3) Funds that are in the bottom quartile tend to stay there. [3]
4) Fund size below $250 million US. [4]
5) The GP has been a successful prior founder. "The outperformance of successful founder-VCs is consistent with them adding more value post-investment" [5]

How have the VC markets changed?
The VC markets have undergone massive change in the past 20 years.
1) Massive growth in total assets under administration from $521 billion US in 2006 to $5.7 trillion in 2025
2) Time to liquidity has extended e.g. average time to IPO is up to 14 years,
3) GPs have difficulty in achieving exits e.g. Late 2024 had $3.6 trillion of unrealized value.
4) The secondary market was small in early 2000s but is now a major source of exits.
5) Net asset loans (i.e. borrowing against the unrealized value) by GPs were small in early 2000s but are now a major way for GPs to provide distributions to LPs.
6) GPs have started to use line of credit to reduce or change the time of credit calls. This impacts IRR and Direct Alpha calculations and may also change the decile ranking of a fund.

What are the future uncertainties VC GPs face?
The future environment for VC GPs will be different from the past, turbulent and with regular new challenges.
1) Will there be a pickup in demand for exits of VC portfolio companies?
2) How long will investors continue to put cash into continuation funds?
3) Do VC funds as a whole have too much capital invested in portfolio companies?
4) How will geopolitical, demographic, and technology changes impact the creation of valuable portfolio companies?
5) Are there any limits to the number and size of valuable portfolio companies which can be launched?

What will be the impact of AI on GP performance?
There won't be fact-based analysis regarding the impact of AI on GP Direct Alpha performance for several years.

What are your next steps? – as an LP
1) Define the words/concepts you're using, in a glossary. I've seen major confusion when the same words mean different things to different people.
2) Do fact-based analysis on current and relevant information. The internet is swamped with opinions, obsolete data, and misinformation.
3) Create a range of future scenarios.
4) Define the talent characteristics of GPs that will be successful in the unpredictable turbulent future.
5) Assess potential VC GPs based upon the above 4 steps,

Footnotes
[1] 2026 02 17 [anguard] [An optimistic but measured outlook for private equity] [Vanguard Workplace Solutions,]
https://workplace.vanguard.com/insights-and-research/perspective/an-optimistic-but-measured-outlook-for-private-equity.html

[2] 2023 08 01 Robert S. Harris, Tim Jenkinsoin, Steven N. Kaplan, and Ruediger Stucke, "Has persistence persisted in private equity? Evidence from buyout and venture capital funds",Journal of Corporate Finance, August 2023 Volume 81, Page 15
https://www.sciencedirect.com/science/article/pii/S092911992300010X

[3] 2020 11 01 Robert S. Harris, Tim Jenkinsoin, Steven N. Kaplan, Ruediger Stucke, "Has Persistence Persisted in Private Equity? Evidence from Buyout and Venture Capital Funds", Working Paper 2020-167, The University of Chicago, Page 13]
https://bfi.uchicago.edu/wp-content/uploads/2020/11/BFI_WP_2020167.pdf

[4] 2026 05 29 Sonali Basek, Nirali Patel, Aaron Schwartz, and Dan Suzuki, "Chasing outliers: Venture Capital in the AI Era", iCapital
https://icapital.com/insights/investment-market-strategy/chasing-outliers-venture-capital-in-the-ai-era/

[5] 2022 04 01 Paul A. Gompers and Vladimir Mukharlyamov, "Transferable Skills? Founders as Venture Capitalists", National Bureau of Economic Research Working Paper 29907
https://www.nber.org/system/files/working_papers/w29907/w29907.pdf

What further reading should you do?
Your company will fail. Koor and Associates
https://koorandassociates.org/avoiding-business-failure/your-company-will-fail-v1/
How profitable is Private Equity? Koor and Associates

Appendix A – What is Direct Alpha?
Direct Alpha is the annualized return of a fund over a public market index (e.g. S&P 500).
1) Direct Alpha is calculated using the specific cash flows of an LP in and out of a fund. These dates and dollars amounts are used to determine hypothetical purchases and sales of a public market index
2) Direct Alpha also includes the Net Asset Value of the fund, which is the value of unsold assets.

Direct Alpha measures the annual percentage return above or below the benchmark the LP would achieve. A Direct Alpha of 0% means the investor received the same return as if they had bought and sold the public market index. A direct Alpha of 5% means the investor received an annual return 5% higher than the public market index.

Why not use the IRR reported by funds?
1) The IRR reported by funds does not represent the annual % cash returns the LP would achieve over the lifetime of the fund.
2) The IRR can also be manipulated by funds to generate high values.