Aon CFO: Risk and Reinvention
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Aon plc has completely shifted its business model and its nationality. The firm sold its insurance underwriting business and acquired two companies that turned Aon into a risk-management and human resources consulting giant. In 2012, it moved its headquarters to London from Chicago. That strategic shift has also changed the focus of Aon's chief financial officer, Christa Davies. Aon's business kicks off more than $1.5 billion in free cash flow a year. She says her mission is to get the best rate of return on that money.

What is the biggest challenges facing Aon?

On the HR Solutions side we are engaged in two areas. The first is pension, helping companies manage unfunded liabilities and getting good asset returns. The discount rates are improving slightly and CFOs are putting cash into plans. How do you lock in those gains? What if there was a market disruption in the next few years? How do you de-risk your pension plan?

On the health care side, the corporate health care exchanges are an important area of investment for us and an important area of growth. There are 122 million people in employer-sponsored health care plans and the costs of insuring those people are increasing 8% to 10% a year. If you are a CFO, having any line item increase at that pace, you have to manage that. And it's very volatile.

Free cash flow is another challenge, isn't it?

We said in 2012 that we would double our cash flow in the next 3 to 5 years. We need to be rigorous about how we are going to invest it. We need to make sure we are diligent on getting those returns for shareholders. Historically, our highest return on invested capital has been on share repurchases and investing organically within our company.

We are also investing several hundred million dollars a year on data and analytics to help our clients make better decisions and manage the volatility of capital. We have the largest repository of insurance information in the world and that allows us to price products and get the best conditions for clients.

Q: What was the genesis of Aon's decision to exit the insurance business?

It started when Greg Case [chief executive officer] arrived in 2005. He looked at the business from the standpoint of return on capital. Two segments, risk and people, had much higher returns on capital.

We divested our underwriting division, which was one-third of our business. Then we bought two businesses, Benfield Group in 2008 and Hewitt Associates in 2010.

It was that return on capital analysis that drove the portfolio shift.

Now we have significant growth in free cash flow. In 2011, our free cash flow was $777 million. Last year it was $1.4 billion.

The reason we believe we can double free cash flow [from 2012] in three to five years is, first, improvement of operations in our own business, meaning investments in data analytics, talent and pension de-risking.

Second, through decreased use of cash for pension funding and restructuring. We contributed $500 million a year to our pension for the past five years. Now, we have de-risked the plans as they've become fully funded by going into fixed income and derivative overlays to lock in gains. We have also closed them to new entrants. As our pension contributions continue to decline over the next five years, that will generate $600 million in free cash flow a year over the same time period.

Finally, there is the re-domestication of our company to London. We are now incredibly close to Lloyd's of London; we partner with them. It helps us strategically with growth. It helps us deploy cash globally.

How did moving to London help you deploy cash globally?

We had $300 million in [overseas] cash on our balance sheet. We were able to use that in the third quarter of 2012, right after we moved. We can move money around the world more freely. We can invest in whatever opportunity that may be the best return for shareholders. It allows us to be more flexible about where we invest.

What are your metrics for driving returns for shareholders?

We have four metrics.

Organic revenue growth: We are trying to grow in both segments: risk and HR.

Operating margin expansion: For risk our long-term target is 26%; we finished last year at 22%. And for HR, our long-term target is 22% and we finished at 16.7%. So we have substantial opportunities to grow.

Earnings-per-share growth: We grew at 16% in 2013, which is impressive.

Free cash flow growth: And that is to double from 2012 levels in the next three to five years.

Q: How much stock have you repurchased since 2005?

Since the inception of our share buyback program, we have bought over 166 million shares at an investment of approximately $7.6 billion. Share repurchases remains the highest return on cash. But we have a formal process; we have a Return on Capital meeting monthly. Opportunities arise and there are lots of things that can change.

Q: Interest rates have got to be a big consideration in these meetings. Where do you think they are headed?

I had thought they would increase in 2011 and 2012, and instead they declined. That had a big impact and we track interest rates with care. I had assumed they couldn't get any lower. We look at the forward curve as the best market indicator.

What are the biggest issues facing CFOs today?

Risk is the top one - enterprise risk management, cyber security, reputational risk, and certain financial risks, including tax.

Capital allocation is the second one. Since the financial crisis, a lot of companies have gathered cash on their balance sheets. How do you invest this capital to maximize returns for shareholders?

Optimizing the capital markets is the third one. Interest rates are still very low. How are you using the capital markets to get the right debt structure?.

Growth is the last one. Emerging markets are great sources of growth for companies, and figuring out how to invest to drive the maximum returns is complex.