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Prediction markets

An uncertain future

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A novel way of generating forecasts has yet to take off

NOT SO long ago, prediction markets were being tipped as a fantastic new way to forecast everything from the completion date of a vital project to a firm's annual sales. But although they have spread beyond early-adopting companies in the technology industry, they have still not become mainstream management tools. Even fervent advocates admit much remains to be done to convince sceptical managers of their value. "It's still a pretty evangelical business," says Leslie Fine of CrowdCast, one of the firms that provide trading platforms for companies keen to pool the collective wisdom of their employees.

Prediction markets work by giving people virtual trading accounts that allow them to buy and sell "shares" that correspond to a particular outcome. Shares in an outcome that is considered more likely to occur then trade at a higher price than those that represent a less likely outcome. This provides a way to tap into the tacit knowledge that exists in companies, especially ones that have many different divisions or offices.

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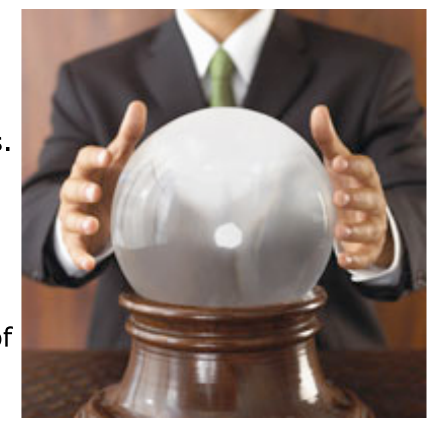

The mists are clearing

Koch Industries, an American conglomerate in a range of businesses including chemicals, fertilisers and commodity trading, has been running prediction markets for the past nine months involving about 200 of its staff from different areas. The group, which has revenues of some $100 billion, has launched contracts on, among other things, the future prices of raw materials used in its chemicals division and the likelihood of bank nationalisations. Koch says the results so far have been pretty accurate compared to actual outcomes, but stresses that markets are complementary to other forecasting techniques, not a substitute for them.

A big hurdle facing managers using prediction markets is getting enough people to keep trading after the novelty has worn off. Many firms use gaming-style leader boards to encourage internal rivalry, or offer modest prizes to the most successful traders. Lloyds TSB, a bank, launched a market in which participants identify the best new ideas by trading in a currency called Bank Beanz, which can then be exchanged for cash—a scheme the bank's head of innovation calls "an exceptional motivator".

Another reason prediction markets flop is that employees cannot see how the results are used, so they lose interest. Wells Fargo, a big bank that has been running internal markets for over a year to identify ways to improve service to some corporate customers, says its most effective trials took place in areas where managers could do something with their findings, making staff feel that trading was worthwhile.

Bosses may also be wary of relying on the judgments of non-experts. Yet many pilot projects run so far have shown that junior staff can often be surprisingly good forecasters. Perhaps the best way to find out when prediction markets will finally take off is to ask your employees—using a prediction market.