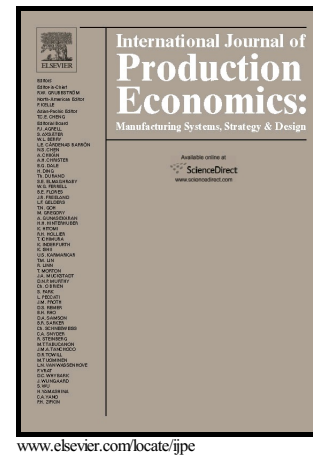


Demand forecasting with four-parameter exponential smoothing

Liljana Ferbar Tratar, Blaž Mojskerc, Aleš Toman



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liljana.ferbar.tratar@ef.uni-lj.si

blaz.mojskerc@ef.uni-lj.si
ales.toman@ef.uni-lj.si

*Corresponding author: Faculty of Economics, Kardeljeva ploščad 17, SI-1000 Ljubljana, Slovenia, Telephone: +386 1 5892 400, Fax: +386 1 5892 698

Abstract

Exponential smoothing methods are powerful tools for denoising time series, predicting future demand and decreasing inventory costs. In this paper we develop a smoothing and forecasting method that is intuitive, easy to implement, computationally stable, and can satisfactorily handle both, additive and multiplicative seasonality, even when time series contain several zero entries and large noise component.

We start with the classical additive Holt-Winters method and introduce an additional smoothing parameter in the level recurrence equation. All parameters are required to lie within $[0,1]$ and estimated by minimizing the one-step-ahead forecasting errors in the sample. Doing so, the errors decrease substantially, especially for the time series with strong trend. The newly developed method produces more accurate short-term out-of-sample forecasts than the classical Holt-Winters methods and the Holt-Winters methods with damped trend.

The performance of the method is evaluated using a battery of real quarterly and monthly time series from the M3-Competition. A simulation study is conducted for further in-depth analysis of the method under different demand patterns. We developed and justified the use of a symmetric relative efficiency measure that allows researchers and practitioners to evaluate the performance of different smoothing and forecasting methods.

Keywords

Demand forecasting, Exponential smoothing methods, Seasonal data, Holt-Winters methods, Damped trend methods, M3-Competition, Individual products, Symmetric relative efficiency measure

1. Introduction

Forecasting future values of time series is of paramount importance in all applied sciences and each discipline has its own typical features and needs which should be accounted for by researchers who develop new forecasting methods. In supply chain management, forecasts of demand are required on a regular basis for a very large number of products, so that inventory levels can be planned to provide an acceptable level of service to customers (Hyndman et al., 2002). The

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