

## Let the people predict!

**A revolutionary way of forecasting future conditions could prove invaluable in procurement, says David Rajakovich**

One of the problems raised in discussions with procurement personnel is that they are consistently held back by poor volume forecast. We look to the sales forecast, capacity, our strategy, and other factors to help determine how much of a given product or service will be needed in the coming six to twelve months.

We work with stakeholders and develop statistical models to analyse trends. We may even involve third party support in the hope of finding the Holy Grail of an accurate demand forecast. And every year, we are off by 10 per cent or more.

This inaccuracy is as much the purchasing practitioner's fault as the rainy weather is the down to the meteorologist. Last year was last year, and business conditions have changed.

The problem is that traditional statistical models are based on the past, and the past can almost never be used to extrapolate the future. The few forecasts that turn out to be accurate are likely to have benefited from a healthy dose of luck.

One solution is to turn away from the experts and their calculations and, instead, harness the views of a wide range of people from all levels of seniority. This is the idea of the prediction market. It is an approach which is catching on in industry and has been shown to produce remarkable results.

Procurement people need some form of prediction. We need to choose our suppliers, negotiate with them, form good relationships and write contracts based on something.

Using traditional methods, we can try to build better forecasting models and convince ever more sceptical suppliers of their reliability. We can keep giving forecasts that the suppliers don't believe and modify them based on past experience. Or we can throw our hands in the air and come clean with suppliers about our lack of confidence in the forecasts we are vainly attempting to make.

This lack of knowledge and confidence at best adds waste to the supply chain. In the worst case it can damage trust in relationships.

The answer lies not in ever more expert analysis but in the collective brain of our employees and suppliers. Prediction markets tap into the wisdom of the many rather than the few -- a potentially invaluable strategy for procurement people trying to forecast future market conditions.

The concept is relatively new, first brought to wide attention by the American financial journalist James Surowiecki in his 2004 best-seller *The Wisdom of Crowds*. But the principles are as old as the hills.

Have you ever been near a tourist attraction, but not been sure exactly where the entrance is? If you followed the crowd, it most likely led you right to where you needed to go. Individually, you nor many of the other people, would have known where to find it -- all you had to go on was that run-down sign post a block away -- but collectively, you knew.

Prediction markets harness the wisdom of crowds for just about anything that needs to be forecasted, in a way that is as effective as it is counter-intuitive.

The approach has been used by several companies. An internal market at Hewlett-Packard predicted printer sales more accurately than the standard internal processes, and a similar market designed by Siemens correctly predicted that there was very little chance that the company would complete a software project on time. Best Buy used it to accurately predict gift card sales leading up to the Christmas shopping season.

For procurement executives, the approach can be useful, for example, to predict levels of demand for a given product or service over a period of time. This could then be used to help suppliers plan production, thus limiting overproduction and cutting costs which can be shared.

Benefits include improvements in supplier relationships and contracts. Further, if key business decisions are being made based on the estimates provided from people at all levels of the business, and even outside the business, everyone feels a sense of pride and ownership in the outcomes.

Setting up a prediction market requires sound understanding of the concepts and techniques involved but need not be a complex operation. They can be set up electronically or manually using good old-fashioned paper. The key is to get as many estimates as possible prior to a measurable event from anyone with any knowledge of the situation -- the larger the number the better. Crucially, participants should not be led in their thinking and should be encouraged to make their decisions on their own.

So far, prediction markets are less widely used in procurement than in corporate functions such as sales and production. So this offers procurement leaders great opportunities for getting ahead of the competition.

Only the most advanced, innovative organisations are using prediction markets today, and these companies are reaping the rewards. Will your organisation be the one to take a lead?

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