

# Channeling Crowds

*Why the merger of social networking and prediction markets will launch a new category of tech startups.*

by **Dave McClure**

Social networks are all the rage: You probably can't get through a day without being invited to one. So are online prediction markets, sites that aggregate, assess, and distill group knowledge and opinion to come up with fascinating collective hunches on notable topics, ranging from sports to politics. Now the two are being mashed together, and that is driving a new category of Web 2.0 startup opportunities.

At the same time online prediction markets have been incubating, we have been witnessing a major change in the way technology startups and online services develop content and engage with their customers and communities. This new generation of startups has emphasized the social networks connecting their user communities, and enabled countless niche conversations in countless tiny—and not so tiny—verticals.

Early social network pioneers Friendster, Orkut, Ryze, and Tribe.net paved the way for eventual success and dominance by giants Facebook, MySpace, and YouTube, as well as a wide variety of other popular social networks such as Bebo, Hi5, and LinkedIn. These communities also innovated by creating new ways for members to publish their own content, and made features of their sites available via web services and widgets for others to remix and reuse.

As Web 2.0 ascended, the People Formerly Known as the Audience became both producers and consumers of their own online services and content. →

Web 2.0 feature	What it is	Examples	Impact
Ajax	Rich, snappy client-side applications	Google Maps	Makes the web feel like a desktop application
Blogging	Fast, easy webtop publishing	Blogger, Movable Type, Wordpress	People-driven media
Tags	User-driven keywords, taxonomy, categorization	del.icio.us, Flickr, YouTube	People-driven taxonomies and filtering
Ratings	User-driven reviews and filtering	Amazon, eBay, Netflix	Best content bubbles to the top
Widgets	External application components	MyBlogLog, Snap Preview	Easy distribution of features and content
Social networks	Groups and media based on shared interests	Facebook, LinkedIn, MySpace	Word-of-mouth referrals and viral marketing
Web services and APIs	Remotely accessible application infrastructure	eBay, Google, Yahoo	Standardized platforms for developing new features and applications without client software
UGC	User-generated content	Digg	Community does the work to create content



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*“Web 2.0 was all but predicted by *The Cluetrain Manifesto*, with the observation that markets are conversations. The marriage of prediction markets and social networks remind us that conversations are markets, too.”*

## Give it to us...so we can keep it

How valuable is user-generated content? So valuable that at least one of its leading purveyors isn't giving it away, reversing a policy. In an article in our previous issue, "People or Computers?", we explored Last.fm's potential for using its massive amounts of user-contributed data as a business model. Last we checked, Last.fm had the following notice posted on its site: "We will also provide periodic for data mining and research purposes, soon." Since then, the company has removed this offer and is only providing web services. When asked why, it told its customers, the people who had supplied them the information, that the data is now "too valuable" (see [http://www.last.fm/forum/21604/\\_/239661](http://www.last.fm/forum/21604/_/239661)). —**Brady Forrest**

### A brief recent history of prediction:

Prediction markets are speculative markets open to public participation, created to predict future events, based on the accumulated knowledge and opinion of the people trading on the market. In a prediction market, “stocks” are created whose cash value is tied to a specific event (Will Hilary Clinton be elected U.S. president in 2008?) or numeric outcome (When will the Apple iPhone be available?). Current market price for a “stock” can be interpreted as a probability distribution or collective “bet” by the crowd as to whether an event will occur, or what an eventual numeric outcome will likely be. Under proper conditions, such markets can aggregate group knowledge and provide a reasonably accurate estimate of future events.

Prediction markets have been around for a while, with perhaps the most notable example being the Iowa Electronic Markets started in 1988 at the University of Iowa. Since its inception, this prediction market has successfully projected the winner of the US presidential race four out of five times. The Hollywood Stock Exchange, founded in 1996, is a prediction market used to gauge celebrity popularity and influence. In 2002, it successfully projected 35 of the 40 Oscar winners.

The concepts behind prediction markets were popularized by James Surowiecki’s 2004 book *The Wisdom of Crowds*. Lately, a number of startup companies have begun to apply prediction market technology to a wider array of disciplines: My Currency (estimating home prices), Value Investors Club (stock investments), and others. And, of course, we’ve started to see companies such as InKling Markets (<http://inklingmarkets.com>), which provides software to those wanting to start their own prediction markets. —D. McC.

Site	Market
Hollywood Stock Exchange <a href="http://www.hsx.com">http://www.hsx.com</a>	Entertainment
Value Investors Club <a href="http://www.valueinvestorsclub.com">http://www.valueinvestorsclub.com</a>	Finance, stocks
TradeSports <a href="http://www.tradesports.com">http://www.tradesports.com</a>	Sports
Iowa Electronic Markets, InTrade <a href="http://www.intrade.com/">http://www.intrade.com/</a> FTPredict <a href="http://www.ftpredict.com">http://www.ftpredict.com</a>	Elections, politics, business
My Currency <a href="http://www.my-currency.com">http://www.my-currency.com</a>	Housing
HedgeStreet <a href="http://www.hedgestreet.com">http://www.hedgestreet.com</a>	Finance, derivatives

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## Online Prediction Markets: Betting on the Long Tail

As the mix of Web 2.0 and social networks gave birth to so many micro-vertical communities that contribute and concentrate niche conversations, so will the marriage of social networks and online prediction markets enable these same vertical communities to collect and coalesce their opinions into specific predictions about the future of their community.

While this may not seem too interesting applied to the social network of your average teenager, it could be quite fascinating when applied to the social network of teenagers who are fans of a certain music genre, movie actor, or fashion trend.

- n Instead of a focus group or market research on whether a new record or movie will sell, or whether a new clothing design will be popular, why not run a prediction market in the social network of people who will be the eventual customers for those products? Treat the community’s opinions as bets in a prediction market, and you’ll get useful data about your product or marketing campaign’s chance for success.
- n Rather than an architect or urban planner toiling over where to locate a new sports stadium, highway exit, or civic community center, why not run a prediction market using the local community (or even a vertical community of architects and urban planners) to optimize for the best location, design, or budget?

These possibilities aren’t far down the road. The table above lists just a few examples of online prediction markets now being aimed at specific vertical communities. There may be millions of new prediction markets waiting to be born among the nooks and crannies of today’s online social networks. By focusing community into vertical categories of interest, and by providing the audience with social media tools for content production and commentary, we create a conversation. By furnishing these vertical communities with prediction market engines and tools, we let the community state its collective opinion about any discrete piece of that conversation—and thereby create a market.

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